NATIONAL ACADEMY OF SOCIAL INSURANCE

For the Common Good: What Role for Social Insurance?

NASI's 19th Annual Conference

Session V: Do We Need a New Social Contract? How Would We Pay For It?

Friday, February 2, 2007

This session convened at 2:15 PM in the Ballroom of the National Press Club, 529 14th Street, NW, Washington, DC.

Introductions

Lawrence Thompson, Senior Fellow, The Urban Institute

LAWRENCE THOMPSON: If those outside would come in and sit down, we could get started. Our final session in this year's conference addresses the issue of "Do we need a new social contract, and if so how should we pay for it?" I'm Larry Thompson, and I am the chair of this session, which means that my value added is to keep the clock.

We originally were scheduled to have six speakers. Maya Rockeymoore had a commitment that she couldn't get out of, and so she's not with us this afternoon, leaving us with the five distinguished speakers described in great detail in your pink handout. They will speak in the order in which they are seated: Regina Jefferson, professor of law at Catholic University; Kimberly Morgan, assistant professor of political science at the George Washington University; Michael Graetz, Justice Hoskins professor of law at the Yale Law School; and John Schwarz, professor emeritus of political science at the University of Arizona; and our third co-chair, Jacob Hacker, political scientist at Yale University.

Regina?

The Social Contract and Retirement Security

Regina Jefferson, Professor of Law, Catholic University

REGINA JEFFERSON: Well, as it has been stated numerous times over the last two days, the three-legged stool is crumbling. A massive shift from traditional defined benefit plans to 401(k) plans has placed the pension leg of the stool in the most precarious condition. This is because the popularity of 401(k) plans in large part results from the fact these pans are cheaper and easier for the employer to maintain, rather than their suitability to function as primary retirement savings vehicles. As a result, the increasing use of 401(k) plans for retirement savings purposes has serious implications for America's workers as well as for its pension and tax policies. Consequently, a new social contract, which includes greater retirement security in today's pension landscape, is needed.

The private retirement system is voluntary, employment based, and tax subsidized. Each of these characteristics significantly affects the structure and policies of the existing retirement program. The rationale for the employment-based characteristics of the private retirement system is that employees obtain comparative advantages from saving in an employer-sponsored plan as opposed to personal saving arrangements. One such advantage stems from the fact that an employer who invests large sums of money can benefit from economies of scale. Consequently, average investment return should be higher and average administrative costs should be lower for the employer-sponsored plans because of the large client of assets they hold.

Another reason employees are more likely to receive greater returns inside than outside the plan is because employers are presumably in a better position than many employees to retain the services of financial experts to manage their retirement funds. Because the system is voluntary, employers are encouraged to establish qualified retirement plans with preferential tax treatment. As a result of the tax payable treatment of private plans, each year the Treasury forgoes billions of dollars in tax revenue. Put more exactly, the tax expenditure estimate for employer based retirement plans for fiscal years 2006 to 2010 total $577 billion, making the private retirement system one of the nation's most costly tax expenditures. Therefore, to justify the employment-based structure as well as the high cost of the pension program, employees covered by qualified retirement plans generally should be better off then they would be saving in personal arrangements. This should be true regardless of the type of plan the employer chooses to sponsor.

However, this is not always the case. Some participants in qualified plans have no protection against shortfalls in their expected retirement benefits and rather than benefiting from economies of scale are passed on excessively large administrative fees. Moreover, they are required not only to elect whether to participate and what level to contribute, but also how to invest their plan assets. Therefore in these instances, effectively there is no difference between saving in an employer-sponsored plan and saving in personal arrangements.

Under current law, many tax preferred qualified plans are in fact permitted to operate essentially as personal savings arrangements. These plans fail to deliver the advantages employer-sponsored retirement arrangements are designed to provide as well as the level of retirement security they are subsidized to achieve. Unless significant changes are made to existing pension laws to address this situation, not only will many workers fail to receive the retirement benefits that they expect and on which they have relied, but also the tax expenditure for the private retirement system will become increasingly more difficult to justify as more and more retirees unprotected against plan losses require additional government assistance in their old age.

ERISA was designed to regulate defined benefit plans, not defined contribution plans. However, the massive shift from traditional defined benefit plans to defined contribution plans has not been accompanied by any significant amendment tot the pension law. Thus, the increased risk posed by defined contribution plans in general, and 401(k) plans in particular, has not been addressed in any meaningful way by legislators. The failure to amend ERISA to reflect the realities of the changing pension landscape exposes participants in 401(k) plans to the enormous risk that they will have insufficient assets for their retirements.

Thus, as part of a new social contract with America, significant changes to the existing pension law are needed. The Pension Protection Act of 2006 introduces various rules that are designed to enhance retirement savings and defined contribution plans, such as encouraging automatic rollovers in 401(k) plans, requiring faster vesting for certain employer contributions, and creating a safe harbor for automatic enrollments in 401(k) plans.

Although these changes are laudable and may have some positive impact on contribution and participation rates in 401(k) plans, they are not sufficient. These changes do not modify the risk allocation and basic statutory framework of 401(k) plans, which continue to overestimate the participants' ability to adequately protect themselves against the risk of plan losses. In order for 401(k) plans to provide adequate protection against plan losses, new legislation at a minimum should address the following issues: first, employer stock in 401(k) plans. The availability of employer stock as an investment option in 401(k) plans adds greater complexity to participants' investment decisions and can further jeopardize retirement security.

Two-thirds of the 500 largest companies in this country offer their own stock as investment options in their 401(k) plans, with many workers holding quantities of employer stock well in excess of 10 percent of the recommended level. Therefore, the success of these pans disproportionately depends on the performance of a single company. Too much investment in a single stock is always ill-advised, but too much investment in employer stock is worse, because an employee's investment capital and human capital are linked together. For this reason, encouraging plans that invest in company stock with substantial tax preferences is very questionable pension and tax policy.

Accordingly there should be mandatory caps imposed on the amount of company stock that can be held by qualified 401(k) plans. For plans that do not impose such caps, there should be a reduction or elimination of the tax benefits that they receive. The reduction in the tax benefit is warranted because plans that invest in company stock fail to provide the level of retirement security envisioned by ERISA. To encourage such plans with the same tax benefits that other qualified plans receive not only frustrates the primary purpose of ERISA, but also unjustifiably rewards these saving arrangements with the special tax subsidies that should be reserved for legitimate retirement savings programs.

The second issue is guaranteed retirement benefits in 401(k) plans. In order to reduce the risk of loss in all 401(k) plans, there should be a voluntary insurance program. The objective of the insurance program would be to provide a guaranteed minimum benefit for properly diversified 401(k) plan accounts. Under this proposal, for an annual fee, plan participants could elect to receive a guaranteed minimum benefit from their 401(k) plans of retirement while retaining the right of self-direction. To the extent that an account was insured, it would be required to adhere to predetermined investment guidelines for diversification. The annual fee would be risk based and economically derived so the insurance program would be financially viable. The insurance program could be either federally of privately administered. The minimum benefit would approximate an average return over a participant's working life. As a practical matter, the minimum benefit would be less than the return the participant would have received had she not elected the guarantee, but would be more than the rate of return for low risk, low yield investments such as Treasury notes.

Skeptics of 401(k) insurance have expressed concern that such insurance necessarily would present the moral hazard problem of insurance, which says that those who are insured against certain risks have no incentives to use optimum care to avoid the risk. However, the moral hazard problem can be easily resolved by requiring that insured participants maintain a diversified portfolio. If 401(k) accounts were insurable only to the extent that they would diversified according to predetermined standards, participants desiring insurance effectively would be forced to protect themselves against the insured risk.

Insurance for individual accounts is neither a complex nor radical concept. Various insurance options offered by mutual fund companies are similar in design. The products generally allow investors to pay an additional fee ranging from three-tenths to five-tenths of their investment assets per year in exchange for a guaranteed minimum investment return. Thus, depending on the age of the insured, the additional fees for the guaranteed minimum are approximately $300 to $500 per year, per $100,000 of investment. Investors pay the extra fee for the guarantee in addition to regular fund management fees, which average 1 percent to 2 percent of their assets.

Since introducing the basic insurance product several years ago, mutual companies have added enhancements such as bonuses and options, suggesting that there is a market for the product. Interestingly, the structure of 401(k) plans allows employers to easily pass on administrative costs of the plan to participants without detection. Therefore under current law, 401(k) plan participants are often forced to accept lower investment returns in their accounts as a result of hidden fees and costs. These fees are not insignificant, and are typically much higher than the three-tenths to five-tenths annual fee charged by mutual fund companies for guaranteed minimum returns.

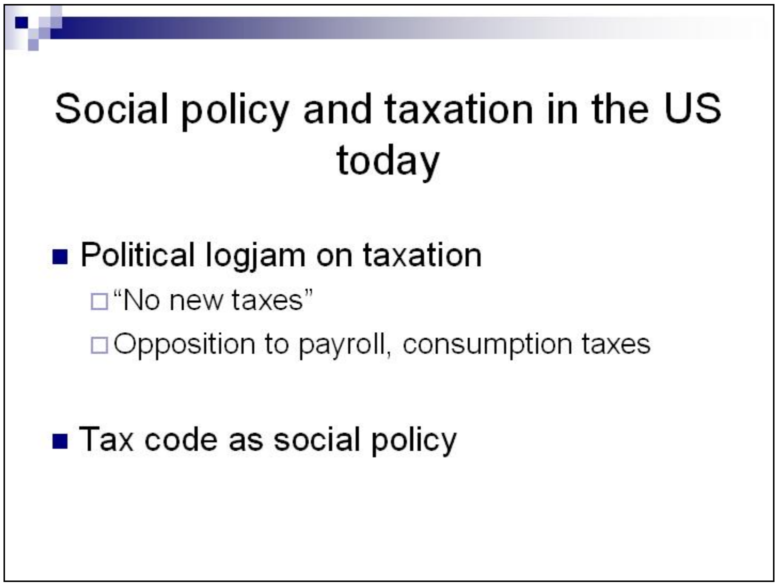
Service fees in 401(k) plans alone can erode lifetime accumulations by as much as 20 to 40 percent. Additionally, many high profile investment companies aggressively advertise their products. The costs associated with their advertising campaigns are also passed on to plan participants. Therefore it is reasonable to believe that participants would be just as willing to forego a portion of their investment returns for greater security as they are for administrative and marketing expenses.

