Center for American Progress

EXPERT POLICY FORUM

"A FAIR AND SIMPLE TAX SYSTEM FOR OUR FUTURE: A PROGRESSIVE APPROACH TO TAX REFORM."

MODERATOR:

MR. JOHN D. PODESTA,
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
CENTER FOR AMERICAN PROGRESS

MONDAY, JANUARY 31ST, 2005

Transcript provided by
DC Transcription & Media Repurposing

SPEAKERS:

DR. WILLIAM G. GALE
ARJAY AND FRANCES FEARING MILLER CHAIR,
DEPUTY DIRECTOR AND SENIOR FELLOW,
BROOKINGS INSTITUTION AND CO-DIRECTOR,
URBAN-BROOKINGS TAX POLICY CENTER

DR. JOHN S. IRONS,
ASSOCIATE DIRECTOR FOR TAX AND BUDGET POLICY,
CENTER FOR AMERICAN PROGRESS

DR. PETER R. ORSZAG,
JOSEPH A. PECHMAN SENIOR FELLOW IN ECONOMIC STUDIES, THE BROOKINGS INSTITUTION AND CO-DIRECTOR, TAX POLICY CENTER, URBAN INSTITUTE AND THE BROOKINGS INSTITUTION

DR. ROBERT M. SOLOW,
INSTITUTE PROFESSOR EMERITUS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

JOHN D. PODESTA: Good afternoon, everyone, and thank you for being here. I'm John Podesta, the president of the Center for American Progress. In 1789, Benjamin Franklin famously wrote, "Our Constitution is in actual operation. Everything appears to promise that it will last, but in this world, nothing is certain but death and taxes." A century and a half later, Will Rogers added that while Franklin's observation was true, he said, quote, "Death doesn't get worse every time Congress meets," unquote.

Four years ago, the conservatives in charge of Congress proved once again how perceptive Will Rogers could be. Americans want tax reform. We want a tax system that's fair and a tax system that's simple. And four years ago, the conservatives said that's what they wanted, too. But instead of offering a plan to make taxes fair and simple, their approach was to make them simply unfair: unfair to middle-class families who were forced to shoulder an even greater share of the burden for financing the federal government; and unfair to our children, who, thanks to their reckless tax policies, will inherit an America that is far weaker economically than the one that was given to us; and an America that now has an annual budget deficit of $448 billion; an America that today is almost $2 trillion in debt to China, Japan, Britain, Korea, and other foreign countries.

Meanwhile, America's soaring current account deficit has not only eroded any faith that central banks once had in America's commitment to sound fiscal policy, it now threatens the very future of the dollar itself. That will invariably mean higher interest rates for all Americans. That's the legacy of President Bush's first term. And all signs tell us that the conservatives are gearing up to do it all over again.

Once again, they're talking about lower taxes for the wealthy, shifting more of the burden to the middle class, and protecting corporate tax loopholes, even the ones that actually reward businesses for shipping American jobs overseas. And what about tax simplification? Since coming to power, the conservatives have actually added 10,000 pages to our tax code and other tax regulations. Now, even President Clinton's autobiography comes in at one-tenth that length, and it's printed in larger type, too.

Well, how about their plans for reducing the budget deficit? Don't even bother looking for it. It really just simply doesn't exist. At the Center for American Progress, we believe out nation can do better than that. We believe that a strong, growing and vibrant middle class should not be relegated to America's past; instead, it must be part of America's future. And with progressive tax reform for middle-class families, we're convinced that it will.

The principles of our progressive approach to tax reform are not difficult to explain. In fact, they're as enduring as our republic. From the Boston tea party on, the belief in fair taxes has been fundamental to American values. Progressive tax reform honors those values with a renewed commitment to fairness, to equity, rewarding hard work, and the belief that progressivity is an essential component of tax justice. Progressive tax reform honors America's values by upholding the principle that the best tax system is the one that's easiest to understand and simplest to use. And our plan for progressive tax reform honors one of America's highest ideals by promoting new opportunity and the prosperity that only comes through economic growth.

Let me take a moment to outline a few of the features of our plan with you. It begins by rewarding work. It's simply wrong that if you're a nurse or a firefighter and your sole income is your paycheck, chances are you're paying a higher tax rate than an oil company executive does for his investments. That's unfair and it must change. That's why first our plan for tax reform would restore fairness to our tax code by equalizing the treatment of all income, wages and capital income alike.

Second, as I noted a moment ago, the conservatives had led America into a bottomless pit of debt. Our plan for progressive tax reform will help America to finally climb out by restoring fiscal discipline and equity. Over the course of ten years, our plan will generate nearly $500 billion in new revenue. At the same time, it would eliminate the need for the alternative minimum tax, which threatens now to ensnare over thirty million middle-class families in its incredible complexity by 2010.

Third, our plan for progressive tax reform would offer bold new incentives for men and women to save what they earn, and create new opportunities for themselves and their families. Our plan would offer new incentives for low income and middle-class families to save, and we'd expand eligibility for the child tax credit.

And fourth, we'd simplify the tax code. Progressive tax reform will cut the number of income tax brackets in half, and replace them with a simple, fair three-rate structure. The standard deduction would be raised to slightly over – would be raised slightly to $10,000 for a married couple and indexed to inflation. We'd also invest in enforcing existing corporate tax laws in closing the tax loopholes that encourage companies to send American revenue and jobs to other countries. Conservatives may see the value in rewarding businesses that export American jobs. We think we've got a better idea: let's create incentives to grow good jobs in this country.

So what would progressive tax reform mean for middle-class families? Well, the vast majority of households with incomes under $200,000 a year will get a tax cut in the neighborhood of $600 or more. We also guarantee additional revenue to the Social Security Trust Fund and cut in half the long-run 75-year difference between dedicated revenues and outlays.

So who won't like this plan? Well, if you make more than a million dollars a year, and you don't care very much about the future of the American middle class, chances are you won't be too happy. But you know something? I think we underestimate the patriotism of wealthy Americans. I believe the majority of those who are doing very well understand the kind of trouble the country is on the path towards and I think they're willing to do their fair share to help us get out of it.

I also know that many of them have not forgotten that when President Clinton got America's fiscal house in order and raised the rate on the top 1 percent of taxpayers, not only did it not hurt the economy, it helped trigger the greatest economic boom in modern American history. And by the way, those people at the top end of the economic spectrum did pretty well under that economic boom.

There are some people who think the American dream has become little more than a cliché, but I think most of us who are in this room would not be here had our parents or grandparents not believed in that dream and worked hard to make that dream come true for their children. They had faith that in America anyone willing to work hard can do better for their children than their parents could do for them, that they could own their own home, that they could send their kids to good public schools and then to college, that they could retire with dignity. That faith, that uniquely American vision, is at the foundation of the middle class, and the middle class is the foundation of America's greatness.

