NATIONAL ACADEMY OF SOCIAL INSURANCE

Family Well-Being, Public Policy and Economic Growth: Lessons from History and Insights for the Future

September 19, 2006

This policy seminar convened at 2:00 PM in the Ballroom of the National Press Club, 529 14th Street, NW, Washington, DC.

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PAMELA LARSON: Good afternoon, would everyone please come in and be seated?

Good afternoon. Welcome on behalf of the National Academy of Social Insurance. I'm Pam Larson, the Executive Vice President of the Academy and we are very pleased that you're here. Others will join us; in particular, we're delighted that a number of Howard University economics students will be joining us in taking a little different look at how economics is used in policy.

This seminar on family well-being, public policy, and economic growth is one more in a series of academy forums designed to examine the facts underlying the beliefs, principles, and future directions in social-insurance policy. We thank the Annie E. Casey Foundation for supporting this event. U.S. social insurance has a rich history and a challenging future. We believe that policymakers and the general public need to better understand the history, achievements, and the context for social insurance in order to shape its future. That's why we have asked you all to be here.

To help accomplish that, we are bringing you presenters who are experts with a variety of perspectives on these issues. And you, our seminarians, come from a variety of organizations and interests in social-insurance policy. We encourage you to join in the discussion period, which will follow the presentations. There won't be a break in the middle of this, unlike some of our conferences, so please feel free, also, to go down the hall if you need to, and over to get refreshments. It will be a very intellectually exciting afternoon and one that we don't want to interrupt.

We will close this session at around 4:30, but not until we've gotten most of the comments and questions that you all bring to this gathering, to the microphones. Then afterwards, our academy staff, board, and some planners will reflect on the ideas aired here for some future work of the National Academy. So as part of that, we also urge you to take seriously the green evaluation form that's inside your folders. We do use these, and so, particularly if you want to amplify a comment that you made or would have made in the microphones, we appreciate getting those comments from you on the evaluation form.

Before I introduce our seminar moderator for the day, I want to remind people to turn off their cell phones and to please bookmark your computers so that you always know what our next offering from the National Academy will be.

All right, it's my pleasure to introduce Professor Bill Spriggs, who is also chairman of the department of economics at Howard University. Bill is a member of our board of directors and he is on our committee on leadership development, which guides our Washington internship on social insurance. It is a summer internship program and we have more than 200 alums from that who are – many of whom are still engaged in our work.

His bio, along with the bios for other presenters, is in your folder, but I just found out something that's probably not in that bio. Bill was just named to chair the independent healthcare trust for the United Auto Workers retirees of Ford Motor Company. Talk about being in a very important position at a very important time. I want to introduce Bill Spriggs, and ask you to take over and introduce our seminar.

Thank you.

WILLIAM SPRIGGS: Thank you. (Applause.) Our sponsor for this seminar is the Annie E. Casey Foundation and many of you associate them with children and the wonderful things they do to support children. And often people think of us here at NASI as the group that deals with Social Security, so they think of this as the group that deals with retirement and folks who are old. So, it may first strike you that you might have walked into the wrong place or something, but let me reassure you that you are in the right place at the right time.

Today's seminar is the first in a series where we're going to look at how promoting economic security affects America's families. We should remember that the original Social Security Act had many different parts to it, all of which were aimed at the American family, not just dealing with the issue of old age. Those programs have evolved and one of their key components is that they tend to be very countercyclical. The result is that these entitlements that were created by the act cause federal spending to increase at a tremendous rate when the economy turns down, and normally we end up with the conversation here, in Washington, about how to curb entitlements.

The problem is these programs are easy targets for reducing government spending. We need to actually go beyond the ideological questions about government spending to the deeper questions about what does that really have to do with the original intents, in terms of social welfare. The original intent was to actually secure the economy by having some countercyclical programs and providing families with social insurance.

So, how do we really look at this long-run issue, the historical record, when it comes to making families secure and government efforts at that? So, we are going to be treated today to a talk by Professor Peter Lindert and then we are going to have discussants that will follow.

I read a lot of Professor Lindert's work while I was a graduate student at the University of Wisconsin. Professor Lindert is the Distinguished Professor of Economics at the University of California, Davis. He will be speaking from his latest book, "Growing Public: Social Spending and the Economic Growth Since the Eighteenth Century." This book has received the Allan Sharlin Award for best book in social science history and the Ranki Prize for the best book in European economic history.

Then we will have, after Professor Lindert, a series of panelists who will be responding. And I will introduce them from my left and from your right, going from Professor Lindert. And you have their bios, so I will be brief in introducing them to you, but they will follow Professor Lindert.

Kimberly Morgan is Assistant Professor of Political Science and International Affairs at George Washington University, here in Washington. Her research and teaching interest include European politics, comparative social policy, and women and politics.

Itai Grinberg is an attorney in the tax group of Skadden, Arps, Slate, Meagher and Flom. In that capacity, he provides legal and policy advice on a wide range of cross-border and domestic transactional, legislative, and regulatory tax issues for major multinational corporations. He previously served as counsel to the President's Advisory Panel on Federal Tax Reform.

Next is Peter Orszag, who is the Joseph Pechman Senior Fellow and Deputy Director of Economic Studies at the Brookings Intuition. He is the director of The Hamilton Project, director of The Retirement Security Project, co-director of the Policy Evaluation Project, co-director of the Tax Policy Center, and Research Professor at Georgetown University, here in Washington. He previously served as Special Assistant to the President for Economic Policy, and as Senior Economist and Senior Adviser on the Council of Economic Advisers during the Clinton administration.

Next is Jack Ebeler, who is also a member of the board of NASI. He is President and CEO of the Alliance of Community Health Plans. Prior to joining ACHP, he served as Senior Vice President and Director of the Healthcare Group at the Robert Wood Johnson Foundation.

And last but not least, is Rudy Penner. He is a Senior Fellow at the Urban Institute and holds the Arjay and Frances Miller Chair in Public Policy. He was formerly a managing director in the Barents Group of KPMG Peat Marwick and a resident scholar at the American Enterprise Institute. He was director of the Congressional Budget Office from 1983 to 1987.

Now, following the presentations—we're going to do all of them together—we will do a brief question-and-answer period. So I am going to turn it over right now to Professor Lindert.

PETER LINDERT: Thank you very much, Bill, and my thanks to the National Academy for Social Insurance for doing all the hard legwork to make the event happen, and of course, to the Annie E. Casey Foundation.

I am delighted to be here. I know that I am going to learn a lot because I certainly know the work of the other panelists, so I'll be taking notes.

The academy correctly described to you my role in the materials they sent you. I have a book and an ongoing research project, because I have found a subject I love and I am going to do more of this kind of empirical historical work. Think of any big issue today and realize that people have not fully figured out how it's been moving over time. Basically, that's because economists are clueless about history, historians are frightened about economics, and there is an arbitrage opportunity for a few people like me who are absolutely nutty about this kind of material, I love it. (Laughter.) Let's get into it.

I always start with the conclusions to make sure things don't get lost along the way. And here, I will go through them really quickly in fast introduction, partly because I will come back to the same points, also because you have the materials with you, both in paper and in PowerPoint form.

The first is an empirical point that has just turned out to be true in recent years, as are all of these conclusions. The welfare state is not an endangered species; it is not shrinking. There is no "race to the bottom," whereby countries might compete against each other to slash their programs the most, in order to slash taxes the most, and bring all social spending down.

Second, the point for which my book has been most discussed, I suppose, is this free-lunch puzzle. If you look at the experience of the rich industrial OECD countries, what you find is something that is seldom said. The actual cost in terms of GDP of the real-world package of many different kinds of social transfers that are often called the welfare state is indistinguishable from zero. So it's a free lunch nationally in that sense – of course, not a free lunch for everybody within the nation. About 10 or 12 European countries have achieved longer life through better healthcare facilities and more equality of income without losing any GDP. How? I won't just give it to you as a statistical result; we want to figure out how that could be.

First, I want to add to the puzzle and make it look even stranger because we can list all sorts of ways in which relatively low spending countries – the United States, Canada, Australia, and Japan, and until recently, Switzerland actually have better institutions than the Western Europeans.

There are plenty of mistakes that I can list on the European side of the transatlantic comparisons of who's got the right institutions for economic growth. But as you can see, those European mistakes are unrelated to the welfare state. That is, they are mistakes, but they aren't related to what we do with the poor, the sick, and the elderly. The mistakes do relate to protections against competition, something the Americans tended to get more right. Note also, this sliding geography of Europe – there are certain countries in Europe that have this problem more than others, and you can see on the screen that Southern Europe will have some trouble.

The screen first lists advantages in favor of welfare states: better tax mix – that's not tax levels but that's tax mix, and we can discuss that; investment in mothers' careers, especially healthcare insurance; relatively cleaner governments – that's slightly – there's only a slight difference among the rich countries, but in fact the countries that have the best sort of no-corruption ratings are those welfare states of Northern Europe; and perhaps something on the screen there with the four letters ALMP, that is, active labor market policy. I'll come back to that.

Okay, we will want to worry about the big question of how the future might differ from the past. If I give you evidence that shows that in the 20th century having a large welfare state has not yet been a huge problem, you can still say, as we've all been sensing from our watching of the media that things will break down in the 21st century. The population-aging crisis means trouble for pensions, healthcare, and other things related to age. You can see on the screen a couple points I want to make about that.

First of all, we've already got a hint from OECD experience how public programs will adjust because they will have to in the 21st century. This is not a phony issue raised by someone who didn't like entitlements programs, there is a real issue here relating aging populations.

And then finally, an even more sweeping gloss at the end. Now this one is less empirical, but I'll stand by it and if we had the chance, I'd elaborate. It's not true that you have to choose between equality and efficiency. The political process often does, because one side or the other gets the upper hand, but you don't have to. Every country has passed up the 20-dollar bills on the sidewalk where they could have made people more equal and the whole country richer. Let's go into these six conclusions.