These are just two of many needed changes to adequately protect participants in 401(k) plans against plan losses. The impact of replacing traditional defined benefit plans with defined contribution plans without significant change to the law unilaterally eliminates a main portion of the social contract. To the extent that the government foregoes revenue in connection with qualified plans it is effectively a financial partner with employers that establish and maintain these plans. Accordingly, it is incumbent upon the nation’s policymakers to amend ERISA to provide a level of retirement security in 401(k) plans that not only provides adequate requirement security to plan participants, but also justifies the cost of the tax subsidies that these plans receive.

Thank you. (Applause.)

Political Perspectives on the Financing of Social Benefits
Kimberly Morgan, Assistant Professor of Political Science, George Washington University

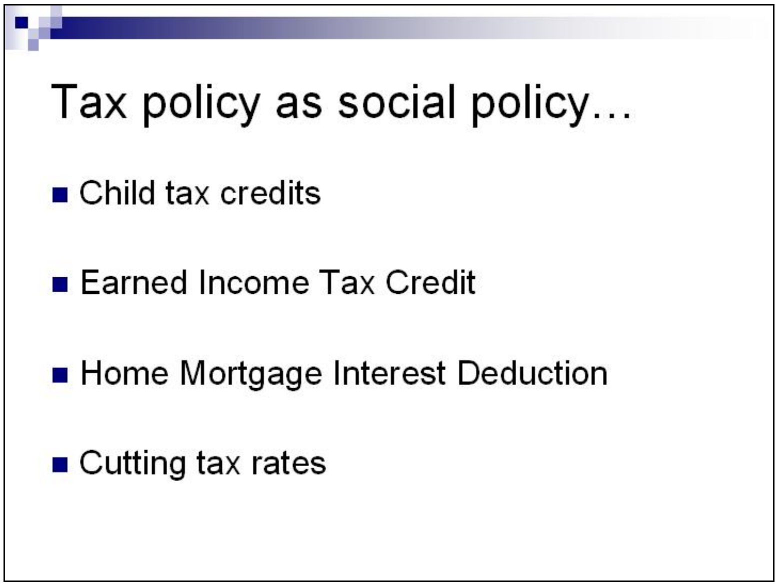
KIMBERLY MORGAN: It's a delight to be here, although I have to say I think it's a bit of a challenge to have to talk about taxation in the last panel of a two-day conference, at which point conference fatigue begins to set in. I think for a lot of people tax policy is not exactly a topic that quickens the pulse, shall we say. Yet on the other hand, I think tax policy is so vital to any conversation we want to have about the social contract. That's true both theoretically, because when we talk about social rights we need to talk also about obligations that people have to society, but also as a practical matter, financing is essential to many of the things that we might like to do in social policy that we have been talking about at this conference.



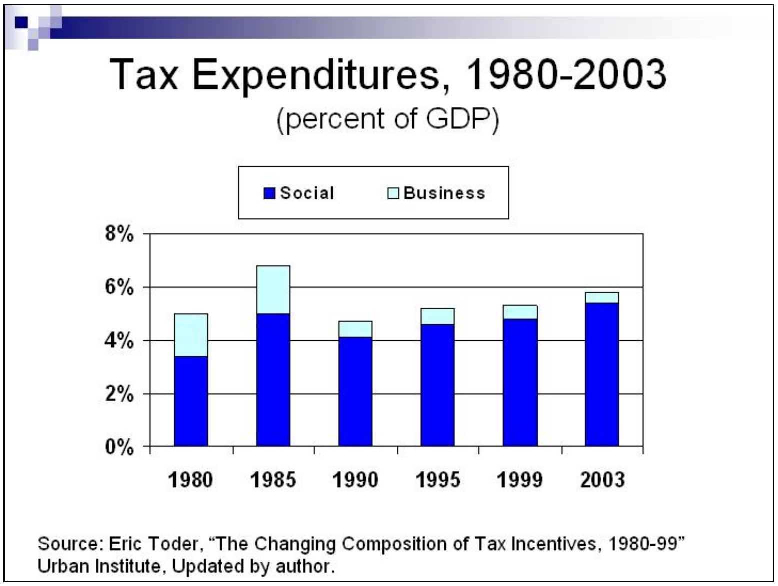
So the first observation is that we face some significant challenges in the area of financing social programs. Our existing social programs will become more expensive in the years ahead, and many conversations at this conference have pointed to other things that people might like to do that will also cost money. Yet we're facing a political logjam on taxation. That word logjam has come up repeatedly today, I notice. I don't have a little picture of a logjam that Joe Antos had on the slide, but certainly the word logjam seems to come to mind on some of these questions that we've been talking about.

But on the conservative side there have, of course, been pledges for no new taxes and an effort to reduce taxes and perhaps shift to more of a flat tax system. On the left, there's been a favor for increasing taxes on the rich or on corporations, strong opposition to something like a national sales tax, which many people view as regressive. And if there's anything that people on the left and the right might agree on it's their negative assessments of the payroll tax. I think a lot of people feel like the payroll tax in unfair to low-income people because it's levied at a flat rate and there's a wage ceiling on the wages assessed.

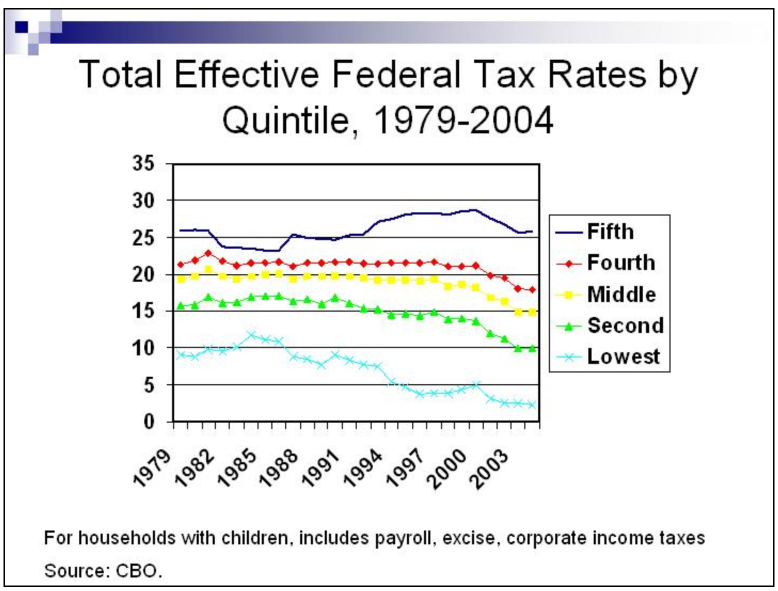
If you add up all these views, you basically arrive at the point where there is virtually no agreement on any form of taxation that people would agree on raising, and that makes it very difficult then to increase taxes. The result being that we lack funding for significant increases in social spending.



So our default solution then to meeting various social needs has been of course the tax code. And I think this very familiar to people in the room, so won't spend a lot of time on the ways in which we use tax policy as social policy.

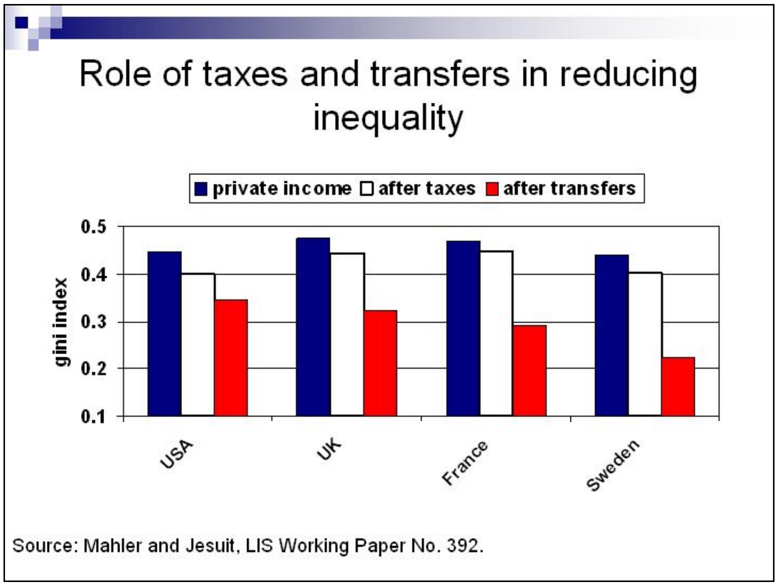


There's a nice chart that shows how since we're increasingly using tax policy as social policy, social tax expenditures have been increasing as a percent of the economy. It's a nice chart from the Urban Institute. But also arguably this policy of cutting taxes on the poor has been a kind of social policy, and it's been something that people have been trying to do very explicitly.