Can we have a tax system that honors the middle class, that renews the American dream? Yes, we can. A tax system that's fair and that's simple, that doesn't expand the deficit, but helps to shrink it; that doesn't export jobs, but helps create them; that doesn't weaken the middle class, but strengthens it. We can choose to have that kind of tax system or we can continue the reckless policies that have failed our country and now threaten our country's future.

Mark Twain had a keen understanding of politics, and one of his insights still rings true today. He once said, "Principles aren't of much account, except at election time. After that you hang them up to let them season." Today, our message is that the principle of fair taxes for all Americans has been seasoned long enough. The time is ripe for action.

We're very privileged to have a distinguished panel to discuss both our program that we're putting forward today, and the overall position that we find ourselves in economically from the prospective of where we've come to in taxation in this country. We're very, very privileged to lead off this panel to have Robert M. Solow. Dr. Solow, of course, is institute professor emeritus at the Massachusetts Institute of Technology where he has been a professor of economics since 1949. For a number of years, he served as a member of the Board of Directors of the Federal Reserve Board of Boston, and was chairman of that board for three years. He's the past president of the American Economics Association. He received the National Medal of Science in 2000, and of course, in 1987 Dr. Solow received the Nobel Prize in economics for his theory of growth. He is currently foundation scholar at the Russell Sage Foundation.

After Dr. Solow – I'm going to go ahead and introduce the whole panel and then turn it over to Dr. Solow. But after he speaks, John Irons, who's the associate director for tax and budget policy at the Center for American Progress where he specializes in federal tax policy, will take it over and give some more detail on the tax plan. But before joining the center, Dr. Irons was the senior economic research and policy analyst and staff economist at OMB Watch.

Following his presentation, we'll hear from Dr. William Gale. Dr. Gale is a senior fellow and holds the Arjay and Frances Miller Chair in federal economics policy in the Economic Studies Program at the Brookings Institution. He's the deputy director of the Economic Studies Program and co-director of the Tax Policy Center, a joint venture of the Brookings Institution and the Urban Institute. He specializes in tax, budget, and fiscal policy.

And finally, we'll hear from Dr. Peter Orszag. Dr. Orszag is the Joseph Pechman Senior Fellow in Economic Studies at the Brookings Institution, and a co-director of the Tax Policy Center – as I said, a joint venture between the Urban Institute and the Brookings Institution. He's the co-author of *Saving Social Security: A Balanced Approach*. He served as special assistant to the President for economic policy at the White House, and a senior economist and senior advisor on the President's Council on Economic Advisors.

So with that, let me turn it over to Dr. Solow to give us some background.

DR. ROBERT M. SOLOW: Thank you, John.

You should realize that I'm not a Washington person. I'm about 85 percent academic economist and 15 percent outraged citizen. And I thought that perhaps the most useful thing I could do here was to take my 10 minutes to describe what the – how the principles of public finance suggest that you judge – that you categorize and judge tax systems and changes in tax proposals, and try to say a little bit about why I think that some basic reform is needed now, and then a little bit about how the tax program you're going to hear about today meets the basic criteria for analyzing and judging the tax system.

You could look at what a tax system does under three basic categories. Before that, though, obviously you needed – you want a tax system that raises the amount of revenue you need. And it ought to be, if you're thinking about changing the tax system, something you could get to from here. When anybody tells you that they have a tax scheme which will allow you to file your income tax return on a postcard, I often wonder where that postcard is going to be postmarked, someplace like Neverland. We're talking here about things that could, in fact, actually be done.

Given that, there are these three basic kinds of effects that any tax proposal has. Every tax has effects on the allocations of resources: who does what, and what methods they use to do it. In a way, every tax system distorts individual and business decisions in the sense that it induces taxpayers to do things that they wouldn't otherwise do. Sometimes, that's an intended part of the proposal. Corrective taxes on pollution, for example, induce behavior on the part of business firms and individuals that wouldn't be there were it not for the tax system, or high taxes on cigarettes or other damaging products have corrective affects. But there are also a lot of the behavioral effects, the allocational effects of tax proposals that are not intended. They occur normally in the way people act so as to avoid paying taxes, and often the things that they induce people to do are inefficient. Their use of resources is inferior to other things that might have been done.

To take the homely example, there's an awful lot – I know this from personal experience – of mediocre do-it-yourself work around the house that gets done because to hire an electrician who actually knows what he's doing or what she's doing, you have to hire out of your after-tax income, and with some probability that person pays income tax on their income. Lousy do-it-yourself work, all those frayed wires around our place come because that's untaxed income in our system. So that's one thing, allocational affects.

Secondly, every tax change or every tax measure has distributional effects. There are amongst the broad class of taxpayers some winners and some losers. or it may be that the – there are some big winners and some small winners, or some big losers and some small losers. Very often – this is an interesting thing that arises from studying public finance – very often the distributional affects are the main affects. They're the biggest, first-order affects of tax measures. They're often hidden from view behind rhetoric, but you can always tell what the distributional affects of a tax proposal are by looking to see who's lobbying for it and who's lobbying against it. So that's allocational affects and distributional affects.

Third, many taxes – not all, but many of them – have significant affects on employment and growth possibilities. One important way they have this affect is through effects on national saving and investment, including – this is very important – including an investment not only in plant and equipment, but also investment in education, in skill-building, in training, and investment in new technology. So those are the three – apart from practicality, those are the three fundamental rubrics under which the principles of public finance look at tax systems.

Now, the outraged citizen in me reflects the fact that the tax proposals from the Bush administration, old and new, seem to meet to pervert every one of those criteria. They have been focused very strongly, almost entirely on redistribution from the poor and the middle class to the already rich to the extent of sacrificing nearly everything else to that unappetizing goal, at least unappetizing to me.

If the object – and this is the standard excuse – if the object is to increase national saving and investment, then income tax reduction for the very rich is a very ineffective way of accomplishing that goal as recent history shows, most especially when those tax reductions are financed in large part by budget deficits because – and this is often forgotten – every dollar of deficit is a dollar less of national saving. Budget deficits on the parts of governments are negative saving. There are many better devices available, some of them mentioned in today's proposal. It's hard to take the savings investment excuse seriously.

The main allocational effect of current policy, it seems to me, is – as John Podesta mentioned is to shift the burden of taxation from capital to labor, from people whose main source of income is wealth to the people whose main source of income is work. I don't have to remind you that shifting the burden of taxation from income capital – from income from capital to income from work is pretty much the same thing as shifting the burden of taxation from rich to poor. And I don't think it has escaped the attention of people out there that even amongst those who draw their income mainly from work, it's those with the – it's the very highest earners who will be able – will find ways to convert labor income into what the tax system will regard as property income, stock options being only the most obvious of these.