First, I'll use the terms "social transfers" and "welfare state." The paper, the long version, tells you more about what I do and don't mean here. But on the screen, you can see the kinds of social transfers that I want to focus on here. Most of them are what the national product accountants would call transfers; that's not true of all of them. In particular, not everybody would have used the term transfers to describe public health expenditures, but I will just for convenience.

A country will be called a "welfare state" if those social transfers added up to 20 percent of gross domestic product or more. I choose that definition because it makes my quantitative yardstick for what's a welfare state happen to match the way the media usually decide which countries are welfare states.

I won't talk about public education spending here. It's not so controversial; it's a separate subject, worth a whole separate conference or seminar. And anti-market policies are also defined as not part of the welfare state – so, for example, minimum wage, protecting people against firing, protecting businesses against foreign competition, none of them count as welfare state policies. People have used the phrase, "social protection" to defend such programs, but they're not in my definition of the welfare state.

Okay, very quickly, that point about there being no race to the bottom. This is like the old conclusion number one, the one I first listed. If you look at the set of countries that are in this category, ever since the late 1960s, the group has basically not changed much at all: very few new members in this group of welfare-state countries, and almost nobody dropping out. Ireland dropped out, and it's a very interesting case to discuss. Switzerland has just come in, a bit surprisingly for such a conservative country. Some Eastern European countries now qualify as democracies and therefore as welfare states. I guess I didn't tell you earlier that only democracies count in the way I use the term welfare states.

Conclusion number two is the free-lunch puzzle. At the moment, what is being said on the screen is the result of a lot of statistical work. The OECD shows no net effect of greater social transfers on GDP. I'm not the only one to say so. Several authors had said so before me, but I said it at more length and with what I considered some improvements in the way the statistics were done. I try to be as transparent as I can. If you want to see my data, there they are. They're on a website, they're in a boring volume two of this book. By the way, you would only be interested in volume one, which I recommend as a Christmas present, you know – (laughter) –because volume one is written for human beings. Volume two is for quantitative social scientists to keep them off my back, basically. (Laughter.)

Okay, that's the statistical result, and you can often get a statistical result where something looks like it could be zero, and who knows if that's really true or not. But there are good reasons why this might be true. And under "A" here I really want to emphasize an important point about discourse on controversial social issues like these. How many times have you seen somebody say, oh, we know this to be true, some great economist has shown it?

The example that I want you to think about at the moment in connection with A is, we supposedly "know it's true" that the welfare state costs an enormous amount of GDP because just think of it; you are taxing people on the basis of their being productive and you're giving more to people, the less productive they are. And that's the basic tale. But, that is fiction, to put it in a stark way. It's good imagination, socially responsible imagination – you better worry about that possibility.

But I'm saying it is fiction in the sense that real-world welfare states don't make such basic mistakes. They don't say to somebody leaving high school, do you feel like not working ever? Would you like to strum your guitar? We'll give you 70 percent of the wage you might have earned for the rest of your life. Enjoy. But the parables, the way it's often told certainly in academia, and sometimes in the press, would make it sound that simple. There is no country that has done something as bad as that.

Rather, there are policy mistakes on all sides, and on the European sides, the mistakes don't happen to center on the welfare state. Let me tell you about different policies where these countries first got it really bad, and then they got it really good. First, I want to add to the puzzle by telling you reasons why these countries are doing things that would keep them behind the United States. And these all have that common denominator of being anti-competition policies; that's what I'm emphasizing here.

Higher education is a social sector where the Americans, I think, got it about right. It's the social sector that has the least to do with the poor, the elderly, and the sick. It's a sector where all countries wisely saw that there's some case for public subsidy because there are gains to knowledge being generated by this sector. But American practice makes everybody compete. Berkeley has to compete against public-sector UCLA, as well as private-sector Stanford. They have to compete against them for good students, for good faculty, for federal grants, and so forth. And so they are actually all are competing against each other. And when you look at the international rankings of institutions in higher education, it's a bit embarrassing for most of the non-Americans. The Americans got that one about right. We don't give free rides to everybody in that sector.

Competition in product markets – I'll show you on the next screen a diagram of this. The United States and other low-spending countries, outside of Europe especially, are leading the way and the Europeans are slowly following toward having more competition in the main product markets, and this is an advantage for the outsiders over Western Europe. Western and Southern Europe, in particular – think Mediterranean and France and Belgium – have a lot of other barriers to competition.

Here was that graph of what is happening to product market competition. This is an OECD indicator for how restrictive you are. It only covers part of the economy, and there's actually more that's actually going on than those OECD economists in Paris could have shown you with that graph, but this is just for sectors like public utilities, et cetera. You see the USA at the bottom, that is to say the least restriction, probably the best policy in that respect, and others catching up. The continental Europeans are still just catching up in that respect.

Let me talk about that other kind of restriction, the employee protection laws (EPLs). Now, I've just coauthored a National Bureau paper with more statistical work on this. Employee protection laws make it extremely hard to fire anybody who is a regular employee. You would have to go to great trouble to do that, and it is true of much of Europe, especially Southern Europe.

Does it raise or lower jobs overall, and does it raise or lower productivity overall? My argument will be it lowers productivity in the long run; it makes the economy less productive. And in red and green here, I've given you some examples of countries that differ very much in this kind of policy. I can't describe here how that EPL strictness is measured, but you know the a high number there means they really restrict the ability of employers to lay off senior workers or mid-career workers. Greece and Italy are very restrictive in that respect; Ireland and Denmark are not.

One thing I can show you – tell you for sure, is what I've already begun advertising in this language on the screen -- is that EPLs tilt unemployment toward youths and toward women. They have more of it. It takes them far longer to start their careers in those countries like were shown in red. On the screen, at the moment, is the result for youth. Another screen that you have and that I'll skip past in a second, shows the same thing for women.

How do I know that this lowers productivity? Well, aside from my telling you we worked on it statistically, you can just work it out over as you go through a generation or more. What happens is this: Consider somebody who was subject to these restrictions was shut out, forced to stay home and live with their parents for longer, in, say, Italy, in the late 1960s and early '70s, even now late in their career, they're still suffering a productivity and pay effect from it because it took them longer, basically, to start their main career. And since so much of learning is done on the job in your main career that is a loss of productivity. The same was true for women: Again, on that right-hand column, higher ratio of unemployment for women than for men in the working-age range.

Non-Europeans, like the United States, look best drifting toward the other end of the spectrum. Next let's go back to a classic argument: If you actually pay people unemployment compensation to stay out of work for a while, won't they stay out of work longer? Won't that cost jobs, et cetera? It does. That's what many other scholars have found; that's what I find. It has a very small effect on GDP, however, so that if there were something else in the bundle of national policies that was good, it could easily offset this.

Okay, so here's your first exam question. The basic point here is that when you think about the way in which people with low incomes or unemployed are being treated, the issue of what gives them the right incentives is a subtle one.

So, exam question number one, multiple choice: Which of these gave a poor single mother, my definite – the group that I want to focus on here – the least incentive to get a job? It is A. Of those cases it would have been the U.S. under Reagan in the first administration.

Now, the red clarification of the answer gives it to you a little more directly. The big disincentive happened twice. The Johnson administration made this same kind of fateful step, as Charles Murray and others said so very eloquently. The work disincentive was reformed away under Nixon, Ford, and Carter, came back under early Reagan. What happened there?

Well, what happened is you had an environment, to say in the Reagan case, where it was so abhorrent to many people that somebody a little bit above the poverty line might actually get welfare payments. This was called welfare cheating. So they toughened the system and make sure that everybody would lose benefits at a pretty fast rate, as soon as they took a job. So think of poor single mom who is getting a hamburger-flipping job. When she does that, the benefits are taken away. The implicit tax rate at the margin was very high in both of those eras, for opposing political reasons.

USA under Clinton – here I have to give you a little more of the political flavor of that. I'm actually referring here to the 1993 initiation of more generous Earned Income Tax Credit (EITC). You can find it on Form 1040. It means that if you have a really low income, you'll not only be excused from taxes, you can get money back. While it says on the screen "under Clinton," it's actually a bi-partisan improvement, something that worked out very well in American policy. Other countries have begun to imitate it because it says, in effect, someday if you get a job and go up the career ladder someday you'll be a taxpayer like everybody else. But for a long time, while we get you into that career habit, at initially low rates of pay, you're not going to be paying those taxes.

Raising the EITC in 1993 had bi-partisan appeal. For Republicans, it's tax relief for working people. For Democrats, it's a relief for people with low income. So it worked politically. Tony Blair imitated it in the year 2000; they gave it a different name in Britain. Sweden's welfare state does not quite take everything away from you. There has been a debate between me and somebody else in the blogosphere about this. But Sweden will make sure she continues to get the childcare benefits, the healthcare benefits, and things like this, universal benefits that are not taken away by any kinds of means testing.

Okay, this being an American audience let me ask specifically: Who deserves the credit for the drop in U.S. welfare caseload? Is it this EITC, giving a tax break to low-income workers? Is it sort of the tough love of the 1996 welfare reform, which said block grants of the states and people are going to face their welfare limits very soon?

Here I rely on the other economists, and you can see on the screen what the best experts on that seem to say. Nada Eissa and Hilary Hoynes have found that EITC, that tax break for the low-income workers is definitely making more of them work. There's some cutting of hours. That wouldn't be too surprising down at that end of the spectrum, that there'd be a lot of part-time work involved. But, definitely you're raising work participation. And that's one of the reasons why other countries have begun to imitate it. This is a respect in which the Americans are getting high marks from those who are concerned about such social programs.

The EITC and the toughness of the welfare reform of 1996, with the term limits, and the combination of that and all of the other degrees of flexibility that that program actually gives to states, and to welfare mothers is responsible for increasing work participation. Rebecca Blank's portrayal of this as being something that got gains by putting people more back to work with a mixture of continuing benefits and some restrictions is probably all right.