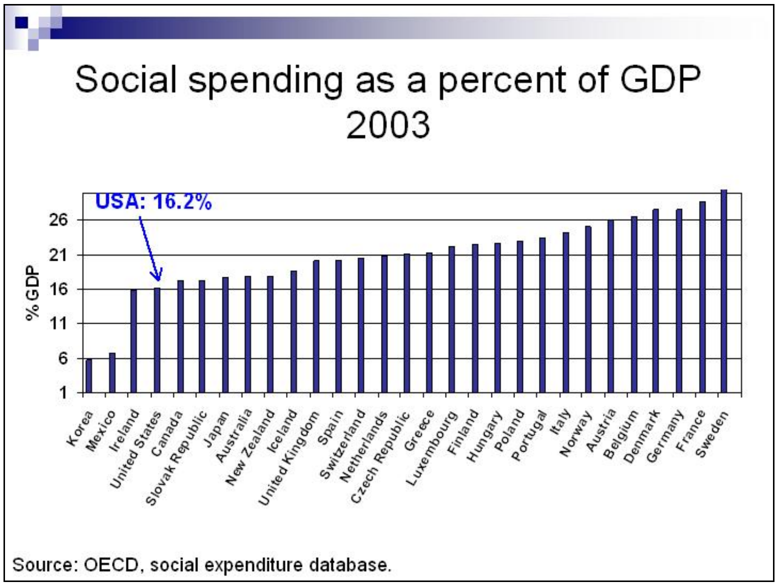
This just gives federal tax rates, that includes things like payroll taxes, and shows a quite marked decline in the tax rate on people in the lowest quintile.

So my first point, then, would simply be something many people in this room know: that our direct spending programs have been truncated and constrained by our inability to agree on funding sources, but that the tax code has kind of substituted as our major instrument of social policy. Well, how has that been working out for us? I would argue, it has not been working out very well.



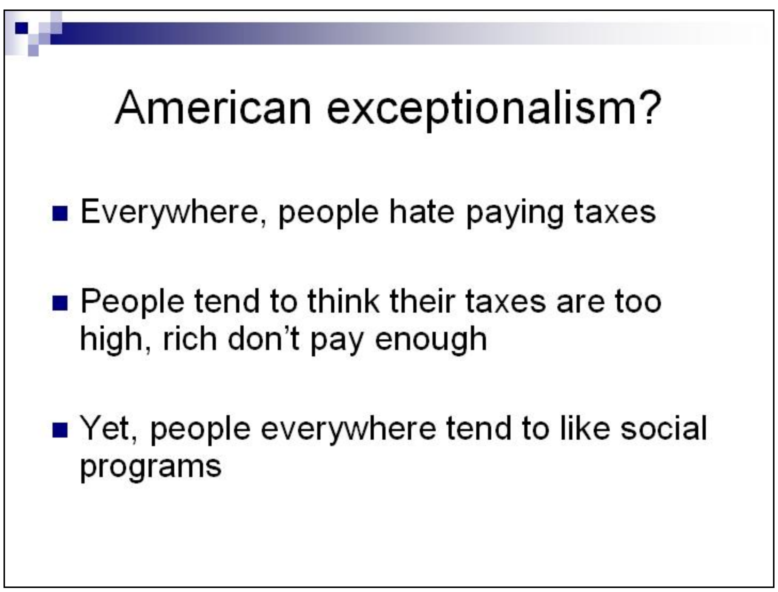
I chose this one measure; one could pick other measures of how well our social insurance system, and our social safety net is working. This one looks at the role of taxes and transfers across countries and reducing inequality. So you see first market income in the blue bar, then after-tax income that people have in the white bar, and then after-transfer income in red.

I think this shows, comparing the U.S. to a couple of other European countries, that the U.S. has done reasonably well, even better than some European countries in using the tax system as a way of reducing inequality. But that really most European countries reduce inequality or address poverty or address any other kinds of needs is through the transfer system, through services and benefits. And that's really where the bulk of this comes from.

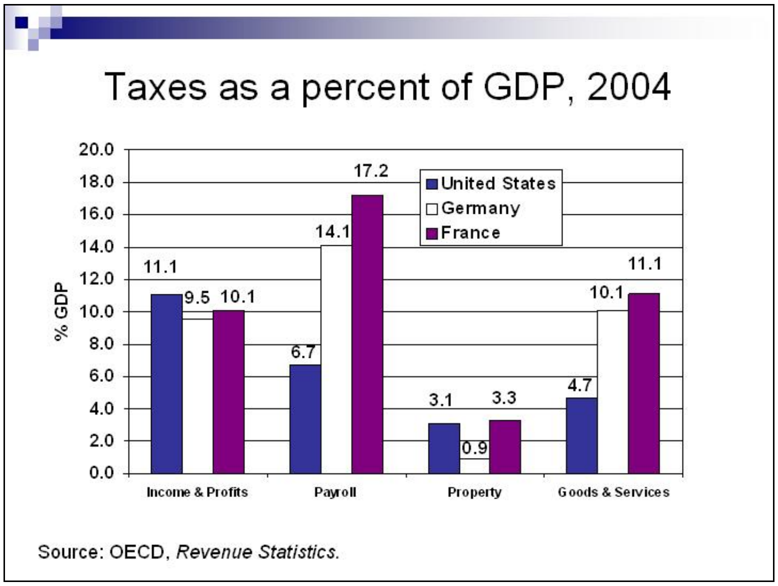


An obligatory chart whenever talking about other countries: these other countries, of course, spend a lot more on direct social spending than we do, and they are spending it in ways that are reducing poverty, that are reducing inequality, and that are addressing various social needs.

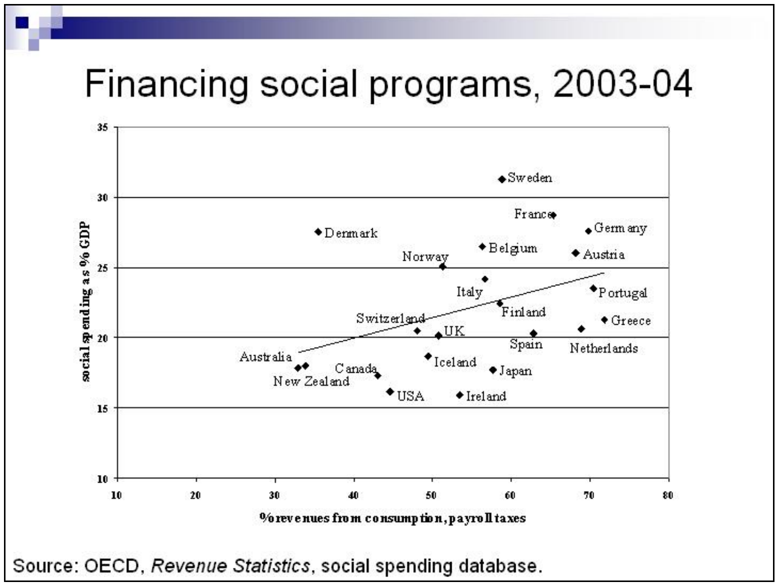
So speaking of all these other countries, is there anything we might learn about how it is that they are actually raising the revenues to pay for this direct social spending that they engage in? I think the usual reaction people have to that right away is that the U.S. has nothing to learn because we're so exceptional, we're so individualistic, our culture predisposes us against paying taxes, and thus we don't have much to learn from Western European countries.



And I would actually argue that that's not really true. And I don't have time to go through all the comparative public opinion data that addresses this question, but I think if some broad conclusions were to be drawn, it would be that Americans are not so unique. People everywhere really don't like paying taxes – maybe hate is a little bit strong – but people don't like paying taxes. People everywhere tend to think their taxes are too high and that the rich are not paying enough. Yet everywhere people tend to like social programs and frequently want more of them. Thus, in other words the impulse to try to get something for nothing or something for less then the full price is actually a fairly universal tendency, and not simply an American one.



So how do other countries then pay for these programs that people want but are not necessarily excited about paying for? And I think the surprise when you look cross-nationally is that most countries that have more extensive social programs don't just pay for them by sticking it to the rich and to corporations. They do not finance their programs wholly or even mostly through progressive forms of taxation, but instead things like consumption and payroll taxes are very significant. In other words, as I pointed out earlier, they do their redistribution through the spending side of the budget and less through taxation. That is the opposite of what the United States is doing.



I just have a couple of charts to support this. This one compares the size of different forms of taxation as a percent of the economy, income and profits versus payroll, property, and goods and services. On income and profits, the U.S. doesn't look very different. In fact, our income tax is even more significant that Germany or France, and if I put other countries on there you can see that our income taxes are more significant than in a number of European countries. But where we're really different is in much lower payroll taxes and then much lower goods and services taxes because all other advanced industrialized countries have adopted a value added tax and we have not.

VAT rates in 2006

Australia	10%
New Zealand	12.5%
Germany	16%
UK	17.5%
France	19.6%
Sweden	25%

Source: OECD.

More generally you can see a relationship between social spending as a percent of the economy and revenues from consumption and payroll taxes. It is kind of a loose relationship, but generally shows that as countries expand their social safety net they don't do so simply through increasing taxes on corporations and on personal incomes, but that they tend to turn to consumption and payroll taxes as the way to finance these. As a small example, I did graduate research in Norway. When I first got there, I went out of my little small graduate student stipend and ordered a couple of beers, as graduate students are prone to do. And when I got the bill, I realized that I just consumed much of my food budget for the week. I had really no idea how much more expensive everything was in Norway and food was a lot more expensive, too. So really, the price of consumption in Europe is considerably higher, and that's something that always worries people on the left, that consumption taxes will disproportionately impact lower-income people.