Why do I think that's perverse, that allocational shift, that making labor more expensive and making capital, so to speak, cheaper? Don't we need more saving and investment in this country? Yes, we do. However, there are two reasons, I think, why that's a foolish, perverse allocational effect. The first I've already mentioned. It's ineffective. There are far better ways of stimulating saving and investment. You'll hear about some of those in a moment.

Secondly, and I haven't seen this mentioned either, we're looking ahead to a future when labor is going to become relatively scarce, scarcer than it is now in our country for demographic reasons that can no – that simply cannot be avoided. Capital is not the only factor of production. Shifting the burden of taxation from capital to income from work is not a good way to increase the supply of labor. Maybe this is a novel application of the principle of the carrot and the stick. People are supposed to work harder, because a lot of their incomes will be taken away, so it's sort of a carrot for capital income, and stick for labor income. That's a new one on me. Taxation of labor income – heavy taxation of labor income also discourages the investment in human capital that is known to contribute a lot to higher individual incomes and to higher levels of national income.

Now, the program you're going to hear about today proposes to reverse a lot of what I have just been describing. It will tax income from all sources equally and tax it progressively. It will end the increasing dependence of federal revenue on the regressive payroll tax by shifting some of the burden to general revenues, which are less regressive than the payroll tax. It will contribute to long-term growth and job creation in several ways. One is by democratizing the incentives to save that are already in the tax code, but available only in a small way to people of middle incomes, and will open those incentives more fully to middle-class income and even to lower-income people.

And a second growth-enhancing, job creation-enhancing effect is by raising enough revenue to finance a substantial contribution to deficit reduction, and even a little contribution to building up the Social Security Trust Fund.

I will remind you again that deficit reduction is the most efficient dollar-for-dollar way of increasing our national saving or increasing the national ownership of capital investment that already occurs here. So this is a serious attempt to improve the distributional, the allocational, and the growth-favorable aspects of our tax system. That shouldn't be so hard to do, given the dismal record of the past four years and the sort of stuff that's on offer now, but I think that the Center for American Progress has done a very fair-minded and clever job, so I hope you'll pay a lot of attention and listen carefully to what John Irons and Peter Orszag and Bill Gale are going to tell you now.

Thank you. (Applause.)

MR. PODESTA: John?

DR. JOHN S. IRONS: Thanks.

First, let me say that I'm very pleased to be able to present to you some of the details of the Center for American Progress's new tax reform plan. I'll try to highlight some of the main components of the plan in my presentation, but I would also direct you to the document included in your packet, which lays out the full details of the plan. It looks like this with a blue cover on it.

As you've heard, we believe our tax code is broken. We also believe that we are headed in the wrong direction and that a new course must be charted on tax policy. As part of our efforts to present new ideas from a progressive prospective, we are very happy to be able to present to you some of the details on how we would reform the tax code.

By reforming the entire system, we can address some of the fundamental inequities of the current system and put our nation on sound financial footing for the future, allowing us to fund both vital domestic and national security priorities in a way that is consistent with our values as a nation.

We believe that the tax system ought to be based on three fundamental principles of fairness, simplicity, and opportunity and economic growth. These fundamental principles ought to guide any tax reform plan. Unfortunately, under the current system, our tax system has become unfair and overly complicated. While we have heard a lot recently about the need to be fiscally responsible, our current tax code is reckless and irresponsible. We have seen nothing but mounting deficits over the last four years, which are largely the result of current tax policy. Our tax (code?) system has become unfair. Our tax system has come unfair in three ways. It has shifted the tax share away from the highest income earners onto the middle class. It has shifted from – away from the progressive federal income tax and onto the regressive payroll tax. And it has shifted away from wealth and onto work.

When we take a look at the combined effects of the 2001 through 2003 tax changes, we find that those at the top of the income distribution received a much greater share of the reduction. Those making more than $1 million a year saw an average cut of well over $100,000, while those in the middle received only about $600. When you look at the broad historical pattern, we can see that the payroll tax has become increasingly relied upon to finance the federal government. Today, more than 40 percent of federal revenue comes from the payroll tax. Since the payroll tax falls more heavily on lower and middle-income taxpayers, this shift has made the entire tax code less progressive. In addition, recent tax changes have reduced our reliance on those components of the tax system that are the most progressive, primarily by reducing tax rates on income generated from accumulated wealth.

The current tax code has become excessively complicated. The alternative minimum tax has increasingly impacted more and more people, and this increased complexity can lead to inequities and can allow corporations and individuals to avoid taxation. And as we heard, the Bush tax code has added 10,000 pages to our code and related regulations.

Finally, the current tax law has played a significant role in turning record surpluses into massive deficits. At just 16.2 percent of GDP, total federal revenue for 2004 was at its lowest level since 1959. We feel that it's important to reform the tax code to restore fairness by treating income from wealth and work more equally, and by relying on progressive forms of taxation, not on regressive forms. We need a simple and pro-opportunity tax code.

Let me jump into the overall outline of the plan. As I mentioned before, details can be found in the Progressive Priorities document in your packet. It is important to keep in mind that the reform package that we are proposing today must be viewed as a comprehensive whole. While it may be tempting to take away individual parts, we believe that the tax system must be viewed in its entirety and, therefore, individual changes may not be desirable when considered in isolation.

Let me first begin with fairness. We would begin by taxing each source of income the same. Income from accumulated wealth would be treated according to the same rate schedule as income from work. We would retain the estate tax, exempting the first $2.5 million from taxation. We would reduce the dependence on a regressive payroll tax by eliminating the employee component of the Social Security payroll tax, and shifting the tax share onto restructured federal income tax, and we would remove the cap on the employer's side to make the payroll tax less regressive.

Next, let me address simplicity. We would reduce the number of income tax brackets from the six that we currently have to three with marginal tax rates that are 15 percent, 25 percent, and 39.6 percent. We would aim to close corporate individual tax loopholes, especially those that allow very wealthy individuals to escape paying their fair share. By reforming the system and closing loopholes, you would eliminate the need for and thus remove the alternative minimum tax in a responsible manner. We would increase economic opportunity and growth by first restoring fiscal discipline. Our plan raises nearly $500 billion over ten years when compared with the current policy. This increase in national savings would help to improve our economic growth in the future.

We would offer tens of millions of Americans new opportunities to save and create wealth for retirement. We would replace the current upside-down, deduction-based savings incentives where those in higher tax brackets receive bigger tax benefits and savings with a 25 percent refundable matching credit. This means that 33 million Americans for the first time would receive a tax incentive to save for retirement. To encourage long-term savings, we would allow half of capital gains to be exempted for assets held more than five years for those making less than $1 million per year. Exemption starts at 10 percent after one year; it would be phased in over the next five.

Finally, we would be in favor of allowing some of the additional revenue to be used for – to be used to create additional incentives for retirement savings for low and middle-income savers. To further increase opportunity for all Americans, we would lower the threshold for receiving the child tax credit to incomes of $5,000 and would eliminate indexing for inflation. This would mean many more families would be able to receive a credit, both now and in the future.