Now, let's come to the tax mix. And Itai will want to talk about these issues too. But here is something, I think, it's still news for many people. So there's your next exam question. Which of the following tax rates do the big welfare states not levy as the higher tax rate than in the United States? Which of these kinds of taxes? Again, the right answer is A.

Let's talk about that a bit. You know, there are many people who imagine that the big-budget welfare states are countries that soak the rich and tax corporations and top incomes the most. Not true. There is not a clear distinguishable difference. And on many of those fronts, it looks a little odd if you said a country would be foolish to double tax dividends, say, both at the corporate and at the personal level, because that might discourage growth and accumulation. Well, that would be the United States and they've only partly changed that under the Bush administration. It's not the welfare states that tax dividends most heavily.

No, labor income is taxed more in the high-budget welfare states. A political corollary is that the people who are actually paying for that social insurance are largely overlapping with the people who would have voted for it. So it's not quite the Robin Hood story that I think many people had in mind.

And then C and D, on which I have particular points. C is a tax on general consumption, the VAT in Europe, or sales tax, you would say in the United States. That is quite high in Europe, as you've known if you've been there as a tourist. Is that good for economic growth? Here's my particular way of putting it right now: Every conservative in a low-budget country, like the United States, says it is. Isn't it interesting that it happens elsewhere, and not here?

And then finally the sin taxes on these addictive products that have bad health consequences – you can see those three here, and in Europe it's over five dollars a gallon for gasoline. Alcohol and tobacco are also taxed very highly. And my rhetorical point about that is, what's so bad about such taxes for economic growth?

Now I want to go on the other side where the welfare states have some advantage over the United States. And others I think will be discussing this too, so I'll just be brief here. I'll give you a little bit of historical twist on this.

Public health is the clearest social sector where the U.S. is severely disadvantaged. We have more bureaucracy than an all-public system, we have higher administrative costs, we save fewer lives. That's only partly because of ideology and the unwillingness to have "socialized medicine."

It's also due to oddities of American history. First, our history has tied healthcare to your job; the secret is out. And if you change jobs, you have a serious problem in the United States. How did we get that? What is the logic of that? It's very elusive. It goes back to wage-price controls in the 1940s and tax rulings of the Supreme Court in the 1950s. We decided that there should be special tax advantages for healthcare insurance through your employer. And, that being the case, we have created a giant healthcare-and-pensions group-plan industry, which can be guaranteed to lobby against any reform that would ever make them unnecessary. Second, since 1965, Medicare has caused soaring costs of civilian health care provided only to the age group for which the cost of each extra year of life is the highest.

On support for mothers' careers in Europe, I'm going to be a little quick on that because I need to save time, but there is a big effect in welfare states. Mothers' human capital, their ability to become productive over the lifecycle is very much affected by society's willingness to give them the help with childcare and early-parental leave, and the welfare states, especially the northern ones, do a lot better on that. I cannot elaborate on cleaner government and ALMP, since I'm short on time.

The pension crisis of the 21st century: What's going to happen now when we have everybody really old? Well, that's the first of three familiar sources that we want to just remember here quickly about how you get into trouble with pensions. These remarks will be on the pension side, not on the healthcare side.

First, it's really inconvenient to live a long time – (laughter) – not a good idea. And Japan and Italy have really fallen into this trap. Their defect demographically is that they live forever, they have no children, and they have no immigrants. I might have exaggerated a bit, but that's the idea. They're going to be in serious trouble; some other countries will too.

Trouble with pensions can come in two other ways. The next way is something I do not define as being part of the welfare state because William Beveridge and others who set it up didn't either. This is subsidizing earlier retirements so that a male who's 52 gets more or less full benefits and stops working forever. That's a feature of the Mediterranean countries, in particular. If people are going to be living longer and longer, why should you take taxpayer money to make them retire earlier? There's going to be a real problem for the budget and for paying for the pensions later on.

Having an overall government deficit is likewise problematic. After all, pensions in the end rely on all government money. You can ignore what you heard about special reserves for the pension fund. The countries that have the biggest deficits among the rich countries – well, that would be Japan. They are bringing it down now but they are still in the number-one category. The United States has been in second or third place since 2001. It's not the welfare states that have been running large deficits.

How can we get out of this and grow older gracefully? Any provision for old age will have to face this issue. Something has to give. As you get older and older, you have to somehow change the ratio of how much you get in retirement to how much an average worker pays into retirement. Everybody has to make an adjustment described in the screen, whereby the pensions that each elderly person in a certain position gets are going to have to grow more slowly than the average working income. It has to be true. Just work it out. If the ratio of old people to currently working people is going up, there has got to be an adjustment to keep this budget from rising as a share of people's incomes.

Some countries will have to make only small pension adjustments, by international standards. We are in that category. You know, for all of the attention we deserve to give to this problem in the United States, we don't have it the worst, nor do the other immigration countries or Norway or Sweden. It's really continental Europe that is going to face this problem in a very big way.

I want to stress, though, that the problem is basic and unavoidable. If the population is going to live longer and consume during all of those extra years, something does have to give; it really doesn't matter what kind of pension system we were talking about.

That basic point about aging transcends the choice of pension institution. Suppose there was no pension system from your job or the government or anything. Suppose you saved everything for yourself. You would have the same problem. The more people realize that they are going to live a long time, and the more they feel it would be nice to retire earlier, the more there is this problem. What is available for consumption every year in retirement will be lower and lower relative to what a person earns. So, you have to make some kind of adjustment in the system no matter what the system is. The pay-as-you-go system that we have now, where the young are paying for today's elderly is not the only one that shows the problems. In fact, if you were to reform all of this and go back to where everybody is only receiving in old age what he or she themselves put away into a lockbox, politically the system would undo it sooner or later. That is what we did with Social Security before; we all started with a lockbox, save-for-yourself-because-you're-forced-to kind of plan, and we walked away from it.

The final point relates to my sixth conclusion. If you hear that there is a tradeoff between equality and efficiency, you should know that that is false if they're saying you have to choose one or the other. Every country passes up ways in which they could make people more equal and make the economy grow faster due to political pressures. Just think: have you ever seen a political system that took advantage of every chance to have egalitarian growth?

I know of no such case. I'll leave on the screen a very nice description by Alberto Alesina on what options a country does have. He was speaking of Europe when he said, "You can have efficient competitive markets as long as you can couple them with efficient redistribution system, social programs like some of the Northern Europeans are doing." Thanks.

(Applause.)

KIMBERLY MORGAN: Great. Thank you so much to the organizers for putting together this very interesting panel on some very interesting work. I think Professor Lindert has spoken and written very eloquently about this question about the economic sustainability of the European welfare state. And as I am not an economist, I dare not tread upon the realm of economics, but as a political scientist, I thought I would talk about the political sustainability of the European welfare state; in other words, why despite repeated predictions in the media and among some academics that the European welfare state would collapse in crisis, why it has proven so politically sustainable.

I'll talk about this by first looking historically at the political foundations of European welfare states, focusing in particular on the design of tax and benefit programs and how that has affected their political sustainability. And then I'll talk about some recent reform efforts.

And I would like to focus in particular on a point raised by Professor Lindert about policies that support working mothers and support families more generally, and how there have been growing efforts in Europe, in Western Europe, to improve these kinds of supports, and that this is very much in line with the kinds of politically popular policies that politicians have long pursued on the European continent in the redistributive realm.

Before I get started, I should just note some geographical limitations. I'm really just talking about Western Europe. That is in part because Eastern European welfare states have had a different trajectory, but also on a more mundane level, I'm simply less knowledgeable about Eastern Europe so I'm going to just kind of stick with terrain that I'm a little more familiar with.

So, first, I'm going to talk a bit about the political foundations of the European welfare state model. Readers of the mainstream press would know that the demise of the European welfare state has long been predicted. Yet outside of the U.K., there has been virtually no major drive to slash the welfare state in Western Europe. And even under the U.K. under Margaret Thatcher, I think a lot of people would say that her efforts essentially failed.

You don't even really hear a strong anti-welfare-state rhetoric in political campaigns in Europe brought by opposition parties. And the interesting question this raises is why this is the case and why this is contrary to what media has often predicted.

In answering that question, I think I could take a number of different tacks, but I would like to focus on one factor that Professor Lindert has especially highlighted in his work, and that is the design of welfare state benefits and financing, and where he has really talked about the economic sustainability of this model, I'll talk about the political sustainability of it.

First, in the area of social benefits, European welfare states consist, as we all know, of universal social insurance programs, essentially for things such as pensions, health insurance, maternity and parental leave, unemployment compensation and other areas. These are universal programs, and the fact that they are universal gives us one hint as to why they have been so politically sustainable. They basically reach a very large constituency; they include the middle class in them, and thus are likely to have more political strength than, say, means-tested programs that target a much narrower constituency.

Just as important is the fact that these are social insurance programs, in which people pay a percentage of their income, and what they get back out is also related to their income. So it's not that people get back some kind of universal flat-rate benefit from most welfare state programs, but they get back according to their income, basically income replacement.

This has reinforced the political strength of these programs because it has kept the middle class within the universal welfare state, rather than having to look outside the welfare state for private supplements, private forms of insurance, to assure that their income would be replaced in the event of illness or old age or unemployment. Social insurance benefits basically keep the middle class within this universal constituency and create strong support among the general public for the programs of the welfare state.

The second critical part of welfare state design, though, in the European context, is what Professor Lindert has pointed out, the financing of these programs. And I think he has highlighted something that a lot of people hadn't really thought about very much, about how European countries finance the state. Namely, there is a particularly heavy reliance on consumption taxes and payroll taxes, and relatively less on things like income taxes, capital taxation, and so on.

Now, while from an economic standpoint, these taxes might be less harmful than other forms of taxation, as Professor Lindert has highlighted, they may also be more politically sustainable, too. If you take the example of payroll taxes, people often say they like payroll taxes, or at least dislike payroll taxes less than other forms of taxation. If you look at public opinion data in the United States – and there are data that go back many decades – it shows that people consistently say that payroll taxes, such as the Social Security taxes they pay are the most fair or the least unfair of the taxes that they pay.