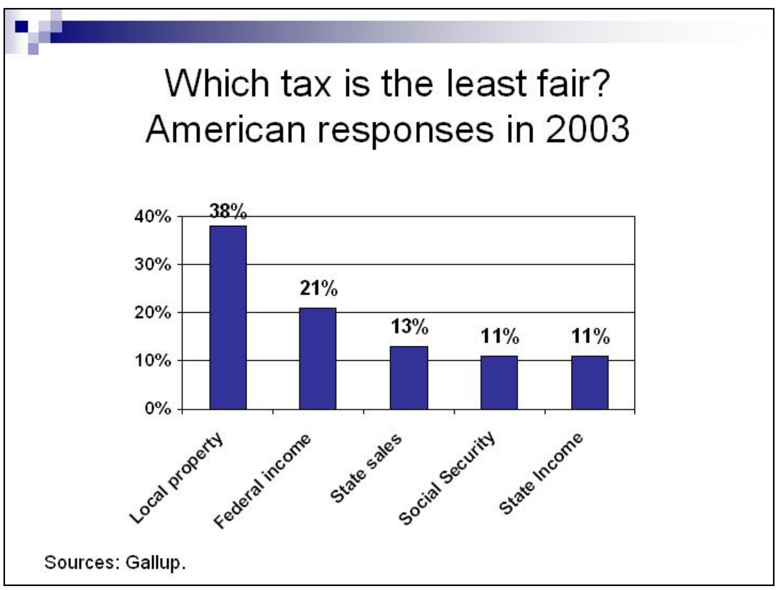
So given that, then why is it that these other countries – and I'll focus in particular on some West European countries – why are they financing their social programs through these taxes? Why are they financing them through VATs and payroll taxes to such a large extent? Certainly there are some economic reasons why. Peter Lindert has raised this as the answer to his free lunch puzzle, the puzzle being why is that that so many European countries have been able to maintain high levels of economic performance when they have had these large welfare states and resulting having tax burdens? And part of the answer here I've used is that their tax systems have been more growth oriented. They have taxed consumption and labor fairly heavily relative to having taxed capital and that has actually been positive for the economy. And there's some evidence that at least some governments in some of these countries, have actually thought about it in this regard that they try to keep personal and corporate income taxes down and treat capital more kindly because of their concern that if they raise taxes too high, this could have negative economic consequences.

But as a political scientist, not an economist, I always try to find political reasons for why everything happens and I think there are potentially some political reasons why countries rely on these forms of taxation. And here are just a couple of them and I wanted to walk through them as a way to reflect upon some of the political qualities that different forms of taxation may have. The first point could be that some of these taxes are less visible, that if people want something for nothing, then maybe you have to be tricky as a policymaker, that the income tax is something people confront every year. The property tax, again something very irksome: people see the sum that they owe to the government, and that's why they tend not to like these taxes. But maybe a sales tax one can sneak into the price of goods and people don't really notice.

A number of economists have been studying this for a long time, trying to see if this is in fact true – if there is real evidence that some taxes are more visible and antagonistic to people than other forms and the evidence on this is not really clear. From my own experience in Norway, and spending time in Scandinavia, I have to say that you do become aware of that 25 percent VAT after you've been there for a little while. Payroll taxes I would say are arguably less visible. Surveys show that only small percentages of the people actually know how much they pay in payroll taxes, and the employer contribution is truly hidden. So I think arguably they are less visible and this may contribute to their popularity in some countries.

Which really brings the second question or the second political reason: it's just simply popularity. Maybe some forms of taxation people just think are better. They think they're fairer, and they like them better. In principle, people think the rich should pay higher percentages of their income in taxes, but in practice people complain about income taxes more than any other forms of taxation practically, except perhaps property taxes.

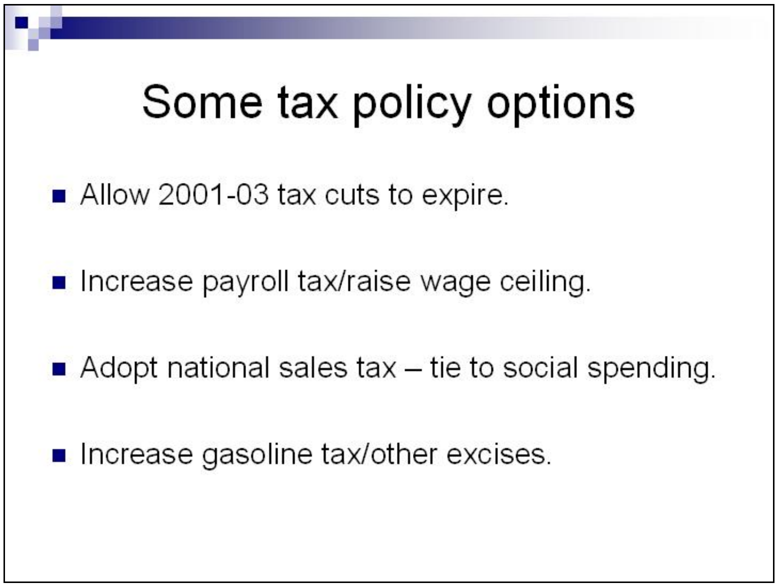
The VAT isn't any better. There has been a lot of political opposition to the VAT, when it's been adopted. The payroll tax, however, has the most political support out there and that's for reasons familiar to the people in this room; people tend to view payroll taxes, Social Security taxes as contributions they are making to their own retirement and health insurance and so on, and so they tend to view them as fairer.



Some evidence for this – this is just a graph from 2003 but the data goes all the way back to the '40s, and you can pretty much find the same thing – that the least popular taxes were always property and income taxes, they tend to switch back and forth, which ones people hate. Sometimes they hate the federal income tax a lot more than the property tax, or find it the least fair, and Social Security taxes are always viewed the most favorably, or least unfavorably if you want to put it that way.

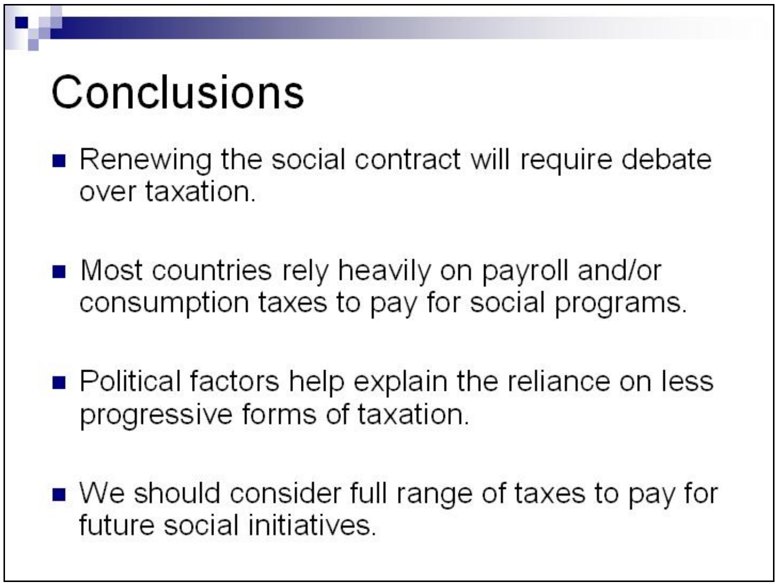
Finally there's a possibility that some forms of taxation are more conducive to political compromise. But perhaps the issue isn't really what ordinary people think but it could more be what powerful groups in society think. So perhaps taxes that particularly antagonize the wealthy, business groups, and so on – maybe those are the ones that are the most damaging, because it prompts those groups to lead a challenge against taxation in the welfare state of social programs more generally. In this argument, something like a VAT may actually appease these groups and it may enable keeping lower taxes on corporations and on wealthy people that may then sort of keep their political challenges muted. And there is, again, as I indicated, some evidence that at least some governments in Western European countries have been mindful of that when they're thinking about the tax mix and when they adopt a VAT – in part see it as a way to try to keep down those other forms of taxation that could be more politically volatile.

So what are the implications of all these for the U.S. situation? And I have to say this is where, I think, the talk gets difficult for me. I had a really hard time deciding what I thought the lessons were; and in fact, I'm really still thinking about it. And I think one reason why it's difficult to draw meaningful lessons for the United States – as I said before, I don't really buy the argument that we're culturally predisposed against taxation and against social spending. But nonetheless the U.S. is really different in many other ways from Western European countries. And one of the ways that we're so different, I think in the last three decades, has been that our politics around taxing and spending have been so fierce and so polarized that there's a lack of common assumptions and common ground among so many political actors in this country than I think, by contrast, you would find in a lot of European countries. There are of course differences between people in the left and the right but the overlap between perspectives is much greater. In the U.S., we have this polarization around taxation, in particular, but that it spreads the whole host of questions about the role of the government in the economy that makes it very difficult to think about how we would get out of this logjam, how do we actually move forward?



So I think, a general point that I would make is that we need to keep all forms of taxation on the table, to basically try to think pragmatically and strategically about ways that we might move forward to address various social needs and social risks. I would especially put in a plea for the Social Security tax. I know Michael Graetz is going to disagree with this, and probably other people in the room, but I really view the Social Security tax, the payroll tax – well, for one thing is one of the most politically acceptable ways to raise money. I think there are ways that its impact on lower income people can be mitigated by the way it's structured and also by other aspects of that tax code, and I also really view the payroll taxes is at the essence of the social insurance model that develop in much of Western Europe and the United States: the idea of contributions creating an entitlement for benefits in a sense of social citizenship that follows from that.

As for the VAT, I have to admit I'm a little bit less comfortable, but certainly if there were proposals to tie the VAT to some kind of expansion of needed social programs, I would be listening. I would be very intrigued and want to learn more. And more generally, I'm wondering aloud if there's some kind of compromise to be had whereby some changes in the tax system could be made to satisfy conservatives and some expansions in social programs be made to satisfy liberals.