In addition, we would remove the disincentive to marry embodied in the earned-income tax credit. Overall, our plan will increase the take-home pay for most people earning under $200,000 a year, and will provide an average tax cut of over $600 for this group. Most people – most of those making more than $200,000 a year will likely see a tax increase relative to current policy. We have posted on our web site at americanprogress.org/tax – a calculator that will allow you to see how you fare under our plan versus the president's policy.

In contrast to current privatization schemes, you would – which would create additional risk, our plan would enhance retirement security. We do this in several ways. Our plan includes new savings incentives with 33 million Americans, and provides enhanced savings incentives for thirty million more. We would enhance our full commitment to Social Security by continuing to dedicate the employer's side of the Social Security payroll tax to the Social Security Trust Fund, and this dedicated revenue would be enhanced by the additional revenue raised by removing the cap on the employer side.

In addition, we would dedicate 2.25 percent of GDP from general revenues to the Trust Fund and enact tough safeguards to prevent future Congresses from cutting this dedicated revenue stream. And I'll have to take a drink of water. I apologize. I usually teach economics, and usually when you go into tax policy, people's eyes start to glaze over. And one of my favorite tactics is to more or less run up and down the aisles waving my hands up in the air, but I'm trapped behind a desk now, so I can't do quite the same thing, but we're almost done here.

So as I said, we would dedicate 2.25 percent of GDP from general revenues to Trust Fund. And, again, enact stringent safeguards to prevent future Congresses from cutting this dedicated revenue stream. These changes would be sufficient to close half of the long run, 75-year excess of outlays over dedicated revenue for the Social Security program.

Finally, by raising an additional $500 billion relative to the president's policy, we'd be better placed to meet the challenges of an aging population. We believe that this plan offered by the Center for American Progress provides a stark contrast to current policy. The administration's fiscally irresponsible policy shifts the tax share away from wealth and the select few at the top, and onto working and middle class. We would instead create a fiscally responsible tax code that rewards work, and we would base our policy on a fundamental principle of fairness: that those who can best afford to pay and who have benefited the most from our economy should pay a greater share. We hope that our plan will help illustrate that there is another way and a better way to reform our tax code.

Thank you.

MR. PODESTA: Thank you, John. (Applause.)

Okay, a slight change of plans. Peter will be going next – Dr. Peter Orszag.

DR. PETER R. ORSZAG: Thank you, John. Thank you, John and John.

I want to emphasize that both – while both Phil and I are co-directors of the Tax Policy Center, and there are lots of part – many, many parts of this plan that we both appreciate and like, that obviously that this is a Center for American Progress plan, not a Tax Policy Center one.

I want to focus on one of those parts of the Center for American Progress plan that I particularly like, which has to do with the incentives for saving. And it's very important to realize that what's been happening has already been emphasized that over – is that over the past few years, we have been moving the tax system toward one that only taxes labor income, and does not tax capital income. This proposal, the Center for American Progress proposal, would move the tax system in the opposite direction, back towards a true income tax. And I want to note that that is precisely what we did in 1986.

The administration and others are invoking the legacy of 1986 in the tax reform debate, but the fact of the matter is, the 1986 reform moved us back towards a true income tax by reducing tax preferences for capital income. It reduced the access to tax-preferred savings vehicles. It eliminated a capital gains tax preference. It tightened up business depreciation rules, and in a whole variety of ways moved back towards a true income tax the same direction that this proposal would be moving the tax system.

You often hear supporters of the administration's approach talking or almost defending the changes, as if they were moving towards a, quote, "consumption tax," end quote. And I want to pause on this, because I think it's a very important point to realize that a consumption tax imposes a tax break only for new saving, not for saving that had been done in the past. And the way you can think about that is that consumption can come from two sources. It can come from saving you've already done – accumulated assets that you already have in the bank, if you will – or from future wages. And when you impose a consumption tax, you need to impose a tax on both those potential sources of financing of consumption or else you don't really have a consumption tax. And what's interesting is that most of the research in this area shows that it's the tax on existing assets that cause – that triggers most of the efficiency gains from moving to a consumption tax.

When you move to a consumption tax, the, let's say, $100 you have in a bank account is effectively devalued or taxed because if you went to spend it, a tax is imposed on that spending. Whereas, under an income tax if you have $100 sitting in the bank, it can effectively sit there or have only a very small tax burden imposed on it. So the bulk of the economic benefit from moving from a consumption tax comes from imposing a tax on the owners of existing capital. And guess what? That is not what the administration has been doing. It has not been imposing a significant tax on people who own capital, and that is the key step to getting any efficiency benefit or any economic benefit from moving to a consumption tax. Without that tax on existing assets, all that you have is a wage tax, and a tax – because remember, those two pieces of future consumption – either future wages or existing assets, those are the two sources of financing – if you don't tax existing assets all you're left with is a tax on future wages.

And that has all of the downsides of the consumption tax in terms of its impact on inequality and its adverse distributional consequences, and none of the macro-economic benefits or very little of the macro-economic benefits. So you wind up with the worst of both worlds, and that's precisely the direction that we're heading. It's the direction we've been moving toward over the last few years, and it's the direction we will continue moving toward under the administration's proposals.

I also want to raise a broad question, even about the thought that we could use the tax system to encourage new saving – that the way to encourage new saving is to provide – and Bob Solow hit on this a bit, but to – the way to encourage new saving is to provide tax breaks for that new saving. That is part of the fundamental aim of either a consumption tax or a wage tax, if you will. And the flaw is that the bulk of the tax benefits that are provided go to the top end of the income distribution, which has adverse distributional consequences, but it doesn't even get you very much new private savings. The evidence very strongly suggests that a dollar put into a tax-preferred savings vehicle by a high-income household is very likely to have been saved anyway. Some of the leading research here is by Eric Engen and Bill Gale.

And so what you get is a loss of government revenue, and therefore an increase in the budget deficit, which, as Professor Solow emphasized, adversely affects national saving. And in exchange you get very little increase in private saving, because the high-income people disproportionately respond just by shifting assets that they would have saved anyway into the tax-preferred account. So again you have regressivity without any substantial economic benefit. Again, the Center for American Progress proposal would move in the opposite direction and that, I think, is precisely correct.

So if providing regressive high-end tax breaks on new savings is not the right way to boost either national saving or even frankly to boost private saving, what is? And I think basically there are two key steps. First, one of the strongest findings from behavioral economics is that what really matters here is the structure: making it easy to save, making it automatic. For example, if you have to sign up for a 401K plan, the simple form – the simple step of filling out the form is a significant impediment to many people signing up. Experiments have shown and real-life, real-world evidence shows that if people are in a 401K plan unless they specifically opt out, participation rates are much higher than if they have to sign up for it. So simple things like that – making it easier to save for the vast majority of families that are burdened with lots of other decisions and time pressures, for things to happen automatically, I think, is one of the most promising ways of boosting private savings.