Similarly, consumption taxes are also potentially have some politically sustainable dimensions to them. And there are a number of reasons for this. One is that consumption taxes might be less visible. People are not confronted with the annual bill of how much they pay to the federal government once a year with consumption taxes. Instead, these are spread out over the year, and in the case of the value-added tax are incorporated within the price of goods, so conceivably people are not even necessarily aware of just how high consumption taxes are.

One thing I would also say about the political appeal, potentially, of consumption taxes that is also true of payroll taxes, is that they can be seen perhaps as more acceptable to groups that might otherwise lead an anti-tax movement, namely the rich or business groups. These potentially powerful opponents of the welfare state might be less mobilized under a system of taxation that taxes consumption and labor rather than taxing income and capital.

Some people are starting to argue that the financing of European welfare states really rests on a sort of cross-class compromise, one in which seemingly regressive forms of finance, which are less likely to antagonize powerful groups in society and are simply less visible to the public, basically fund progressive redistribution through social benefits. And if you look at the consequences in terms of inequality, the tax systems in a lot of European countries are not terribly progressive, but the reduction in inequality and the redistribution of income really comes through the progressive social benefits, the net result being lower overall inequality in European countries than in the United States, and also of course lower poverty rates.

Thus, to give a contrast with the United States, and sum up this point about the political feasibility and sustainability of the European welfare state, we can think about the U.S. and its system of financing and its system of public benefits. On the one hand, we use a tax system that is arguably quite visible and fairly antagonizing, that is, a progressive income tax structure that used to be especially progressive – is much less today – and also relatively high taxes on capital. And arguably, these are precisely the things that have catalyzed an anti-tax movement in this country that has really become a movement against the welfare state.

In addition to this, we have a welfare state that is smaller and simply less visible in people's lives. People just don't perceive that the state does much for them; especially the non-elderly population would argue that the state does very little for them. Of course what they don't realize is all of this sneaky backdoor ways in which the state is actually doing things for them, things like tax expenditures which subsidize employer-provided health insurance and pensions, and also things like the home mortgage interest deduction. Very few people would recognize these benefits that the federal government is providing for them, and instead would insist that the state does very little for them.

In other words, this combination of a fairly visible and antagonizing tax system, and a fairly invisible welfare state arguably has done much to undermine support for the welfare state in this country. By contrast, these European welfare states have more visible systems of benefits and services. People really see what the state does for them in their daily lives, how it supports them in a range of ways, and a less visible or antagonizing tax system.

Now, all of this is not to say that there are not problems with the European welfare state or that Europeans themselves are not cognizant of various problems facing them. There is this problem of chronic unemployment, particularly in continental Europe, and especially the Southern European countries, as Professor Lindert outlined, and also much concern about the sustainability of large pension and healthcare commitments in the face of an aging population.

But I would say the way that countries are trying to respond to this and various other problems they are facing has not been to try to radically cut the welfare state or adopt an American-style model, but rather to try to recast it and reorder its priorities. In other words, countries are trying, and it's not always very easy, to reduce spending in certain areas and redirect social spending in other places that could be seen as more productive. This helps account for the reason why there have not been overall reductions in social spending. But that is not to mistake the fact that there have been ongoing reforms and efforts to improve the workings of the welfare state.

One area that I think is gaining growing attention in Europe is precisely one that Professor Lindert has outlined as a particularly important investment that states could make, and that is investment in mothers' employment and in supporting mothers in paid work. Now, it's important to note that European welfare states have always contained systems of universal family supports. That was really part of the welfare state from the beginning in Europe, from early in the 20th century; that they are not only about supporting an old-age population but also about supporting families and providing universal supports for families.

This meant things like universal family allowances, allowances paid to people according to the number of children that they have, basically to subsidize the costs of having children, various tax subsidies provided as well, things like wage supplements for breadwinners, and various social services that are universally available.

However, European welfare states were really forged in an area of much more traditional social values. They were really created in the 1950s, the 1940s, a time when the assumption was – and it was really born out in reality – that most mothers would be home, and the issue then was providing supports to male breadwinners.

With the rise of women's employment, though, over the last few decades, this has really put pressure on welfare states to recast themselves, to reorient their spending, to take into account the changing needs of the population. This has lead to attempts to create policies that would support mothers' employment, policies such as universal childcare, generous paid parental leave policies, and also part-time work possibilities as well.

Now, there are numerous reasons for this, and numerous discourses that surround this whole discussion about women's employment. One set of goals is about gender equality. This has been something that has been very much pushed by the many women in European politics. Women have higher rates of representation in parliamentary politics in Europe than in the United States. But I think it also reflects some pragmatic goals to try to recast the welfare state to meet some of these changing conditions.

Thus, when faced with the problem of unemployment and the ways in which women are shut out of labor markets, as Professor Lindert was outlining, this sort of labor market that makes it hard for youths and women to break in, these policies try to mobilize women's employment and give them better access to the workforce.

Faced with the problem of an aging population, people are increasingly talking about promoting women's employment as a way to address that. The goal is to encourage women to have children because they don't have to worry so much about being able to stay in paid work after their children are born. A lot of the Northern European countries that provide these supports for women have higher fertility rates. Also in the coming decades, as the baby-boomer population retires and the labor market starts to shrink, causing labor shortages in Europe, promoting women's employment is just plain good economics.

Finally, to of conclude, I think it's also part of this political orientation of the welfare state, that in this time of changing family needs, policymakers are trying to find a way to recast the welfare state, to continue to keep the middle class within its ambit and provide policies that will actually support them in their various goals in their lives. And so in this sense, I think this effort to reform the welfare state will very much contribute to the political sustainability of the European model in the years to come. Thank you.

(Applause.)

ITAI GRINBERG: Thanks to NASI for organizing this event and to the earlier speakers for such insightful remarks. I'm just going to take a moment and want to do three things with you all in my segment.

I'll first elaborate a little bit about Peter's remarks on our tax system and comparing it with those of Western Europe. Then, I will say a little bit about the significantly increasing pressures on our income tax structure, a subject with which this audience will be really familiar. Finally, I will describe how value-added tax, a consumption tax used by every major developed economy except the United States, could fix the mess that our income tax system has become and avoid what otherwise could be a fiscal disaster.

This slide illustrates that the United States is in fact a very low-tax country. We collect only 25 percent of GDP at the national and state level. That compares to about 36 percent for the OECD, the organization of the major developed economies, and to about 40 percent for the EU 15, the countries of the European Union excluding the newer Eastern European members.

But, although we have a low overall tax burden, our income tax burden is relatively high. We collect a larger percentage of our total tax revenue from the income tax, as other speakers have mentioned. And our corporate income tax rates are particularly high, both on a statutory basis, as shown here, and in terms of marginal effective rates. In fact, the US has the second-highest corporate tax rate in the developed world.

Now, to illustrate why this matters, think about the fact that 12 of the 15 largest cross-border mergers and acquisition deals involving U.S. companies over the last 15 years ended with the surviving parent company being foreign. That decision about the country of incorporation of the surviving parent is often made with tax factors in mind. And research suggests that the country of incorporation of multinational companies affects where it puts its research and development jobs, and management positions.

This question is important not just for shareholders, but also for U.S. workers. And similarly, startup companies that expect global revenues now often incorporate outside the United States in order to limit their exposure to the U.S. tax system, even when much of their workforce and much of their expected revenue is in the U.S. The corporate income tax rate is an important question, not just for people who own capital, but also for individuals generally.

More generally, relying excessively on income tax to fund government is sub-optimal, and by doing it, the U.S. fails to take advantage of our status as a low-tax country. The income tax impedes economic growth, creates confusion and unfairness, and is tremendously complex. Some estimates suggest that economic waste from distortions imposed by the income tax reach almost a trillion dollars a year.

The result of the complexity of the system is over a $150 billion spent on compliance, and yet the tax gap, which is to say the difference between the amount that should be paid and the amount that is actually collected that is more than $300 billion. Polling data suggest that everyone thinks the system is confusing and unmanageable, and in particular, young people no longer have compunction about cheating the system. Perhaps this is because with a set of rules as complex as our own, they worry that everyone else cheats, too.

That is just what is wrong now. Unfortunately, things are about to get much worse. The first looming problem is that we have no status quo. Between now and 2011, the most basic provisions of our income tax system are set to change or expire. The top rate will rise from 35 percent to 39.6 percent. The bottom rate will increase from 10 percent to 15 percent. The child tax credit falls from $1,000 to $500. Meanwhile, each year, Congress passes a patch to keep taxpayers out of the AMT, the Alternative Minimum Tax.

The first year that the AMT expires, more than 12 million taxpayers would pay the tax. Note that it is neither an alternative nor a minimum; rather, it is a mandatory maximum tax. It requires everyone to recalculate their tax a second time under a different set of rules and if that comes up with a higher amount, then they the higher number.

But allowing 20 to 50 million Americans to pay this gotcha tax is a political train wreck, which really means that it won't happen. The funny thing, though, is that our official budget estimates assume this is precisely what will happen. Since keeping 20 to 50 million Americans out of the AMT costs $1.2 trillion just over the 10-year-budget window, what you are really talking about is the mother of all accounting fraud. This makes Enron look like small fries.

This won't be news to anyone here. We are at the National Academy of Social Insurance event, but the problem I just described isn't the worst of it; the biggest problem is our growing entitlement catastrophe. By 2047, the CBO projects Social Security, Medicare, and Medicaid will account for 18.3 percent of GDP. That's the 30-year average of federal tax revenue as a percentage of GDP, which is to say that unless we increase taxes or change the programs, the entire federal budget will go to paying for these three programs.

This means that a serious fix requires major entitlement reform, dramatic and unprecedented increases in tax revenue or the elimination of a lot of other federal spending. This is just a graphical representation of that same point. The social insurance programs swamp out the rest of the government unless you increase revenues. We go from being a government that's an insurance company with an army to a government that's an insurance company without an army.