Unfortunately, I have no ready-made package of tax policies to offer and I think it's difficult to talk about these tax policies in the abstract. They have to be evaluated in combination with the social programs that they would be funding, and evaluations then have to be made about progressivity and so on. But at the very least I hope to prompt people to think we should start a conversation on this. Otherwise I fear that it would be very difficult for us to achieve many of the ideals and goals that we have been talking about at this conference.

Thank you. (Applause.)

Funding the Social Contract

Michael Graetz, Justus Hotchkiss Professor of Law, Yale Law School

MICHAEL GRAETZ: Thank you. I'm, in fact, not going to disagree with Kimberly at all. I think she may disagree with me, but that's a different matter. (Laughter.) This talk is entitled "Funding the Social Contract." It should probably have been entitled "Funding the Social Contract in 10 Minutes or Less," so I can only give you the headlines.

But the first point is that the social contract, as we all know, includes much more than social insurance. As everybody in this room knows well, demographic changes, the aging of the population, longer life expectancies, and healthcare costs rising faster than the general economy will put enormous stress on our ability to fund our government in the years ahead. But even so, the government must be more than an insurance provider and a borrower with an army. The social contract requires us to finance infrastructure, effective public education, and homeland security in addition to social insurance just to name a few other necessary items.

Second, there is the question what do we mean by social insurance? In our book, "True Security," Jerry Mashaw and I defined social insurance broadly to include all government-supported protections against shocks to labor income without regard to the techniques that are used to fund and deliver those protections. So in my view, social insurance includes all government supported techniques for supplying disability benefits, unemployment insurance, retirement income, and health insurance, for example, whether financed by a dedicated payroll tax and universally available, as with Social Security, unemployment insurance, and part A of Medicare; or whether it's financed with direct subsidies from general revenues, as with parts B and D of Medicare; or whether it's financed through tax benefits, such as those Regina talked about, for employer-based defined benefit or defined contribution plans or for health insurance.

One important point that I want to emphasize here is that the technique of trying to provide social insurance through tax incentives does not work well. Coverage is partial, typically protecting only people in the top half of the income distribution and varying greatly depending on whether one works for a large or small employer. So our nation's tax-based employer-linked health insurance system has become the Titanic of domestic policy, leaving us with an extraordinarily large number of uninsured workers, despite extraordinarily high health insurance costs.

Notwithstanding their well-documented shortcomings; however, tax deductions, exclusions and credits have become the favorite technique of politicians from both political parties and the left and the right for providing social insurance. Today they dispute only whether the tax break should be in the form of an exclusion, deduction or refundable credit against income taxes or whether or not also apply to payroll taxes and so forth. Tax breaks are catnip to Congress. They are the politicians' answer to every economic and social ill facing the country. Weaning Congress from this bromide will require radical surgery to our tax system.

Let me make one other observation before turning to the financing issue. Social insurance by its very nature involves risks spreading. That is what we mean by the word "insurance." There surely is an important role for personal savings and for prefunding, but savings is not insurance. To make this point clear, think about the defined contribution plans that Regina just talked about. Even if they did provide each retiree with an adequate amount to supplement Social Security during his or her retirement – a heroic and not realistic assumption – we would still need insurance, probably in the form of an inflation indexed annuity, in order to protect against the risks of longevity and inflation – price changes. This will require spreading risks either directly by the government or by government regulated and subsidized alternatives applicable to private parties. Social insurance is a mechanism for spreading risks not just accumulating funds.

So how should we finance social insurance going forward? Let me start with a few facts: we all know that our current tax revenues are not quite adequate to pay for our current spending, and more importantly will fall far short of producing the revenues necessary to fund our government after the baby boom generation retires. The baby boom generation is eligible for Medicare, starting in 2010 and fully eligible for Social Security, beginning in 2011.

The size of this funding gap is a matter of considerable dispute and depends critically on the future growth in healthcare costs, but everyone agrees it is large. The GAO, for example, has estimates that range from 2.7 percent of GDP to 6 percent of GDP, depending on different healthcare spending estimates and whether the 2001 and 2003 tax cuts actually expire as scheduled in 2010 or are extended. These are large numbers: 2.7 percent of GDP in 2008 is $378 billion. And going forward, we may need even more social insurance, for example for long-term care, as was mentioned at lunch, or better unemployment insurance to protect workers against the ravages of technology combined with globalization of the economy. Some are even calling for wage insurance to protect people against those shocks.

In the short-term, relatively modest changes in spending or in our tax system can balance the budget. But going forward, even assuming that there are changes in Medicare, Medicaid and Social Security to reduce their costs, only by restructuring our nation's tax system can we effectively fund the social insurance contract. We have an archaic tax system, designed in the World War II era, when the United States had virtually all the money there was. Even a horrid tax system, one with individual income tax rates as high as 91 percent, but no more progressive than the one we have today, could not then stymie our economic progress, but the world has changed. Today the U.S. economy must compete worldwide for the investment capital that is essential for economic growth. Capital that is necessary to produce a rising standard of living for the American people. Economic growth is the engine of tax revenues. Our tax system should advance the competitiveness of American workers and businesses not stifle it.

So how would I reform our nation's tax system so it is conducive to economic growth fair and simple for the American people to comply with? First I would retain existing payroll taxes as a crucial financing mechanism for social insurance. Many Democratic politicians and think tanks want to imitate the Republicans' penchant for tax cutting and to focus their tax cuts on the middle class. Since more than two thirds of our income tax revenue now comes from the top ten percent of the population, and a family of four today pays no income tax with income up to $43,000, reducing payroll taxes is the only way to go.

So to take one example, the Center for American Progress, in a tax reform plan released in 2005, proposed repealing the half of Social Security taxes applicable to employees, now 6.2 percent on wages up to about $95,000, as you all know, and eliminating the wage ceiling so that the employers' 6.2 percent tax would apply to all wages without limit. Obviously their goal was to give low and middle income taxpayers a tax cut and to shift their burden up the income scale.

This idea echoes the complaints of Frances Perkins and others who opposed using payroll taxes to finance Social Security. Franklin Roosevelt responded that we put these payroll taxes there to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits; with those taxes in there no damn politician can ever scrap my Social Security plan. Taken together, the taxes and benefits are progressive, and while Roosevelt was wrong on the law, he has been right on the politics for 70 years. I wouldn't mess with the payroll tax financing system now, just when we are looking at the funding shortfalls and when high income taxpayers are even already they're not getting their money's worth from Social Security and politicians on the right are pushing to substitute individual accounts for our current Social Security protections.

Equally wrong-headed in my view, is George Bush's recent suggestion to introduce a standard deduction for health insurance into the payroll tax system. Once we start with deductions for that sort, the payroll tax will soon have all the complexities and holes of the income tax. The payroll tax now works. It is simple for people to comply with and it does not stifle economic growth. For more than seven decades, the middle class has understood that in order to get Social Security and Medicare, it must pay payroll taxes. There is no reason to change that understanding now. Given the increasing share of labor income going to people at the top of the income scale and the shift in the composition of income at the top away from capital income and toward labor income, there may well be room for some additional payroll taxes on high earners. But these funds should be used to close the social insurance funding gap rather than to provide tax cuts to the middle class.

The bigger fiscal problem is that the income tax is broken. No matter what their income, all Americans confront a necessary and costly complexity. The income tax now is four times larger than "War and Peace" and considerably harder to understand. (Laughter.) The regulations total 20,000 pages. Americans spend $150 billion each year just to calculate and administer the tax. And the income tax is riddled with incentives for unproductive expenditures. These, along with the efforts of individuals and businesses to structure their affairs in a tax-favorable fashion, have been estimated to cost our economy

$1 trillion a year. In today’s global economy, these are costs we can no longer afford. And as I have said, the income tax breaks have proved a failure as a mechanism for delivering social insurance or otherwise solving our nation’s economic and social problems. The income tax, the centerpiece of our financing system, is failing us badly.

The only way to wean politicians from thinking that tax benefits are the solution to our nation’s problems is to get most Americans out of the income tax altogether. We can do this and at the same time have a tax system that is much simpler and much more conducive to economic growth by replacing the income tax for most Americans with a Value Added Tax of the sort that Kimberly described, a broad based tax on consumption used in every other OECD country and in 150 countries around the world.

I do not have time to go into the details, but here is the general scheme. Basically what I am going to suggest would put our system back to where it was before World War II, in terms of its underlying structure, although it would modernize it. First, enact a Value Added Tax at a 10 to 14 percent rate to finance a $100,000 exemption from the income tax and to lower the individual income tax and corporate income tax rates that are applicable to income above that amount. That would free 150 million Americans from having to deal with the income tax at all. Use a smart card to offset the regressivity of the VAT for low- and moderate-income people and to replace the EITC. Retain the payroll tax and the estate tax, and create incentives for the states to adopt similar models. This would make the U.S. very similar to other countries in terms of its consumption taxes, but we would be much lower in terms of our payroll taxes or income taxes than the other OECD countries.

This system would allow our government to raise the necessary revenues without limiting our nation’s economic potential. Unlike most other tax reform plans that have been suggested, it would not shift the tax burden away from the wealthiest citizens down the income scale. It would be far simpler and less costly to comply with. It would be more favorable to savings, investments and economic growth than our current system and it would fit well with international arrangements and improve the competitiveness of American businesses and workers. Finally, it would stop the madness of relying on tax breaks as a solution to the nation’s social insurance and economic problems. I have set forth this plan in a series of articles and I’m detailing it in a book forthcoming this fall, I hope you will take it seriously.

Thank you. (Applause.)

Breaking Out of Our Present Mindset: The Idea of Freedom as the Way Forward

John Schwarz, Professor Emeritus of Political Science, University of Arizona

JOHN SCHWARZ: Hello. It's a privilege – more than a privilege, an honor for me to be here and I'm appreciative that you invited me. Taking off from the excellent presentations on ways of financing, I'm going to return to yesterday's conversation about the moral justification for social insurance that our opening presenter David Moss and yesterday's first panel spoke to.