Beyond that, we should level the playing field for the financial incentives to save. Again, the evidence suggests that contributions to tax-preferred vehicles made by high-income households are more likely to represent asset shifting and not new saving than contributions made by lower-income households. And yet, the current system provides larger incentives to the high-income households who are more likely to merely shift assets, and who, by the way, are already better prepared for retirement in any case.

So what would the Center for American Progress proposal do? Let's look at the current system. A family puts $100 into a 401K or a traditional IRA. Under the current system, a high-income family saves $35 immediately in taxes, because that – the family is in the 35 percent marginal tax bracket. A middle-income family in the 15 percent marginal bracket saves $15 from making that contribution. A low-income family that has no income tax liability saves nothing. That the upside-down tax set of incentives that we currently have for retirement saving. You can think of it as a government match for retirement saving that is exactly the opposite of what would make sense, given the evidence on asset shifting and given the need for more retirement saving that is inversely related to this pattern.

The Center for American Progress proposal would level that playing field by providing $25 for each of those families if they put $100 into a 401K. So the basic message would be, regardless of what your income is, you put $100 into a 401K, you save $25. And that kind of leveling not only makes sense in terms of fairness, but also makes sense in terms of trying to raise private savings, because by boosting the incentives at the bottom you're more likely to induce new saving than by providing large incentives at the top, which is where we currently provide them.

So I'll just wrap up by saying that obviously this plan has many moving parts. And among its many features, the proposal highlights the need, in my opinion, to fundamentally rethink how we try to encourage private saving in the United States, and it therefore represents a very useful contribution both to the tax reform debate and to the debate that we seem to now be engaged in over retirement security in this country.

Thank you.

MR. PODESTA: Thank you, Peter. (Applause.)

Dr. Bill Gale?

DR. WILLIAM G. GALE: Thanks very much. It's a pleasure to be here this afternoon and be on this panel.

I'd like to talk about five things that I like about the CAP tax reform proposal, and two areas that I also like that I think could be pushed a little farther, and I hope that in the ensuing debate actually do get pushed farther.

The first thing to note is this is the right level for a serious tax reform debate in two regards. One is that when you mention tax reform to a certain type of person, they immediately go off and start talking about their ideal systems, which exist only on paper. They could never exist in the real world because of constraints like the existence of politicians, the existence of lobbyists, the existence of the tax shelter industry, public notions of equity, and limitations on the ability of any government agency to enforce taxes. So it sort of reminds me of the fierce debates we used to have when we were kids. Would you rather be Willie Mays or Mickey Mantle? Well, that's not really the question that we face here.

To paraphrase Donald Rumsfeld, which probably doesn't happen very often here, we need to talk about tax reform with the real world that we have, not the real world that we wish we were in. This plan does that. It's practical. It's well motivated. It's internally consistent. They offer significant reforms. It's not some crazy pie-in-the-sky idea and it's not some endless laundry list of proposals, so I think it's very much the right level for a reform plan to lead off the debate.

The other thing I like about this at this level is that there tends to be this artificial separation between the level of revenues and the way we raise those revenues. And people talk about tax reform, they talk about revenue-neutral issues, and then separately people talk about tax cuts or tax increases. We don't have that luxury anymore. We are facing long-term fiscal gaps that will force us either to cut spending by unbelievable amounts or to raise taxes. So to me, a first-order concern in the tax reform debate should be how do we structure the system so that when we need to raise revenues in the relatively near future, we will have a system that will allow us to do that. This tax reform plan also gets us a nice platform for doing that.

All right. Point two. The plan combats the shift in the tax base from wage – from capital to wages over the last 50 years. As was mentioned, corporate taxes have gone down, and payroll taxes have gone up, but it's important to realize the shift has gone way beyond that. We have the potential repeal of the estate tax on the horizon – the potential permanent repeal, rather. We have cuts in dividend taxes, cuts in capital gains taxes. We have a vast array of incentives – what are called saving incentives, but are really incentives for contributions to particular accounts. We have an increase in the aggressiveness of sheltering techniques over last 20 years, so there's been a very strong shift away from the taxation of capital income toward wage income.

And the only concern with that shift is that first it's distributionally unfair. Second, it's enormously expensive. And third, it does not generate benefits in terms of increased economic growth. So it's a very expensive way to shift revenues with very little redeeming social value. We need to move away from that shift back towards taxing all income and this proposal is the way to do that.

The third feature that's worth noting is the integration of payroll and income taxes. There's an economic side to this and a political side to this. I think the economics are sound, because a worker pays a payroll tax on the very first dollar that they earn. A family of four doesn't really start paying income tax till they're up around $30,000. As a result, three-quarters of households pay more in payroll taxes than they do in income taxes; and in the bottom half of the income distribution, it's even higher than that. And so we need to divorce Social Security reform discussions from only having one way of raising revenue from Social Security reform, being the payroll tax. And I think that this is a helpful way to do that.

Now, there is a political side to here that's worth mentioning, and it goes very – it goes all the way back through the legacy that Roosevelt established with the creation of Social Security. And that is, workers pay their money in, and it's – therefore, it's their money and they get their money back out. That's a very strong political statement. I don't want to diminish that at all, but I have two thoughts in response. One is that while I greatly respect Roosevelt's vision, it's not evident to me that the political system or the powers that be right now share that respect.

The second issue is that payroll taxes have been used as a political football the last 20 years. In 1983, we raised payroll taxes in the Social Security Commission that existed at the time. That helped generate surpluses over the next 15 – 20 years. And then as a manner of paying for the tax cuts that came out of the surpluses there's been a suggestion that we cut Social Security benefits, so I think there's a lot of confusion about the government accounting system, and I'm not sure how the politics play out on this, but I think the economics are sound.

The fourth point, the plan eliminates the alternative minimum tax, which is near and dear to my heart, and it does so in a responsible way. You can't just eliminate the tax. If you do, (a) you reduce an enormous amount of revenues; and (b) you recreate all the shelters that existed before the tax was put into the (stock or?) shelters. So if I understand the proposal, those shelters – those anti-sheltering provisions are moved back into the regular income tax, then the AMT is done away with. Then that combination –

being able to raise revenue in a plan that eliminates the AMT is an amazing thing, and it should not be understated. So that's a fourth item I like about this.

The fifth item is the effect on national saving. We talked about equity and simplicity; the last piece of the puzzle is the economic growth effect. Everyone agrees that growth matters, but there's disagreement about the best way to stimulate economic growth; the three candidates being tax cuts, increased spending on education, health, and other productive items, or an increase in the budget deficit. From my reading of the evidence – sorry, a reduction in the budget deficit and increase in the surplus. It's right up into a (sign change?), I guess. (Laughs.)