Some people tell you that we can grow our way of the problem. That's not true. The federal government currently has $43 trillion in current dollar IOUs, and closing the fiscal gap without cutting spending or raising taxes requires double-digit, real-average-annual-economic growth for 75 years. No country on earth as ever done that.

If we do nothing to solve the problem, we either have to cut spending by 60 percent or increase taxes by 250 percent.

The good news, though, is that we can avoid all of this. There is a way to save ourselves from all of those terrible consequences. Again, The U.S. is a low-tax country overall, which gives us breathing room. Average U.S. sales taxes are well below the consumption tax rates among our major trading partners. That suggests there is substantial room to impose a value-added tax without exceeding global norms. And the VAT can raise enough revenue to make income tax reform possible, by which I mean lower-income tax rates and a more sensible system that's less complex, and bring in revenues that can help us deal with our growing entitlements. People are getting older and we are going to have to help support them in one way or another.

So before going any further, I just want to slow down for a couple of minutes and explain how a VAT works. A VAT is just like a sales tax but it is assessed in smaller pieces and collected at every level of production and distribution. Imagine that you buy a $350 chair at a store and you pay $35 of tax in a sales tax. That is pretty straightforward, a 10 percent rate.

The problem, though, is if you are a consumer: you are not supposed to pay the tax if you are a small business, but it is really hard to tell whether a guy coming into store is buying a chair for his house or a chair for his office. Sales taxes are notoriously prone to one of two problems: they either double tax stuff by taxing the chair and then when the company sells the product, it is effectively being taxed again, or they don't tax the chair at all because they are trying to avoid the double tax. The VAT helps solve that problem and also has some other administration and enforcement advantages.

For example, imagine you are a lumberjack and you sell a $100 piece of lumber. In a retail sales tax system, you would not assess tax since you are selling the wood to a chair maker and the chair maker is not a consumer. By contract, in a system with a VAT, you charge 10% or $10. The chair maker then makes a chair, which he or she sells to a store for $250 with a 10% tax as well, which is $25. But instead of remitting the $25 to the government, the chair maker says, hey, government, I am sending you $15 and this receipt, which says I already paid the lumberjack $10

Once you get to the level of the store, they are going to charge you $35 in tax for the $350 chair. The store says, hey, government, I paid the chair maker $25. The tax is collected at exactly the same rate; it is a 10 percent tax, you pay $35 at the store, but each of the companies has just told the government how much tax they paid the other guy, and in the process they have just helped the government collect the tax. It is hard for businesses to admit to all of their tax revenue, particularly when they are smaller, but it is easy to get someone to say, don't look at me for taxes; go to the guy I bought something from. That is the genius of the VAT.

I want to just make one comment. In some European countries the VAT is not on the receipt when you buy stuff at the store but it doesn't have to be that way. You can make the VAT every bit as visible as a sales tax is in the United States, as they do in Canada.

Why would we want this tax? Well, it allows us to exploit our competitive advantages of a low-tax country, and a broad based 15 percent VAT could collect 65 percent of the revenue of the income tax, around $750 billion per year. Now, that's enough to take 100 million people off the income tax roles, reduce the top individual and corporate income tax rates to 15 to 25 percent, and repeal the AMT. You could provide an exemption from income tax for families with $100,000 of income or less. You could also help fund Social Security, Medicare, and other entitlement programs, and you could balance the budget. The U.S. could and should have one of the lowest income taxes in the world without reducing government services or making our overall system less progressive. By keeping our income taxes high and our consumption taxes low, we basically fritter away our competitive advantage.

What are the main objections to the VAT? Well, from the left, the objection has historically been that the tax is regressive. That may be true, but the appropriate thing to do is to make other adjustments to guard against regressivity, especially if shifting from an income tax to a VAT. Now, in contrast, the VAT is actually more progressive than the payroll tax and that is worth keeping in mind. A payroll tax taxes work earnings below an income cap, or at least ours does, and only work earnings are taxed. A VAT, on the other hand, taxes only spending and it taxes all spending. If you make a million dollars a year, you are taxed on the $900,000 to a million dollars when you spend it. It also taxes capital income, so when you earn money on investments, you are also taxed. Given the choice between encouraging savings, which a VAT does by not taxing them, and taxing working, I find it hard to see why we would choose higher payroll taxes over a VAT to pay for needed revenue.

The main objection from the right to the VAT, on the other hand, is that it is a money machine. People think it is invisible and therefore will allow government to grow. The basic idea here is that it is a really efficient good tax so we shouldn't do it. (Laughter.) The data don't support that analysis. The best studies suggest that there is no clear connection between imposing a VAT and government getting larger. That said, if we wait too long and then try to address our entitlement crisis in sort of the final days with the VAT, we might find that this particular criticism is a self-fulfilling prophecy.

The debate over appropriate amounts of redistribution and size of government, to my mind, should be largely distinct from the debate about whether to use a VAT to help fund whatever level of transfers and size of government we choose. My own preference is for lean but also progressive government that spends more on the young or more economically displaced, or the poor, and less on the middle-class old. But the decision about implementing a VAT does not in anyway require that similar preference. It is just a source of revenue from which you can then make the decisions you want about how big a government you want to have and how you want to spend the money that it raises.

The final slide is just another way of showing the magnitude of a difference the VAT makes. It compares the rates that the president's advisory panel on federal tax reform, a panel that existed last year to propose reforms for the income tax, was able to reach, in revenue-neutral reform in other words reform that doesn't raise money, with and without a VAT. What you see is that when they really simplify the income tax, they could only get down to a 33-percent rate; when they put the VAT in place, they got down to 15. It just illustrates how much more a VAT makes possible.

So in conclusion, the current system is extraordinary complex, inefficient, unfair, and cannot raise enough money. The VAT can do all those things, encourage savings, facilitate simplification, lower rates, allow lower- and middle-income taxpayers to treat April 15th as just another spring day and finance other changes that ensure the overall system is as or more progressive than the status quo.

(Applause.)

PETER ORSZAG: Thank you. Itai's remarks actually reminded me of Larry Summers' barb that we don't have a VAT because Democrats think it is regressive, and Republicans think it is a money machine, and we will have a VAT as soon as Democrats realize that it is a money machine and Republicans realize that it is regressive. (Laughter.)

I want to talk about the central topic of how and why we should provide additional economic security to American families in a growth-enhancing way, and it will feed into much of what Peter Lindert has already briefed us on.

American families in the middle of the income distribution are not only facing stagnant real wages and real incomes, but also a very significant increase of income volatility or economic risk. For example, the probability of a 50-percent or larger decline in family income from one year to the next has more than doubled since the early 1970s, from about 7 percent then, to about 17 percent now.

And this degree of economic risk or economic insecurity is not only harmful to family well-being, it is also directly harmful to economic growth, for a variety of reasons. For example, lacking an adequate degree of economic security can discourage people from taking risks that lead to stronger economic performance. Lacking a core level of economic security means that when bad shocks happen, people don't get back on their feet, back on to a productive path again, quickly enough. They get locked into a low-productivity state, as it were.

And then finally, and perhaps most importantly, the political economy of not providing adequate security is likely to induce a backlash, in which directly growth-reducing policies like protectionism or direct-market interventions are where people try to grab for security rather than providing it through alternative means. So for all of those reasons, providing some form of economic security can increase growth.

Now, how do you go about doing that in a growth-enhancing way? There are three different approaches to providing economic security. The first is to try to provide better preparation ahead of time before adverse shocks happen to families and workers, and that is primarily in the form of education and saving, and I'm going to come back to that.

The second is through social insurance: providing some assistance after the fact, when bad things do happen in a market-friendly way to help people get back on their feet. And then the third category is direct-market interventions. So that means protectionism or hiring and firing restrictions or trying to protect particular firms even, to somehow stop the underlying cause of the need for some adjustment.

I think both sides of the political aisle would agree that we should do the first category. It is clearly beneficial to provide more education and saving. Education is beneficial, not only because it raises future productivity, but also because better-educated workers are better able to adjust to shocks and so it is not only an investment, but also an insurance policy. There is a lot that we can do to provide better education in the United States.

And then personal saving, also, provides a buffer against shocks occurring when you have some assets that you can draw on to weather the storm, as it were. There is also a lot that we can do to promote personal saving in the United States. Most of you have heard my shtick on this before, but just because some of you are new – (laughter) – the single best step that we could take in the United States to increase personal saving is to make it more automatic.

Families are busy with other things. The evidence is overwhelming that if you force people to wade through a binder of complicated materials, they will put that off, but that if saving is automatic, even low-income and moderate-income workers do it. We should be moving very aggressively to a system of universal-, automatic-savings accounts in which, regardless of where you go to work, the default is that you are saving in a 401K or an IRA.

And you are allowed to opt out of that if you want to so it is not forced saving but it turns inertia in a pro-saving way rather than an anti-saving way. Not only are you enrolled in a savings vehicle, unless you opt out, but your contribution rate is increasing over time. You are automatically invested in the diversified fund, and at each step of the savings process, you can opt out of the default, but all the defaults should be pro-saving. And the evidence is overwhelming that this type of approach works, frankly, far better than providing direct-financial incentives or tax breaks or any other step that we could take to boost personal saving.

There is also a very interesting discussion, and both Kimberly and Itai touched upon this, about the distinction between the political hostility to an income tax versus a payroll tax. I agree that this differential exists, about whether it is the salience or the visibility of the income tax that is the problem, or it is the hassle factor of even having to complete a simple form

And a way of testing this would be to see if people who were sent their annual payroll-tax bills so that they could see much it amounted to would oppose those taxes as much as the income tax. And the irony is, of course, very strong because the vast majority of American families pay more in payroll than income taxes and yet the payroll tax does not attract as much hostility. I honestly don’t know whether it is because the payroll tax is automatic or it is because you never see the total bill, or it is because you are less likely to think that somehow someone is gaming the system and getting an advantage that you don’t have. But I think it is a topic that is worth exploring.