I'm going to make the argument that a powerful, comprehensive social contract is not only critical to reaching the overriding moral goal our nation has had in history, but equally that progressive, universal social insurance must play an expanded role in that social contract. Today, the ideal of social insurance faces a growing challenge in the form of an opposing ideology that is promoted by many conservative and libertarian leaders and by a wide array of institutions such as the Cato Institute.

The new ideology calls for each American to take personal responsibility and control through the establishment of subsidized personal accounts and individual insurance coverage through tax incentives that aim to help Americans and their families deal with major areas of life such as higher education, healthcare, the loss of jobs, lowered wages and retirement.

In response to the call for personal responsibility, ownership, and control, what's the compelling argument for social insurance? Universal social insurance faces a more hostile political world today not simply because of the rise of a challenging new ideology emphasizing personal ownership and control. It has also been placed increasingly on the defensive, in my view, because the historic doctrine or ideology that is essential to supporting social insurance has become lost to us over the past 30 years and has dropped almost completely from our vocabulary.

This may have happened because the ideology necessary to support social insurance derives from what, at first glance, might seem to be a generally alien source. Indeed, it derives from the very source that would appear to justify the individual ownership and personal responsibility notion itself. I'm referring to the moral principles of individual freedom. The principles of freedom I believe supply **the** imperative argument for progressive, universal social insurance.

The freedom I speak of though is not the narrow hyper-individualistic freedom of the free market that is currently popular, but instead our founding ideal of freedom, which holds that we have a broad array of shared responsibilities to one another that are part of being free. Those shared responsibilities are essential to the moral defense of freedom itself.

Freedom, in and of itself, is not immediately moral. For example, we would never defend my freedom to steal from you, or my freedom to harm you in many other ways. Instead, we believe in freedom of the individual that protects the freedom of everybody else. Premised on the inherent dignity of every human being, we believe that no person should ever be a mere means to the ends of any other, and, therefore, that no person should use freedom to coerce or wrongfully harm any other person. I go into this in depth in my book "Freedom Reclaimed" and here only quickly outline some of my perspective.

One obvious crucial baseline for freedom is the ownership of private property, since private property ownership is a prerequisite to individual freedom itself. It is necessary to any kind of individual choice, necessary to be able to provide a living through one's own efforts, and necessary to be able to improve one's conditions through one's own efforts. Yet, while private property ownership is a prerequisite of freedom, it also has an obvious difficulty for freedom. The difficulty is that it reduces or entirely eliminates the freedom of everybody else with respect to that property. To overcome the restriction that one person's private property places on everyone else's freedom is where the idea of economic opportunity and security come in, along with the absolutely pivotal need for social insurance.

If freedom restricts each person's access to another's property and resources, for everyone to remain equally free, the equivalent basic economic opportunity must continually remain open to each and every person to similarly attain the resources necessary for individual choice, for making a decent and dignified living, and for improving the conditions of life through one's own efforts. To offset the restrictions on freedom that private property ownership necessarily imposes, continued access to the kind of opportunity just described is as central to every person's freedom as is the protection of private property itself. Each of them – that is the protection of private property and the protection of economic opportunity that suffices – requires the other in order for every person to be free. As a result, just as the protection of private property is no sometime thing morally in any free society, so the protection of economic opportunity that suffices for every person cannot be a morally sometime thing either.

At the most basic level, I am speaking here of the continuous access of all individuals and families to the wherewithal to provide a socially minimally decent living for themselves with all that implies, including, among other things, adequate wages and earnings, reliable access to decent healthcare, and a secure retirement. Only substantial collective action and progressive social insurance programs can assure that this basic level of economic opportunity and security is available and affordable to each and every person continuously. Nothing else – surely not personal accounts or individually purchased insurance policies, let alone the outcomes of the unfettered private market – can come even close to producing this kind of assurance.

To promote the necessary opportunity and security, collective societal action is essential in many areas. They include public education for all from pre-kindergarten through high school and for all who are qualified to higher education and to needed retraining, the minimum wage, earned income tax credit, and other forms of wage assistance, unemployment, disability and wage protection insurance, Medicare, Medicaid, and ultimately healthcare access for all, supported time to care for family, Social Security, and finally what Jacob Hacker calls universal insurance.

All of these programs and proposals build upon the principles of freedom I've mentioned:

First, they attempt to ensure that all individuals in the programs have access to a minimum standard of adequacy, even though I believe that many standards today are demonstrably too low or uneven, and so require upgrading of the programs on many fronts.

Second, in the cases of the able-bodied, the economic benefits that come from most of the programs are related in some meaningful way to individuals' past, present or future employment or work.

And third, the programs operate in the context of a real economic world in which no lesser action, whether it be subsidized individual personal accounts or the private free market, is capable of continuously assuring that access to satisfactory basic economic opportunity and security necessary for freedom will be protected.

I am speaking here not just about my own idea of what individual freedom means, or about some strange or odd definition of freedom – not at all. I am speaking of the transcendent vision of freedom as understood by Franklin Delano Roosevelt in the New Deal, Abraham Lincoln in the Homestead Act and the Emancipation Proclamation, Thomas Jefferson in the Declaration of Independence at the nation's Founding; indeed, going back even to the namesake of the venerable libertarian Cato Institute itself, Cato's letters, written well before the revolution. For all of these people, going all the way back, economic opportunity and security of the kind I have described was an absolute essential of their idea of the meaning of freedom.

Keeping this in mind then, it's imperative to recognize that over the past 30 years, advocates of collective societal action and social insurance have allowed the concept of freedom to be hijacked by the opponents and that stands as a primary reason why proponents of collective societal action and social insurance have increasingly been on the defensive. Because the value of freedom is so quintessentially American, the party or movement that owns and defines what freedom is has generally had a substantial advantage in American politics.

Once, until about 30 years ago, progressives actually controlled the idea of freedom and when they did, they were often victorious. The progressive trustbusters of a century ago, for example, successfully involved the cause of freedom promising to liberate ordinary Americans from the tyranny of an industrial over-class. Freedom was just as pivotal in the appeals of FDR, whose New Deal programs and path-breaking social insurance initiatives were all grounded in the belief that a person without basic economic opportunity and security was not free. Freedom was a galvanizing concept of the civil rights movement and it was the organizing principle behind the push for women's rights.

Historically, progressives have been staunch defenders of freedom and their skill at using the concept and linking it clearly to the common good spearheaded nearly all of their landmark victories. More recently, except in the area of civil liberties, progressives have virtually stopped publicly referring to the idea of freedom. Their political fortunes have declined steadily in the process.

In the void that was left, Republicans and conservatives gained control over the idea of freedom. From Barry Goldwater and Ronald Reagan to George W. Bush, freedom has increasingly been seen as a Republican and conservative concept as it has become equated with the free market and the pursuit of individual self-interest.

Despite the success they have had in filling the void, however, Republicans and conservative actually view freedom as a mere half measure. They focus on the public perception of protection of private property – one important component of freedom to be sure. At the same time, they largely ignore its necessary moral partner and companion, the public protection of economic opportunity and security that suffices for each and every person, which today requires major collective societal action and universal social insurance to realize.

It is time to make it clear that freedom in America is not and cannot be some half-way measure, that it is morally whole, and that it is only freedom which is morally whole that is visionary and inspiring.

It is time for us to recognize the inescapably central role that universal social insurance plays in making freedom morally whole in the life of our nation.

We must grasp the mantle and reclaim the ideal of freedom that binds us as a people and that calls us to social action for the common good.

Thank you. (Applause.)

Providing Security to Expand Opportunity

Jacob Hacker, Professor of Political Science, Yale University

JACOB HACKER: Well, I think I stand in a rather unenviable position. I follow a set of amazing speakers, not just on this panel, not just today, but over the last two days. And as a co-chair, I know that this will seem like self-aggrandizement, but I do think this has been a really exciting, enjoyable program, and I hope you agree. (Applause.) Thank you.

And though I'm not making final remarks, I do want to offer thanks again to the staff, because things have run enormously smoothly throughout this event and it could not have happened but for them. So thank you again all of you, Joni, the rest, for making this happen. (Applause.)

So my first reason for feeling a little trepidation about getting up here is that I follow an amazing set of speakers. My second is that I stand between and the exit to this conference, and I don't know whether the time you're going to have afterwards is an extra hour of work or two to catch up on your email or time with your family, but I do know that I should in these final remarks be brief, and so I will be.

Now, I said yesterday that academics are people who can speak for five minutes and five hours and say exactly the same thing, and so it may be a challenge to be brief. And in that respect I'm reminded of an evaluation I received as a new professor at Yale. The student wrote, Professor Hacker, if I had just 15 minutes to live, I'd want to spend in your class … because that way it would seem like an hour. (Laughter.) So I am going to try to tie up a bit the diverse conversations we've had in this conference with my remarks but keep it relatively quick.

And I'm going to start by observing what I observed at the opening, that the social contract—the network of obligations and rights and responsibility that links employers, individuals, government, families, and communities—is under strain in the United States. And the most obvious respect in which it's under strain is what we've been talking about today: the erosion of our traditional employment-based structure of social protection. We, as I've written in previous work, have a truly distinctive system of economic security, one that relies heavily on employers for the provision of basic social benefits. And that system unfortunately is unraveling before us, and as a result we're seeing more risk and responsibility being shifted from the broad shoulders of government and corporations onto the fragile backs of American families.