From my way of reading it, the increase in the federal fiscal status is the most effective way to raise national saving. Estimates that Peter and I have done suggested every dollar in increased federal saving turns into between 50 and 80 cents of increased national saving. There's nothing else that's out there that has an effect anywhere near that big. Spending on education and investment in human capital, as Bob Solow mentioned, I think are a strong second. And the evidence is fairly strong that tax cuts that are paid for with deficits or that are where the payment is postponed by borrowing end up having negative effects on long-term economic growth. This plan addresses economic growth front and center by increasing the ability of the federal government to contribute to national saving.

All right, in my remaining time let me mention two areas where the plan takes several steps, but I personally would like to see the debate take several more steps. One is simplification. You can't do everything in a single reform proposal. And again, it's a positive attribute that this is not a – this proposal is not a laundry list of 400 things, but we could push harder on the simplification front. We could get 30 to 50 million people off of the need to file tax returns with relatively simple changes in withholding and the structure of the tax system. We could consolidate the nests of incentives for education, for retirement saving. We could consolidate the child credit, the exemption, the EITC, et cetera, into a single program. That consolidation, by the way, would aid in getting more people out of the need to file tax returns.

Let me just toss out one other idea that's been floating around for years, but I kind of like it; that is, raise the standard deduction by the amount of the personal exemption, and reduce the number of personal exemptions by one. You can work through it. It's a very progressive change, and it reduces the numbers of itemizers substantially.

All right. The other area where this reform proposal does a good job of changing the course of recent events, but we could push farther, is in broadening the tax base, eliminating – well, let me take a step back. The biggest tax shelter in the system right now is the treatment of capital gains, and this proposal goes a long way toward reducing the preferential treatment of capital gains in ways that John can detail. We could push farther in that direction, and certainly all of the goals of the proposal – taxing all income at the same rate, making a tax system progressive, making it simpler, and in particular, getting rid of tax shelters – hinge on taxing capital gains the same rate as other income.

That was the lynchpin in the 1986 reform for both simplicity and equity, and the reduction of the anti-sheltering issues. And that – I wish that that could be true again.

It may be that the political system won't harbor any more changes than are put in here, but I would hate to see us give up at the beginning and not make it push in that direction.

Thanks. (Applause.)

MR. PODESTA: Thank you, Bill. And I want to thank all the panelists.

I want to make one additional point to something Bill said, and then do a couple of thank yous, and then open it up to questions. And the way we're going to open up – while you're thinking about your questions, I'd like to take a question. We do have some reporters in the audience – take reporter questions first, and then open it up to general audience.

But first with the one additional point, I think with regard to the question of payroll tax being used and general revenue not being used in the Social Security system, really we crossed that bridge in 1983. That's the whole basis of the O'Neill/Greenspan/Reagan tax compromise on Social Security. I think we visioned a system in which general revenue would be used to support Social Security benefits. And I think there's only one player in the current debate who focuses on 2018 when that crossover takes place. We're accelerating that obviously, but I think we're providing a longer-term basis and a strengthened basis for paying out a guaranteed benefit under Social Security.

I said I had some thank yous. Peter noted that while Peter and Bill, who were both at the Joint Tax Center, aren't endorsing this plan, I do want to thank them for some of the technical work that was – made this all possible and capable. One of the things that's happened is we get more – as we get less and less information from the Treasury Department, we become more and more reliant on the Joint Tax Center for reliable information on modeling and how the tax code actually operates. And I want to thank them for not only being here today, but for doing that work and all the other work they do at the Joint Tax Center with the Urban Institute.

And finally, I'd like to thank Cassandra Butts who's sitting in the audience, who's our senior vice-president for economic policy, and her whole team, along with Gene Sperling, who's a senior fellow the Center who gave us – Cassandra and her team who helped John put the program together, and Gene for giving us valuable input into the program.

So with that, let me open it up, as I said. First, I think we may have a mike in the back to reporters questions, if we have any, or else I will open it up to the public. Fire away. Anybody who would like to ask a question. Got one right up in front.

Yeah, please identify yourself and –

Q: Yeah. My name is Arthur Borden (sp). Can you hear me?

MR. PODESTA: Yeah.

Q: Yeah, I'm a former senior economist with the Commerce Department (and on GDP?), and also a former research assistant on the Brookings Tax Project back in the late 1970s. And I just, you know, wanted to – well, when I was working on the tax project, I was surprised to see how many of the wealthy did not pay very much in taxes at that point in time. And it has apparently been a recurring theme over the ages.

One of the things that I've noticed over the years is that the wealthy really benefit very much from a lot of government expenditures, protections. One of the things being Enron, having the State Department lobby on their behalf in India and other places. A lot of the wealthy use the airlines, fly a lot. I think that probably Homeland Security today – and just was wondering about thoughts on how the wealthy maybe benefit a lot more (off mike).

MR. PODESTA: Well, I think that's a very good point, and as I said in my opening comments, I think – I know actually, and had the privilege of coming into contact with a lot of wealthy people over the course of my political career. I haven't perhaps joined their ranks quite to the extent that I would like, but I've met them. And I think most of the people – perhaps I deal with a rarer breed, but I think there are a lot of wealthy people in this country who really understand the point the questioner is making, which is that they do benefit extensively and that the country really benefits from having a strong and growing middle class, and that great wealth can't be created in this country without a commitment to the continuation of what I described, again, in my opening comments as the American dream: to keep the real wages growing for middle-income people and keeping a tax system that's fair to middle-income people; keeping the opportunity of college open, as Bill noted in his comments, to middle-income people.

So we need to structure I think both a – we need to structure a funding program that supports the important investments that Dr. Solow talked about, but we also need to have a tax system that's fair and across the board. I don't know if Dr. Solow would – might want to comment on that as well.

DR. SOLOW: I agree perfectly with that. One of the ways in which people at our profession seek a lot of effort is trying to measure and allocate benefits from public expenditure. A lot of them are very difficult to pin down, but what Mr. Morton suggested is certainly right. You have a large stake – a wealthy person has a large stake in the country, and anything that – any use of resources to protect that and augment it is certainly a benefit to those people.

MR. PODESTA: Okay.

Q: Last year, when we –

MR. PODESTA: Could you identify yourself, please?

Q: I'm Lee Price, Economic Policy Institute.

Last year when the administration pushed for a zero tax on dividends, they were saying that this was – would be the best possible thing you could do for working people. It's not just wealthy people who benefit, that it's working people. And I was interested in the – as someone who's an expert on growth, but other – the other concepts, you're going the other way. You're saying if taxes are too low on capital; they need to be raised and lower taxes on labor.

Why do you think that – why is your analysis different from their analysis that says the best thing to do for working people is to eliminate that at some point?

DR. SOLOW: Well, I suppose that the argument that was being made that Lee Price heard was that eliminating the tax on dividends would induce a lot of plant and equipment investment by corporations because the after-tax return would now be higher, and increasing the stock of productive capital in the country relative to the supply of labor would increase the productivity of labor and therefore real wages.