In any case, that was all the first category. The second category is more complicated; I want to come back to it in a second. The third category is these direct-market interventions. And what I think is particularly dangerous in the U.S. political context today, is growing attraction to reaching out to those sort of direct-market interventions in the form of protectionism, to prohibit certain retailers from entering certain to create sand in the wheels that would somehow try to shut down the process of creative destruction that leads to some of the necessary adjustments that could better handled in other ways.

And as Peter's work and other work demonstrates quite convincingly, this approach is clearly not the way to go. It has a very deleterious effect from the perspective of economic growth and doesn't lead to good outcomes. It may be well intentioned, but in trying to provide more security by providing protections, you ultimately wind up killing the goose that lays the golden egg, as it were, in the form of reducing economic growth.

So that leaves me with that second category. And I think this is the hardest category – social insurance and providing market-friendly assistance after bad events occur; there is a complicated tradeoff here. On the one hand, as I mentioned before, failing to provide economic security can be growth reducing. On the other hand, as we know, providing insurance or assistance in various different forms can distort economic behavior and that can be growth reducing.

So careful attention must be paid to incentives to get that balance right. But I would say the vast bulk of the policy debate in the United States has been dominated by this simple and wrong view that providing any security whatsoever is necessarily growth reducing; as soon as you provide any assistance at all, you are distorting behavior and therefore, reducing growth.

And for many of the reasons that Peter delineated and that I have tried to highlight also, I think that is just wrong. We need to move beyond that to looking at specific cases of how to correctly balance those incentives. So let me mention a couple specific examples. In your packet you have a paper that we just put out through the Hamilton Project, which is a new project at Brookings that involves a lot of leading scholars and former prominent policymakers and others, in which we try to lay out some specifics in this second category. In particular, we also released three new discussion papers last week that attempt the same thing.

Let me give one example. My colleague Jeff Kling at Brookings has argued that the unemployment system, which was mentioned earlier, should be updated. In the United States, it has not been updated to any significant degree since the mid 1930s, even though the nature of both employment and the nature of risk facing most American families have changed dramatically.

His view is that we should be moving away from a system in which we focus much of our resources on short-term bouts of unemployment and moving more towards the real risk that most American families face, which is that after experiencing that short bout of unemployment, they get re-employed at a lower wage, and that lasts over a long period of time.

Having a lower wage over 10, 15, or 20 years is much more harmful to most families than experiencing a two-month period of unemployment, especially if you had some savings that you could draw on in that intervening period. So Kling proposes moving the system towards providing wage insurance on a revenue-neutral basis and away from a system of simple cash transfers during unemployment. This means that if you get re-employed at a lower wage, then the government would partially make up the difference. He argues this would not only improve incentives for work and efficiency, but it would also be more progressive and provide better insurance than the current system.

I would also point out that a progressive income tax system is a form of social insurance in itself. A progressive income tax system provides some protection against volatility in your after-tax income because during bad years, the tax system more than proportionally makes up the difference. And there are a variety of ways that we can make the income tax system both more progressive and more efficient at the same time.

Let me mention one. In a co-authored paper with Lily Batchelder of NYU and Fred Goldberg of Skadden and Arps, we argue that the federal government currently provides $500 billion a year – and you heard a bit about this earlier – $500 billion a year in incentives through the tax code, for various kinds of socially beneficial activities: healthcare, retirement, homeownership, and more.

The vast majority of that, over $400 billion, is provided in the form of a deduction or exclusion, which links the size of the tax incentive or the subsidy to your marginal tax rate. People have noted that this is not fair because it provides larger tax benefits to high-income households than to low-income households. We argue that it is not only unfair, but that it is also inefficient, because unless you know that high-income households are more responsive to that tax break or they generate larger social benefits from their behavior, it doesn't make any economic sense to be providing them a disproportionately larger incentive.

Four hundred billion dollars a year is a lot of money. We could take all of those incentives and on a revenue-neutral basis, transform them into universal credits, which would be not only more fair, but also more efficient and provide a more progressive tax code, which would then provide protection against fluctuations and after-tax earnings.

So I'm going to end it there just by saying these key issue are exactly where the balance should be in this second category. I want to emphasize the sixth conclusion on Peter Lindert's slide. I think this cannot be emphasized strongly enough: the trade off between equality and efficiency is false. Many of us, and I know there are many students in the room, have been trained in Economics 101 to believe that tradeoff is true, that somehow providing any additional security and equality necessarily reduces efficiency.

Many of the key tenets behind this new Hamilton Project are dedicated precisely to taking that on headfirst. I don't think it is true; I think there are a whole variety of ways in which we can improve both efficiency and equality and risk protection, and we should be doing that. Thank you.

(Applause.)

JACK EBELER: Thank you. I have a couple problems speaking here today. One is that you have an eminent economist and historian presenting a paper, and comments by political scientists, attorneys, and economists. I'm the other guy on the panel. (Laughter.)

The second is that I come with two biases. One is that Dr. Lindert's work is extraordinarily appealing to me because it points in policy directions that I am very positive about. By the same token, over many years, I have learned to be – and try to force myself to be – very skeptical of strong analytic work that supports my personal opinions because something must be wrong with it – (laughter). I worry about playing the Washington game of "I like that study, it proves my point, now move on."

Finally, I'm here to talk about the area where our country has screwed up according to this work, which is healthcare. I'm going to cover some basics in healthcare, the messiness of the U.S. system in the analytic model that Dr. Lindert has laid out, and then propose a view of this work through the lens of what is called variations literature in healthcare, and then finally, touch on some issues for review.

The basics

The quick overview is that U.S. healthcare spending as a percentage of GDP has grown consistently for many, many decades. Those of us who derive our revenue from healthcare thank all of you for this; we appreciate the support. (Laughter.)

The U.S. spends more on healthcare than any other nation, far more than the OECD average. Our spending is not only well above the OECD median but also well above even the next highest country, Switzerland.

And as has been pointed by other speakers, we have shown that you do not have to have high social welfare spending to run large government deficits. CBO's deficit projections highlight a point that Itai made, that we have a potentially false presumption that the deficit will improve in the next couple of years under the 'current policy' baseline. But if you extend the current tax cuts and do something about the AMT, the deficit in fact gets worse. Again, this is not because we have high social spending. It is because we have not balanced our appetite for taxes with our appetite for spending, even though we have lower social welfare spending than other nations.

As is pointed out in Dr. Lindert's paper, the U.S.' higher level of health care spending is not coupled with higher health status or health outcomes, and it certainly isn't accompanied by better health coverage. The dominant source of coverage for those under age 65 is the employment-based system that, as earlier speakers noted, is in some ways an artifact of wage-price controls during WWII. That is the main source of health coverage in the country, covering more than 60 percent of the population, but it is slightly declining in recent years. Public coverage, largely the Medicaid program, has picked up some of the slack. Individual coverage has remained stable. The uninsured, those who fall in the gap between the public and private systems in our county, are a growing percentage of the population.

The US health care system

Second, let's look at the messiness of the U.S. health care system in the context of an analysis like this. It is hard to categorize the U.S. system in the clean terms of the revenue sources that Dr. Lindert talked about. Let's look at Medicare, Medicaid and private insurance.

Medicare is seen as our classic national social insurance program but it is really very diverse. We finance it, not only with payroll taxes but also with taxes on Social Security benefits for higher-income individuals. We have premiums, and we're moving to means-tested premiums, and there are subsidies for the low-income Medicare savings programs, and a much more comprehensive drug benefit with virtually no premium for the low income.

Prior panelists were talking about growth in Medicare and social welfare programs as a percentage of GDP. Medicare is the prime example of that in the U.S., consistent with what Dr. Lindert was saying. The majority of the growth in Medicare as a percentage of GDP between now and 2050 isn't because of aging; it is because healthcare costs grow faster than the rest of the economy. Aging itself only accounts for about 40 percent of the growth; the rest is due to underlying healthcare cost growth.

Medicaid, our other major public program, backstops Medicare among many other functions. It covers about a fourth of the Medicare population, and the most expensive fourth at that. It also has multiple streams of financing: federal general revenues, state general revenues, as well as whatever creative sources of financing states have been able to come up with to finance their share of Medicaid.

Medicaid is really multiple programs. About half the beneficiaries are children, but they only account for about 20 percent of the spending. At the other end of the spectrum, about a fourth of the beneficiaries are elderly and disabled, and they account for more than two-thirds of the spending. Medicaid functions as our nation's default social insurance program for long-term care.

The private health insurance market in the country is equally diffuse. We spent about $1.9 trillion on healthcare in 2004. I love using the word trillion in mixed company. (Laughter.) About a third of that, $658 billion, was private health insurance premium. That share alone is about 5.6 percent of GDP, which if counted as social welfare spending would move us substantially towards Dr. Lindert's definition of a social welfare state. Employers pay about 70 percent of those premiums; employees pay about 30 percent. And while this is a private flow of money, there is about a $106-billion tax subsidy in the form of tax expenditures, because we do not tax those employer payments as income to individuals. That is about 1 percentage point of GDP of revenue that we forgo to subsidize that private transaction. That is a subsidy that flows disproportionately to those of us who are fortunate to have good health insurance package and those of us with higher income – the higher your income, the more that subsidy is worth.

International variations, and variations within the U.S.

I want to turn now to the variations literature. There is a lot of work in the U.S. health community on variations in care and costs around the country. And I think we can look at Dr. Lindert's work, internationally, in that context. Again, he lays out the U.S. – international variations. The U.S. spends about 38 percent more on health care than the average of the next highest three countries, and about 72 percent more on healthcare than the median of OECD. This includes all healthcare spending, public and private, in these countries – so he confirms that there are enormous variations around the world.