This "great risk shift," as I have called it elsewhere, calls on us to think about how we might reconstruct a basic framework of economic security in a new economic and social context, a context that is marked by globalization, de-industrialization, great changes in the family, and changes in employment practices, as well as in the obligations and burdens of government. Now, the task that I want to take up in my remarks today is about how we talk about that challenge of re-envisioning and reinvigorating our framework of economic security.

It's in many ways a problem similar to the one that Paul Krugman discussed so eloquently yesterday: how we talk about social insurance in a new era. For it's obvious to anyone who has followed these debates, and indeed who watched and listened to Mark McClellan today, that it's very easy to say that social insurance is outdated.

Now, McClellan, of course, was saying clearly that he believes in the basic role of Medicare as social insurance, and yet at the same time we hear throughout the discussions this idea that our social insurance structures as they currently operate are outmoded, outdated, and lack the flexibility to respond to changing circumstances. And putting aside the particular merits of that argument with regard to particular programs, I want to address the larger point that's being made in these discussions.

When we talk and hear about "modernization," when we talk and hear about the problems with our social insurance framework, again and again the refrain is that security is somehow a constraint on our economy, that it's mucking with the free play of our market, that it blocks the dynamism, and the flexibility that's needed in a new era. And I want to say that these ideas are not just wrong, they are spectacularly wrong. They are backwards in the most fundamental sense. Security is essential to opportunity—indeed, as John said, to freedom—in a more dynamic and flexible economy.

So what I want to talk about is both the policy and politics of this claim. The policy in the sense that I want to make the case strongly that economic security is not opposed to economic opportunity, not opposed to dynamism and growth. Quite the contrary, well-designed social insurance is critical in today's more dynamic, more flexible, and yes, more uncertain economy. It's essential to give Americans the confidence they need to invest in and achieve the American dream.

With regard to politics, I want to say that this poses a critical challenge for those of us who believe in not just the compatibility, but the essential connection, between security and opportunity. The challenge is how can we move beyond what will seem a relatively academic argument about the role of economic security in a transformed era to a political argument that builds popular support for reconstructing the social contract for the 21st century. And so let me take up both of those challenges quickly in turn.

I was on a panel at the Brooking Institution in the fall as part of their Hamilton Project. I also was part of the Economic Policy Institute's Agenda for Shared Prosperity, which has often been seen as representing a diametrically opposed view. In fact, one wry commentator said that while Brookings has the Hamilton Project, EPI has the Aaron Burr project. (Laughter.) And the reason that I believe that it's possible to be involved in both efforts is that I am impressed by the extent to which at this Hamilton Project meeting many of the figures that in the 1990s were associated with the view that government's role would be principally to reduce the deficit, focus perhaps on helping low-wage workers and doing some minimal investments in the economy to ensure that workers can compete in a new era are much more attuned today to the concerns about economic security that Americans are clearly feeling and which were manifest in the 2006 election.

And so I was on a panel in which the subject matter was: "Is economic security at odds with economic growth?" Now, I right away took umbrage at the question. For one thing: Of course, it's sometimes at odds with economic growth. I can think of lots of ways we could design programs providing economic security that would be very bad for our economy. As Jerry Mashaw and Michael Graetz have written in their book "True Security," social insurance was originally seen as an alternative to some of these ideas, like rigid restrictions on the market or wage floors that were so high that they destroyed jobs, or restrictions on hiring and firing that prevented the economy from adjusting to changing conditions. Social insurance was designed to work with a capitalist economy, precisely to allow these adjustments to occur without vast dislocations in individuals' lives or indeed in the workings of corporate America.

And so the questions really should be: can economic security enhance economic growth? And the answer to that question is clearly, yes. David Moss yesterday, I think, gave us a very good introduction to the tradition of social insurance. I would have liked to see him tie that tradition a bit more to the other theme of his book, "When All Else Fails," that the key innovations of American capitalism were really about providing security to entrepreneurs and investors to ensure that they could have the confidence to make those investments necessary to improve the performance of our economy and their own standing. Think about a secure money supply, think about bankruptcy protection which was originally not for individuals, but for corporations, think about limited liability for corporations, this about deposit insurance which was designed not only to help individuals against the devastating results of bank runs, but also to help banks deal with fluctuations in demand and the financial crisis of the 1930s.

All these public institutions and quasi-public institutions—and that includes today Fannie Mae and Freddie Mac—were based on the basic idea that government has a special role as a risk manager. And we look across the world today, we can read about this – that there are countries that are mired in poverty and deprivation precisely because there are not the basic institutions of risk management and pooling that are needed for a flexible, dynamic, capitalist economy.

The issue today is that those institutions that were constructed to help families manage risk are not just outdated, they have been actively eroded over the last 30 years by those who believe that insurance is at odds with opportunity, that security is at odds with freedom. We have seen attacks on insurance that deny the very role of insurance in making our economy stronger. And look at what has happened. I say in my book that while we still have limited liability for corporations, we increasingly have full liability for Americans families. Bankruptcy – 300,000 personal bankruptcy filings in 1980. Two million in 2005. Foreclosures are five times higher than in the early 1970s. In the last few years, about one in 60 mortgage-owning households have filed for foreclosure every year.

The uninsured – no need to repeat the statistics, but I'll just emphasize that we're not just talking about 47 million or so Americans without health insurance; we're talking about one in three non-elderly Americans going without health insurance every two years. The massive shift away from guaranteed defined benefit plans toward defined contribution pensions. And as a CBO report just released the day before yesterday suggests, we've seen rising levels of income instability as well. Whatever the exact trend, we know that the volatility of family incomes is high and rising. And we know that this imposes huge costs on individuals.

The psychological costs are great. I mentioned in the book what we often forget, but it's clear to any of us who has a young child at home: people are much more likely to feel pain when something they have is taken away from them than they are to take pleasure when they receive something new. You give a kid a toy, they're pretty happy. You try to take it away and they're screaming for an hour. It's the same with individuals. These fluctuations and these risks impose huge psychological costs precisely because we are so loss averse.

I will mention a few others of the costs that are imposed. We harm growth and individual opportunity when we do not give people the resources they need to get back on their feet and rebuild their lives. We impose costs on economy when we tie benefits so closely to work that there's job lock and job inflexibility. And we know that basic kinds of economic protections are also essential to allow people to make investments in their future, which are necessary for our economy to prosper. There is ample evidence that when people are extremely insecure about their jobs, this does not help their productivity, but instead makes them less likely to be committed to their employer and less likely to commit to make the effort necessary to succeed at their work.

We have evidence that entrepreneurial action, from venture capital to self-employment, is highly correlated with basic protection against risk, both across countries and across states. And most basically, as David Moss suggested, the most critical investment that most people make is in their skills, in their human capital, so protection against major labor market risks is really a way of indemnifying people against some of the risks that come with making those investments: going into debt, for example, to go to college. If we do not provide that security, we cannot expect the consistent investments we need for individual and societal advancement.

The other thing we know is that the private sector cannot provide insurance against these kinds of risks. It simply cannot. We can cajole it into doing so, we can subsidizing it into doing so, we can regulate it into doing so, although not very well, but government has a crucial advantage as risk pooler and we should recognize that advantage and be forthright about it. It can compel people to obtain protection. It can overcome problems of adverse selection and moral hazard—problems that this group is familiar with. It has also an amazing ability to provide basic insurance protection with extremely low administrative cost, and this should not be forgotten.

And let me say finally, and this may help explain to some degree why the Hamilton Project has so invested itself in this cause of security, if people are fearful about their economic futures, we have good reason to believe that they are going to be resistant to policies that might promote growth, such as opening our markets up further or deregulating our financial markets further. At-risk people demand policies that can hinder growth and so whatever else you believe, whatever you think about the other arguments I've made, I think it's clear that we're at a point in our nation's history where the economic fears of citizens could stand in the way of further expansion of open and dynamic markets—expansion that could help us overall, but will impose costs on specific individuals.

I said I would start with policy and end with politics. What I have just said is an abstruse argument, and it is not the argument that I believe we should be making first in the public arena. The first argument we need to make is an argument that resonates not just with the minds of policy analysts, but with the hearts of the American people. And I wrote a piece with Ruy Teixeira, a public opinion expert, about public views on the economy and progressives' rhetoric about the economy right after the November election that made this basic point.

Our question was, "where should progressives go in discussing the economy after the victories in 2006?" We noted, as all of you know, that those victories very much depended on peoples' sense of insecurity and their sense that those concerns had not been adequately addressed by the reigning Republican Party. But we also pointed out that there were real debates both within the party and within Americans' minds about what the best direction forward was. And so in my conclusion, I want to talk a bit about how we can reconcile some of these competing instincts, if you will, on the economy.

The basic point that we made in our piece is that progressives when they talk about the economy, are speaking to only one half of Americans beliefs, and this really resonates with what John Schwarz has said as well. Republicans are speaking to the other half, and so let me explain what I mean and then argue that Democrats and progressives who believe in these ends could speak better to both sides simultaneously.

Americans feel that their economic security is slipping away. The polls and the election results suggest that. And yet at the same time we have ample evidence that Americans have very positive views often of their own economic situation and often of their economic futures as well.

A great example of this was a poll that was done by the *New York Times* as part of its series on class. It asked people whether they consider themselves middle class, poor, or rich, and not surprisingly, the overwhelming majority, some 80 percent of Americans described themselves as middle class or poorer. And yet, at the same time, an amazing 44 percent of those polled thought that they would be rich in the future. I call this in my book the Lake Wobegon effect: the belief that all of us are above average. But I don't think that these are necessarily contradictory views, and let me explain why.