You have to be quantitative about these things. I think no one would deny that there is – well, let me quote something to you. Charlie Schultz, beloved among some of us, once remarked about supply-side economics, there's nothing wrong with supply-side economics that dividing by 10 wouldn't cure. And much the same thing is true here. There are lots of ways in which the productivity of labor, and therefore real wages, increase in our society and the amount of extra investment that would be induced by reducing the tax on dividends is so small that anyone could think of better ways of accomplishing that. It's a statement which is right according to the sign, but rather small in the quantity.

DR. ORSZAG: And let me just add two comments to that broad point. First, many of the studies – in fact, to my knowledge, all of them – that the administration was relying on for that kind of assertion assumed a revenue-neutral shift, not a deficit-financed tax cut. And the studies that have looked at the effects of the deficit-financed tax cuts have found that if anything the effect on an overall economic growth in the long term is negative, including the study that the Joint Tax Committee conducted on the 2003 tax legislation.

The second point that's worth noting, while still within the general framework that Bob Solow pointed out, that if there is an effect that's positive, even if it's revenue neutral, it's small, the other thing that's worth pointing out is that the administration's original proposal was not what was enacted. The administration's original proposal only provided a dividend tax break to an individual if the corporation had already paid whole tax on the underlying earnings. That piece was discarded in the final enactment, and some potentially positive incentives that come from that kind of linkage were therefore lost. All of which is to say, even the idealized version that is revenue neutral and that only provides a dividend tax break if the corporation already paid tax on the underlying earnings – even in that situation you're talking about something that's very small and, as Bob Solow already said, probably swamped by other things we could do, but that's not what we enacted anyway.

DR. GALE: I just want to pile on a little bit more. The dividend tax cut is a good example of a backward-looking tax cut. It's a subsidy to old capital; the dividends you're getting now or the income that you're receiving from prior investments. There is no reason in the world to subsidize, now, investments that people made 10 years ago. So there's a substantial element of it that's a windfall gain.

In the extreme, if you believe the new view – all right – of investment, then there's no effect on investment at all. It's completely windfall gain. All right, now couple that with being financed by budget deficits and you've got a negative effect on long-term growth. What you need for the positive effect is a lot of old view and not much budget deficit loss. But certainly what was said, that there are better ways to stimulate growth and improve the prospects for workers in the future is just – is the far overwhelming point.

MR. PODESTA: I want to add one more point, Lee. And I'm the only person sitting here who doesn't have a Dr. in front of their name, so take this with a grain of salt. But I think that if you look back at this latest expansion, we've had the least amount of both the productivity growth that led to GDP growth has fed back less in the wages and benefits than any recovery in the history of our country, not only as an overall – from a perspective of the overall growth in the economy has been weak job growth relative to previous recoveries, but to the extent there's been growth, that has not been fed back at all to workers through wages and benefit increases. And again, take this with – call this intuitive economics, but I think there's a certain kind of Patco effect that goes on at some point. When people make the political argument that you just made, I think that people deciding on the relative of what's happening in business life in this country, sort of take on a signal that begins to effect behavior about what's valued and what's valuable inside the sort of business life in this country, and I'm not sure that that in the long run is sustainable.

Next question.

Q: Adam Zimmerman, legislative correspondent for Senator Charles Schumer. Two quick questions: one a policy one, one more of a political one. On the policy issue, one of the issues that we're most concerned with in our office has to deal with the state and local tax deductibility on federal returns, which we've all heard rumors that that's one of the plans of the administration's policy coming out. So I wanted to get from anyone on the panel a few of your thoughts on the elimination of that and its effect it would have on many of the blue states, so to speak, including New York.

My second question is that a lot of times we hear whenever we, meaning more – those of us on the progressive side are looking to raise taxes on a certain group of people, i.e., the more wealthy among us, one of the primary arguments we hear is that well, they're patriotic, so they'll be happy to pay – almost as if we're indexing feelings of love of country in the same brackets that we index income.

To me, that doesn't strike me as a very effective argument, especially when the interests that represent the wealthiest are so entrenched now in Washington. So as more of a political action question, do we have a better idea in order to effectively promote and float this proposal in Congress?

MR. PODESTA: Well, why don't I answer maybe Peter wants to raise on this on the state and local taxation. But it's not a feature of this plan. I would just say that we decided that there were – that along with state and local taxation there were certain incentives in the tax code that we thought were – including home ownership, education tax credits, et cetera, that we thought we decided were promoting good policies, and we left them alone.

With regard to the messaging component of the plan, I think that – again, I think that focus of our effort is to have a tax system and a government expenditure system that supports and builds up the middle class, and we'll leave it to others, I think, to decide the relative levels. I don't think we want to index patriotism, I just think that most Americans understand that we all have to do well in order for the country to succeed and be as great as it can be.

DR. ORSZAG: I guess, I – just on the same state and local, one point that's worth noting is the lack of deductibility of the state and local taxes under the alternative minimum tax would no longer exist under this program, so in a sense you could think of it as expanding state and local deductibility or at least preventing its erosion over time as would otherwise occur (unintelligible) alternative minimum tax.

I would say there is a act of discussion about the economic effect of state and local tax deductibility with at least many within the economics profession thinking that it's not necessarily a good idea for the federal government to be providing assistance to state and local governments in that form. But just in terms of what the plan does, I think the most important thing it does along this dimension is to address the alternative minimum tax.

DR. GALE: I want to come back to the question about whether people are willing to pay taxes. If you take a poll or survey and you ask people, "do you want a tax cut?" 80 percent will say yes. If you ask them, "do you want a tax cut if it means that we have to cut spending on education, social security, Medicare, defense, whatever?" 80 percent say no. And so you can interpret that as either a framing issue or a realistic – a realism issue, but I think share John's confidence that if the issue is presented to the American public in an honest way, they will be sufficiently informed to make intelligent decisions, if it's presented to them in wave after wave of distortion as might have happened the last few years, then you can get a very different outcome.

MR. PODESTA: Why don't we take a couple and then we'll let the panel answer them. (Off mike.) Stay on this side of the room.

Q.: I'm Victor Folauan, I'm with the International (unintelligible) Movement. And I just wanted to pose the question, would you really be having an honest policy debate if you choose to focus on symptoms rather than the disease, which is expressed in some of these symptoms?

And I'll quickly explain what I mean. It's very clear that the assault which the conservatives are launching on the tax system by attempting to cut taxes on capital gains for example, and if you also look at the assault the conservatives are launching on the Social Security system by attempting to divert the big income stream going into the Social Security Trust Fund into financial institutions that are managed by Wall Street-managed financial institutions, that the attempt these guys are making is to defend a monetary system – a global monetary system which they know is bankrupt: the IMF-centered monetary system.