If we look at the United States Medicare data, the Dartmouth team – this is Elliot Fisher's work – has divided Medicare up into hospital referral regions around the country. They have adjusted for all those things that one can adjust for that could be causes of underlying cost and care differences, and divide us up into spending quintiles. They find variations that are similar to the international variations. The highest quintile of regions in the United States spends on Medicare about 28-percent more than the middle-spending quintile and about 61 percent more than the lowest-spending quintile. So there are enormous differences in spending for a program where the insurance package is the same around the country.

And again, as with international variations, you ask, does that higher spending get you much? Looking at the same quintiles, we see that the quality indicators across those quintiles are at best flat and in fact trend down in the higher spending areas. So you spend 28-61-percent more in the highest spending quintile, and you don't appear to get much, if anything, for it in this analysis.

Taking it up to the state level, you see a number of states that seem to have relatively lower spending and relatively higher quality compared to states, which are spending more and getting less. Even setting aside the extremes, there is about a 30 percent spending difference among the high cost, low quality states and the low cost, high quality states. So looking at these types of variations, it may well be that the best question is not how does the U.S. get to OECD averages, but how and why do some areas and states already appear to have accomplished, within this country, levels of spending that look comparable to the levels we see in Switzerland and Germany, and with better health quality than their higher spending neighbors?

What is the cause of these U.S. variations? The key variant in this country appears to be the delivery system – the supply side. It is supply-induced demand. The high-cost, low-quality areas seem to have more hospital beds, more physicians overall, and in particular, more specialists and fewer primary-care physicians. And in a fee-for-service economic model, that yields more discretionary services in those communities, without improvements in health care quality.

Questions and issues

Lets turn now to some questions and issues that I think are interesting in Dr. Lindert's work. Is healthcare in his analysis an issue for the U.S. because it limits GDP growth, that we are simply not getting value for the dollar, or something else?

I love hearing there is no equity efficiency trade off. In this case, no is a very large number; I'm encouraged by that but it strikes me as a finding that is worth pushing at and confirming a little bit. The final question is: should we be concerned about Medicare? It does grow substantially. We spend a lot more on the elderly than on other groups in the country.

David Cutler, as some of you know, just came out with a very interesting article that finds that our spending and spending growth on healthcare in the United States has in fact produced value and, he converts that into a calculation of the cost per years of life gained as a result of the extra spending.

But even in that very supportive article about higher spending in the United States, he flags some long-term issues. We're spending $36,300 overall per year of life gained, but for those over 65, we are spending a lot more, about $145,000. And the trend line keeps pointing up for the elderly, so it is certainly worth looking at.

Also, there are four policy issues; I'll talk about three of them. The fourth is Medicaid. But I don't hear Medicaid under attack so I don't think I need to defend it today.

What do we do about health coverage expansions? There is one potential reading of a work like Lindert's that says single payer is "the" answer. That is an awkward solution in the United States where we are more likely to answer the question with some type of revised private-plus-public combination. Can we get there? It strikes me that the interesting question posed by Lindert's work is how would we finance the combination that we choose?

Given his analysis, the value-added tax is, obviously, a very attractive option to look at. I think the difficulty in this country is that the conservatives see it as a way to replace existing taxes and have probably spent it twice that way. On the spending side of the equation, liberals see it as potential new revenue and have spent it three times in fixing Social Security, fixing Medicare, providing national health insurance. So it is difficult to see how exactly we get to a decision about the VAT.

Do we really care and should we care about international cross comparisons? The main differences between the U.S. and other countries are that we have higher unit prices and revenue within the healthcare system for what we do – doctors, hospitals, and elsewhere. How do we deal with that?

And second, we have higher administrative costs – as Dr. Lindert point out, we have multiple public and private payers, a whole structure of private health insurance. And the real challenge is that those types of payers have to more clearly demonstrate value. If all we are doing is being transactions processors, one should assume over time that we should be paid as a transaction-processing commodity as we go forward. But that is a fundamental question of demonstrating value for the administrative load, or seeing fundamental change.

Finally, we have to look at the cost-quality variation within the country and do something about the volume differences around the country. Again, this appears to be a very important delivery system/supply issue and it may be a window through which we can look at international comparisons as well. And we can say that we are different than those other countries, but look at the comparable variations within the countries. Can we norm against the more efficient areas within the United States, which have achieved, in some cases, European-level efficiencies in their healthcare system?

I want make sure we end on time, so thank you very much. I look forward to the discussion.

(Applause.)

RUDOLPH PENNER: Well, coming last in this distinguished array of speakers, I won't be very original, but I'll claim my 10 minutes of fame anyway. I have been a big admirer of Peter Lindert's work since I first learned about it by reading the Economist a couple of years ago. And I do think it is extremely important work. It finally explains to economists in general, and conservative economists, in particular, how on earth the countries of Western Europe could have such generous welfare programs without paying much of a cost in foregone economic growth. And basically it's because their tax systems are very efficient. That is the main Lindert message. They are not very progressive; they place a particularly heavy burden on consumption rather than on capital, and a very heavy burden on sin.

It's not much of an exaggeration to say they tax the poor in order to give money to the poor. But while the economic efficiency costs of the systems may be low, there is change in the air. There are reforms taking place on the spending side of the budget and they are important reforms. I was a little taken aback by just one remark in Professor Lindert's presentation, and that was that deficits aren't much of a problem for welfare states, because I saw the prospects of huge budget deficits being a motivator of reform in Sweden certainly, in Italy -- which admittedly he said was an exception -- but I think also of a series of reforms in Germany.

But not all of the adjustment is on the spending side; taxes are still going up with especially big increases in prospect in countries like Italy and Germany. Now, so far the focus of the reform has been on the pension systems. I can't believe that health systems are that far behind because while Europeans start with a lower level of costs than in the United States, those costs are increasing at an unsustainable rate.

The odd man out in all of this is my own home country of Canada that has moved to partially fund their Social Security system with major payroll tax increases while only very modestly curbing benefit growth. But one of the many important points that Lindert makes is that the reforms on the pension side are not really reducing real per-capita benefits much, if anything, below pre-reform levels. Instead, the reforms are simply reducing the rate of growth of benefits below the projected growth rate of wages. That is to say, they are reducing replacement rates at every age of retirement.

I think it's really important to understand that we can do exactly the same thing in this country. Current payroll tax rates are sufficient, or almost sufficient, to maintain average real Social Security benefits for the next 30 years or so, if we reform the system soon. That is to say we are not really talking about the cutting the standard of living of the elderly. What we are debating is how much to increase real benefits as the standard of living of the working population improves.

I fear, though, that the language of the debate may unnecessarily scare people because when you talk about benefit cuts, I'm sure many people interpret that as being cuts in the absolute standard of living.

Now, maybe more controversially, I think that the same kind of argument can be made about healthcare. I don't really think there is any problem maintaining the quality of healthcare for the elderly at today's levels. The economic problem that we face steps from our totally open-ended budget that promises to fund almost any new medical procedure that comes along, no matter how expensive it may be, and with only slight regard to its benefit-cost ratio. And there is the further threat to costs if currently available procedures are demanded more widely.

So again, what I think what we are debating here is how much to improve the average quality of healthcare as technology progresses. Ultimately, despite the inefficiencies of the system that were just discussed, some kind of rationing will have to occur, and one would hope that if it is bureaucratic rationing that it will have some basis in benefit-cost analysis.

But I think that the socialized systems of the world show how hard that is to pull off politically because scientific findings are often rejected, and administratively, as the skilled and well connected are so much better than others at circumventing any rationing system that happens to be in place.

Now, part of Professor Lindert's paper, which he did not discuss today, but which I found very interesting, involved the development of tax-transfer systems in developing countries. And I think the dominant factor there is the difficulty of collecting any taxes at all, which implies great difficulty in getting high levels of participation in any social insurance program. Indeed, even a country as advanced as Italy has a major problem collecting taxes.

I once discussed this problem with an Undersecretary of Finance in Italy. I asked her about the difficulty of collecting payroll taxes in the south of the country, and she it really wasn't a problem because their offices were so inefficient, they didn't pay earned benefits either. (Laughter.) Now, I suspect if the truth were known, this problem, though slight in the United States, is not so slight as to be unimportant.

Very obviously, our illegal immigrants don't participate very extensively in our social insurance system. But other segments of the economy also have some problems. For example, our inability to collect taxes from small business is legend in this country. Indeed, the Bureau of Economic Analysis generally increases the income reported on tax returns of non-foreign proprietors by 50 percent when they compute the income side of our national accounts. So what that implies is that the small-business people are probably not accumulating the Social Security credits that they would if they honestly reported their income.

Well, going back to the basic point, I suppose that the most interesting question raised by the Lindert paper is whether the United States will follow the European path as aging and health costs continually push up Social Security, Medicare and Medicaid outlays as a percent of GDP. That is to say, are we going to invent new consumption taxes and sin taxes that impact the poor heavily? It would be a mechanism for getting the elderly to pay a share of their own benefits.

Now, one important thing, though, about non-progressive systems is that you just can't sit back and let bracket creeper or its equivalent raise tax burdens and revenues for you, while legislators do nothing. And I think that helps to explain why so many European countries are now being pressured to reform the spending side of their system. On the other hand, you would think that would be an option in a country like the United States with a relatively progressive system, especially with the alternative minimum tax bringing in a flood of revenues if you do nothing at all.

And yet, we have never availed ourselves of that option for an extended time period. I think that one of the most remarkable features of our long-run fiscal history is the stability of our overall tax burden. Maybe you can see an upward trend, but not much of one.

The burdens today are little different than the burdens at the end of World War II. In fact, there is some kind of magic law; every time the overall tax burden creeps over 19 percent, we have a big tax cut. We did that at the end of World War II; we did that at the end of the Korean and Vietnam Wars, it happened with the Reagan tax cuts, and most recently with the Bush tax cuts when the burden had been above 19 percent of the GDP for the longest period in history. And in 2006, the overall burden is likely to be almost precisely equal to the average burden over the last 30 years. To me that is just an amazing miscellaneous fact.