I think they ultimately reflect the shift that we've seen in our economy over the last 25 years or so that has moved more responsibility and risk onto the individuals and their families. That shift of risk has at one and the same time made people feel less secure about their economic present and more responsible for their economic success. In other words, Americans simultaneously feel that their economic security is slipping from their hands and that the only way in which they can deal with these economic strains is through their own hard work and determination. Stan Greenberg has done a very interesting series of polls on this. He finds again and again that even downscale working class Americans whose wages have been stagnant, nonetheless believe that it's through their own hard work and luck that they will succeed, it's through their own investments in education that they will get ahead, and woe be to anyone who asks the government for help in this new context. And so if all of us who are concerned about these trends want to try to reclaim the mantle of security in a new era and link it to the theme of opportunity, there needs to be, I think, a new way of talking about this broad goal.

The starting point I think for this vision is the simple but forgotten truth that security and opportunity go hand in hand. But rhetorically and practically what this means is that when we talk about security we need to stop talking only about those who fall behind, those who are in need of help, those who are lifted up because they have stumbled. Instead, economic security and social insurance are ways to help families get ahead. They're ways to help them look to the future with confidence, to reach for the American dream without the fear that a single bad step or single bad event, will mean slipping from the ladder of advancement for good. There is in my view a huge void in American politics that is just waiting to be filled by public leaders who can speak convincingly about how providing security is a guarantee of expanding opportunity.

Efforts to increase health coverage, efforts to contain health costs or the cost of prescription drugs, to improve the quality and availability of child care, to defend and extend guaranteed retirement benefits, or to provide middle-class families with strong incentives to save and build wealth or help them with the strains of balancing work and families—all these need to be placed in the context of helping Americans get ahead, not just helping those left behind. These, in other words, are measures that allow the typical American family to raise its head from the day to day struggle of an insecure economy and concentrate on its most heartfelt wish: to achieve the American dream.

And so as Ruy and I say at the end of our piece, and as I will conclude here, we'd like you to repeat after us: providing security to expand opportunity. Try it. You'll like it. And more important, so will the American people.

Thank you. (Applause.)

Discussion

MR. THOMPSON: We have just a few minutes for comments and questions. If there are any, please remember that the transcriber can't transcribe accurately if you don't give us your name, even though we all recognize you.

Q: Joe Coletti. And I wanted to focus this question to Jacob Hacker, on the idea that there's a risk shift going on. How much of it is less of a risk shift and more of a risk recognition – that individuals have always faced risk because their company could go out of business, because the government may not have the resources to fund them because those resources eventually come from individuals again, and when you try to fund government programs you are also placing a burden on families as much as you're trying to relieve those burdens from families?

And I'm trying to find the common ground here between the progressive ideas that you've been advocating and some of the conservative libertarian ideas that I espouse and that some of the people earlier have spoken about, that when we take a look at health savings accounts and talk about expanding health savings accounts, or talk about individual savings accounts and some of the other types of programs, tax protected programs, it's trying to provide that type of security to individuals so that they don't have to rely on their jobs. You can have a health savings account and take it with you when you leave your job. You can have a 401(k) or an IRA that your employer helps provide some of the income to and again, you can take that with you when you leave your job. And so it sounds like we're both trying to avoid the job lock problem and to provide some security to people. It's just a question of whether the government subsidizes some of those individual programs or whether the government creates a program completely on its own. And I'd like to hear some comments on that.

MR. HACKER: Well, very briefly. I think that the risk shift should not be confused with the question of whether or not employers would be the primary locus of the provision of social benefits. The risk shift occurs not necessarily because there has been an overall change in the total amount we're spending, and yes, ultimately all that spending comes out of our pocket. It really comes from the erosion of broad risk pools and I think that that's the crucial change that I'm concerned about. And therefore, the movement towards individualized benefit options is only a viable response to this shift of risk if it indeed can spread risk broadly and that's I think a very open question.

In my view, there is little doubt that in crucial areas, particularly health insurance, pensions, and in job security, that there has indeed been a transfer of economic risk onto individuals. We see this in the erosion of health insurance, and the change in the form of pensions. Recently, Boston College has come up with a retirement risk index, the risk of falling short of a necessary retirement savings, that shows a fairly dramatic increase in risk just since the early 1980s. And what's really notable and what I want to emphasize is that we really haven't seen the full dimensions of this change yet, since a lot of it takes place in programs for the aged and policies for the aged. We're going to see it much more in coming years. Today's baby boomers are in many ways living in the golden age of retirement. (Audio break, tape change) – benefit options that are modeled after the defined contributions account model. But I leave open whether it could involve other forms of individualized private options, so long as they were ones that really ensured broad risk pooling.

Q: Larry Sidel, University of Delaware. This is just a comment on Michael Graetz's proposal. I just wanted to raise this as a possible amendment for all of you to consider. I agree with almost every part of Michael's proposal introducing a Value Added Tax. I think we badly need to keep the payroll tax and what Kimberly said I think is relevant here. I think it's exactly right. Keeping, as Michael would, the income tax on high-income earners, which is a very progressive part of our tax system – keeping that, the one possible amendment is whether to go all the way to zero on the income tax for moderate and low-income people. And here is where I have my disagreement.

I think it's very important that we can continue to deliver refundable tax credits. I agree with his point that deductions and exclusions are regressive and we ought to try to clean the tax system up and get rid of them, but refundable tax credits like the Earned Income Tax Credit or using it for health insurance or to encourage saving, I think that's a very important positive progressive tool. My concern is that if you eliminate as opposed to cutting the income tax for a moderate and low income, you lose the ability to deliver that. So that's my one amendment that I would suggest to Michael's proposal.

MR. THOMPSON: Michael, do you accept that or not? (Laughter.)

MR. GRAETZ: Well, I do think it's a very important question. You know, I basically in my plan tried to come up with an alternative – I believe it works – to the Earned Income Tax Credit to replace that form of income.

The problem with keeping people in the income tax system is – there are several problems within the income tax system. One is it's extremely expensive because of the difficulty of filing returns. Second, you put it in the tax writing mindset, so I believe you can deliver, for example, the Earned Income Tax Credit if you knew at most people's wages, how many children they have, and how much investment income they have.

But you put it in the tax system and I dare say go to the IRS website, look at the earned income tax credit and see if you can figure it out. You can't. It's unbearably complex and the reason it's complex is that's the culture of the tax code and I don't believe you can change that culture.

And then finally, this whole business of refundable tax credits or not refundable tax credits or deductions and exclusions – notice the president clearly, deliberately, because his father had proposed a refundable tax credit for health insurance and was thinking about a cap on benefits. Actually, it was in the plan until the budget was being produced. I know this to be true. I was there. And the current administration clearly resisted refundable tax credits and went to payroll and income tax deductions instead, so it's not like everybody is going to do it the same way. People are going to do it different ways.

And then the final point is that what we've said is okay, we're going to have one gigantic agency. We'll call it the Internal Revenue Service and it will be responsible for collecting taxes and delivering all of our social and economic policies. And so now there are a bunch of tax credits for renewable diesel fuels.

Well, go over to the IRS building at 1111 Constitution Avenue and walk through the building and see how many people are experts on whether diesel fuel is renewable or not. And so the IRS can't do its job either on the tax collection side or on the distribution of benefits side when you keep it in the tax code. So I think this is an important question. You know, if you took my plan up to that point, you know, I am making progress, but I think it's better to get those benefits out of the income tax.

Q: I'm Joni Lavery and I have a question for Michael and anyone else who wants to answer this. We talk about taxes and the impact on economic growth. Yesterday we heard that we have created in this country a consumer economy, so if we start taxing what we buy and we eliminate the income tax, does that balance out for consumers and the economy as we go forward?

MR. GRAETZ (?): Well, all of the economic analysis that has been done today suggests that taxing consumption alone rather than taxing both savings and consumption is more favorable to economic growth and taxing savings as well.

I mean, it is true that we are relying on a consumer economy and in fact, you know, there have been recent documents in the last day or two about how our personal savings rate has hit all time lows, and so we need to rebalance some in terms of our consumption savings and, you know, if you tax it you'll get a little less of it. I believe that, but we may need a little less consumption and more savings going forward. And I think – I mean, I do think – and this is a response actually to the earlier question that Jacob commented on, but I don't understand why you are having this either/or conversation about individual savings and individual accounts and individual responsibility on the one hand and risk spreading on the other.

You know, of course we could use individual savings accounts in addition to Social Security for retirement. That's clearly right. The Social Security gives you a base of a defined benefit plan. It's not terribly overly generous in my opinion and we need something in addition. That's in fact why we have this broken system of defined contribution and IRA plans and so forth.

So the need to improve the social insurance system, about which I agree with Jacob, is it seems to me complementary to the need to improve the individual savings system and individual responsibility. And here my answer is it's a political dog fight instead of people getting together and trying to work out solutions. And part of the problem is ideology rather than getting together is dominating and in particular the tax issue since 1978, I would put it rather precisely, has become such an issue of high salience in presidential politics. And otherwise it seems to me you're both right.

MR. THOMPSON: Do any of the other three members of the panel have any closing comments they'd like to make reacting to presentations that were made after yours? Okay. Then I think we have reached the end of this session and the end of our conference.

Could we have a hand for the panel here -- (applause) -- which I might add has done a better job of holding the audience than most final panels do; I think there's a vote here by the lack of feet in favor of the panel. I want to thank the co-chairs, two of whom are on the panel, for putting this conference together. It's a lot of work and we appreciate the effort you put into it and the results, I think the people will agree, had been worth the effort.

In order to document that, we have this blue form, which you are all instructed to fill out upon pain of losing your IRA deduction next year. I also want to thank the NASI staff for all of their hard work and once again the conference sponsors that were listed on the front of your program for their financial support, without which we wouldn't have had our lunch. So thank you very much and have a good weekend. (Applause.)

(END)