Why is Bill Gates, for example, betting against the dollar? Why is Warren Buffett betting against the dollar? So if you're not willing to look at the discussion in the context of a bankrupt free trade system and discuss protectionism, discuss the establishment of a fixed exchange rate, fixed interest monetary – global monetary system, then you're not really addressing the disease. You're just discuss the symptoms –

MR. PODESTA: Okay.

Q.: – and to me that's not an honest policy today.

MR. PODESTA: Okay, we got the question. Let's do a couple more, and then we'll let people answer in return.

Q: Yes, my name is Sam Pizzigati from the *Too Much Newsletter*. I have a quick question on the top marginal rate in the plan, which I think is 39.6 percent. And my question is, what is the economic thinking behind setting the top marginal rate at that 39.6 figure and not some other figure?

MR. PODESTA: And then one in the back. And then we'll work off that side.

Q: Good afternoon, my name is Erin Smith from the *Executive Intelligence Review*. And the question that I had – and I know we're discussing taxes is in reference to labor, which was discussed heavily since I've been here – is, is it in the proposal for a cap to actually look at ways to encourage – in other words, a lot of the sort of jobs that I needed to collect a sort of healthy revenue are in the realms of manufacturing, et cetera, which that sector has collapsed.

So you have a lot of companies who have businesses outside of the United States that we don't collect the tax from. So what about instead of – since we can't collect the tax from those companies, say people who are affiliated with Wal-Mart, for example, on the front end, collecting it on the back end through protective tariffs and actually then encouraging manufacturing and other things inside of the United States?

So you have people who have a higher income level in which you can get more tax from to have an overall better revenue. I don't think we're going to get that good of a tax return from people who work at Starbucks and McDonald's.

MR. PODESTA: Okay. John (off mike).

DR. IRONS: Yeah, but let me address the top marginal tax rate. It's at 39.6 in our current system, and many of you might remember last time it was at 39.6 was under President Clinton, and we didn't do so badly then. You know, the economy under – in the late 90's was very good. People did exceptionally well, especially at the top end. So we are returning to 39.6 with the idea of making the entire tax system more progressive. This is part of the overall tax plan again; kind of shifting off of more regressive components of a tax system onto more progressive forms of tax system and making what we have more progressive. So I think it will be returning to a time when what we had worked very well, and we'd like to see a similar tax system today.

(Cross talk.)

MR. PODESTA: Dr. Solow?

DR. SOLOW: Well, that opens a very large field. There's no doubt that – you know, we used to hear a lot about the twin deficits; the notion that somehow the budget deficit of the federal government moved in lockstep with the current account deficit of the whole country. That's false. There are altogether too many moveable links between the budget deficit and the current account deficit to argue in those terms. On the other hand, there's no doubt that one way – the current account deficit for the U.S. serves the purpose of allowing the U.S. to finance investing that occurs in the U.S. by using the savings of other countries.

There's something a little foolish – sounds a little foolish about that, but that's the way it works. There's little doubt that if we – if the U.S. were to arrange, either in the way that was talked about today here or in other ways, to finance more of its investment out of its own national savings, then we would borrow less from other countries.

Is there a danger to that large current account deficit? And the answer is yes. It's – at the moment it appears fairly stable. The U.S. is a very profitable place for foreigners to hold their wealth. Our economy is doing fairly well. I'd like it to do better, it's already doing better than most of the European economies. On the other hand, the possibility of a speculative attack on the dollar, which would make macro economic policy in this country – monetary policy – extraordinarily difficult to pursue is there. It could happen. It could happen at any time, but it might not. It's not something about which – the fundamentals of this are clear, but what – the real danger lies in something that's more psychological than (inaudible).

DR. ORSZAG: Yeah, I would just add in a very similar vein that fundamentally our net national saving rate in 2003 – last year, was under 2 percent of national income. It's the lowest since 1934. And there's just basically no good outcome that comes from saving less – for the world's leading economy power to save less than 2 percent of its income. It has – that necessarily means that we'll either invest only 2 percent of our income, which robs future workers of productivity-enhancing investments, or we have to borrow the difference from foreigners, and that's what we're doing to a large degree.

And as Bob Solow said, even if it's sustainable to continue borrowing that much money from foreigners, it's probably not desirable because it means that we're not reaping the full returns from those investments. Foreigners don't lend us money for free.

MR. PODESTA: Okay, well I would like to – we'll take one more question up here and that'll be the last one and then I think we can stay around and mingle for a little bit if people have other questions.

Q: Thank you. I'm Jim McTeague from *Barron's Investment Magazine*.

I have some questions about components of your plan. I assume the mortgage deduction would remain a sacred cow? Number two, what's magic about holding a stock or a bond for a five years, and would that also apply to investments in an IRA? Like if I had a – would I get – instead of being taxed at 39.5 percent when I'm withdrawing from an IRA or 20-some percent, would I be taxed at half the rate if I – if those investments were kept for over five years?

And third, what about Ireland? Ireland has experienced phenomenal growth because it cut the rates on corporations. By raising the taxes on corporations here, aren't you giving Ireland and other countries an advantage over us and really stunting growth here instead of encouraging it?

DR. IRONS: Let me address all three of your points, the first on the mortgage interest component. I don't know if we label it a sacred cow the way you did, but we retain the mortgage interest reduction.

On the five-year 50 percent exemption for capital gains, yes, it would apply to capital gains broadly speaking – IRAs, et cetera.

In the Ireland component – I love Ireland. I spent my honeymoon in Ireland. I think it's a great place. The assertion that Ireland's economy is doing well because they cut corporate tax rates, I'm not sure that conclusion is valid. It got quite a bit of aid from Europe, and I think they still continue to get quite a bit of aid. And, you know, I don't know; I'm not an expert on the Irish economy per se, but I think it's a little bit oversimplified to say that it's purely corporations.

We don't change the corporate tax rate in our plan. We do address loopholes. We do address some of the loopholes which cause people to shift manufacturing offshore, to address an earlier question. So I think we view that our plan is still very much pro-growth, and there's a lot of people who probably won't like our plan, but we think it's very strong on the growth front.

DR. SOLOW: About the IRA, I'm no specialist in the Irish economy, but I have spent a little time there and thought a little bit about it. And if you try to allocate the recent prosperity of the Irish economy between two boxes, one of the boxes says lower corporate tax rates, and the other box says being a low-wage, English-speaking economy within the European Union, I think that box would be full and the other box would have just a little bit in the bottom.

MR. PODESTA: Well, again, I will – please join me in thanking the panel, and as I said, we'll be – at least John and I will be around a little bit. If there are additional questions from the audience, we'll be happy to stay here and talk a little bit more, but thank you very much for appearing with us today, Dr. Solow, Dr. Gale, Dr. Orszag, and we look forward to working with you on this. Thank you. (Applause.)

(Background chatter.)

(END)