So I think it very unlikely that we are going to solve much our fiscal problem with do-nothingness, that is, letting tax burdens increase of their own accord. Now, it is interesting how much one hears about the possibility of value-added taxation in the United States these days both from liberals and from old-fashioned fiscal conservatives. Henry Aaron, Michael Graetz, and Charlie Walker have all discussed variants on the theme, and that is quite a diverse group ideologically. Does that mean we will go that route and emulate Western European countries?

Unfortunately, I differ from Mr. Grinberg in this regard. I'm afraid we're not going to be so deliberative as to even consider the option seriously. I think that in almost every case of Social Security reform in Western Europe, it was provoked by some sort of budget or economic crisis or both. In some cases, the budget crisis was artificial in that the Maastricht Treaty limitations on deficits provoked reforms that probably would not have happened otherwise. I think that happened in Italy and now in Germany. But in other cases, the crises were more serious. I believe that the Swedish GDP fell three years in a row before their very radical reforms.

I guess I'm a real pessimist because I find it very hard to believe that we're going to act absent a crisis of some sort, and under those conditions, I think that it's very difficult to design and implement a brand-new tax system like that quickly. It's much more likely that the adjustment will come on the benefit side with perhaps some increase in the payroll tax, which is an established tax. In the case of health programs, the easiest thing to do is to cut provider payments, not that that is real easy, but it seems to me the most likely outcome.

It is a really strange thing to say, but I think it's unfortunate that it's hard to imagine a crisis coming very soon. Things are just too good. I know people are disgruntled, but if you look at the basic facts, unemployment, inflation, and interest rates are very low. The budget deficit is way down from its recent highs. Indeed, the debt-GDP ratio is actually declining, and I expect to decline for several years, even though CPO projections are slightly more pessimistic. So it's very hard to see severe budget problems in this country until some time after the first baby boomer applies for Medicare in 2011.

Now, I suspect that if the next president serves two terms, he or she will have to deal with the issue. But it's really a shame it could not come to a head sooner. It would just be so much easier to deal with the problem without almost 10 more years of increased pension benefits and health costs. Thank you very much.

(Applause.)

MR. SPRIGGS: We can give all of our panelists a big hand because they stuck to the time. (Applause.)

I mentioned before we wanted to thank the Annie E. Casey Foundation for helping us out here. Again, so often we think of NASI and social insurance and think only of Social Security as a retirement program; people think of us as only dealing with the elderly. We heard from Professor Lindert that, surprisingly, the welfare state isn't really coming to an end, even in Western Europe. But one of the more fascinating things that we heard was that one of their big innovations has to do with how do we deal with increasing labor force participation by working mothers.

A part of the Social Security Act that the United States has not done very well at revitalizing, is probably the Earned-Income Tax Credit, which gets a lot more credit for having the positive outcome than what we actually did to readdress the problem of how that program fits within the Social Security Act.

We also heard a wonderful idea about looking at unemployment insurance, which was also part of the original act, and thinking how unemployment has changed from being cyclical to being more structural. That is, that people were now experiencing long-term spells of unemployment mostly because they have been permanently displaced from higher-income jobs, and how do we think about insuring income in those situations, and what does family well-being mean when a family suffers dramatic drops in income that affect the long-term ability of the family to invest in itself.

So, there are a number of challenges. And then, of course, we heard a number of ideas about where one might get the money in order to either fund the transformation or clearly, as we talked about towards the end, what do we do about the problem that the whole nation faces, not just the government, not just Medicare or Medicaid, but how does the government and society respond to the rising costs of healthcare.

So there were a number of challenges that were raised there, and so now it is your chance to ask some questions and so please raise your hand, and then if you want to direct the question, that would be helpful. We have a mike there and we have a mike there. So if you could go to the mike so we can pick up the question.

Q: Two hours of sitting – (inaudible, laughter).

MR. SPRIGGS: Maybe what I should have done is say everybody stand up and stretch or something. (Laughter.) We had you too disciplined.

Q: I'd like to follow up on the point that – I would like to follow up on the point that Bill just mentioned about assistance for child raising and for working mothers. One of the major newspapers just in the past two days had an article suggesting that workers who don't have children are in some cases complaining that they are not benefiting from provisions that are helping working families, and that to some extent then, corporations are responding by figuring out ways to help the single or childless folks. That is all very well and good, but doesn't that seem to undo the purpose of trying to help working families and how can we develop some sort of a viable method of helping families without getting childless folks up in arms over it?

MR. SPRIGGS: Kimberly, did you want to try and take a stab at it?

MS. MORGAN: Yeah, I can address that question. I think in the European context, one rarely hears that complaint. I have heard that complaint a lot in the United States. But I just think because the welfare state is so encompassing, and so many people benefit from it, that the sort of zero-sum tradeoffs that are perceived in the U.S. often around these kinds of policies are not the same. People wouldn't be as jealous of parental leave benefit that somebody else is taking advantage if they are also getting supports from the welfare state, you know, health insurance, other kinds of supports, housing assistance, and so on, which is all much more widespread in these welfare states. So I think that really kind of undercuts that kind of movement.

An interesting thing that has happened in one country in the Netherlands, and I think it's spreading to some other countries, is the idea that we should think about these supports for workers with children as not just something for workers with children, but benefit everybody. So in the Netherlands, for example, every worker has the right to work part time and to still get the full compliment of benefits and possibilities for advancement in a firm. And that is seen as a way to not only help working parents, but to say that everybody would like to have a more balanced life, would like to have more time, would like to have more hobbies and so on.

And that idea is something that has really spread, the idea of a six-hour workday, or just the right to work reduced hours and not be penalized in the workforce. That is an interesting example of how these kinds of policies can be spun to appeal to everybody.

MR. SPRIGGS: Peter Lindert, did you want to fill in on this? You did a comparison between the U.S. and other countries on health, where clearly the U.S. has privatized that risk. We have totally privatized the risk for children, whereas in other countries, the family allowance was already a part of what they considered to be the welfare state. So what are other ways in which one might think about our privatization of all-income family risks to children (unless their parents dies or becomes disabled) versus the more advanced way one might think about the way that children are incorporated in the welfare state?

MR. LINDERT: I would like to get on to hear still more questions, and I like Kimberly's answer, so, Bill, I'll just give one short-hand, kind of general response to the great question that you did raise. You raise a whole set of questions.

America is an age trap in terms of its benefits. And Medicare and the way we worked in 1965 and since is kind of a culprit because when you compare Medicare with a system in which there is universal health coverage not specific to an age group, as ours is, what you begin to realize is that our system so jacks up the costs of supporting the elderly that the price of prescription drugs are raised still further for anybody under 65. It raises the cost of physician's services in general, and implicitly it could probably work out that relative to a system where everybody had kind of a similar access in all age groups to healthcare, Medicare has raised the infant mortality rate, for example.

MR. SPRIGGS: I know we have to have questions after that statement. (Laughter.)

MR. ORSZAG: I'm not licensed to practice politics. But it strikes me that there is an important difference between the debate surrounding workplace rules and benefits, and a variety of other ways in which we imperfectly and incompletely do provide subsidies to families and children, including through the tax code. You don't hear a lot of – at least I don't hear a lot of complaint about the child credit being expanded from single people without kids saying why don't I get it.

So there is something particular about that setting – it strikes me that sort of raises the salience of the tradeoffs that I don't fully understand although other people who know more about it fully do.

Q: I have heard a lot about benefits to families, mothers who are working. So I just wanted to raise the point about families who are taking care of the elderly, the other end of the age spectrum. And I wondered if you had some comments about dependent care tax credits for adult daycare or families who are taking care of elderly or disabled persons who otherwise would be in an institution. If you have comments on that, and how Europe handles those issues as well.

MS. MORGAN: Well, I think it has been a trend in Western Europe that more and more countries are adopting either social insurance programs or other types of supports, perhaps through the tax code, to help families with the burdens of long-term care. Germany, for example, enacted a social insurance program early in the 1990s that basically added to their health insurance system support for long-term care, both for nursing home care and home care, and even also provided a benefit for people staying home, disproportionately women, but also men leaving work to take care of aging relatives.

I think this is something that has gained attention in Western Europe. I think the childcare issue has probably been a little bit more on the political stage and gotten a lot more attention, but I do think there have been efforts to really shore up that side of the welfare state and to address that problem.

Q: I'd like to ask Professor Lindert to expand a little bit on what it is about the American higher education system that he thinks is right. We have a lot of schools so there is a lot of competition there, but we finance it in a way that seems to put an awful lot of the burden on the students. So far, we have maybe higher fractions of students still going to school, but yet there is a concern about the incidence of participation. And so are we better off in all aspects or just some of the aspects of the structure of that system?

MR. LINDERT: Every system could stand to be reformed to some extent, and that includes ours. But the Americans are the least bad on the higher-education front in this sense. Ask yourself what share of the cost of higher education families and students should pay. I wouldn't think that would be zero because they get the earning power and a large share of the benefits of their learning will accrue to them, and so it should be some significant positive share.

What you see too often in other countries – Japan has this problem, Western Europe, Latin America, which I have been reading about recently on higher education – they have the problem that what you have got is absolutely free university, where the taxpayers pay for all it, combined with almost a civil-service approach to the faculties and things. So the faculties have a particularly soft secure life, even more than primary- and secondary-school teachers in many of these universities.

And the benefits of the absolutely free university system – Britain is slightly changing toward us, but others are still very free – accrues to what kind of people? Well, people who pass the exams and do really well on the entrance-into-college exams. That is not equality. And you could have spent that money in many other ways.

When I talk about these issues for Latin America, it is obvious what I mean – or India. They have illiteracy. Why are you giving the wealthy classes this free ticket to the university when you haven't solved basic primary education? I can't give quite as stark a statement about Europe or Japan, but I think you see where I am heading. The family should pay some large share of the cost of the higher education. Primary and secondary I, like, by the way, Milton Friedman, Adam Smith, Thomas Jefferson, and others say, not the same; let the taxpayers pay for all of it. It's a different case.

MR. SPRIGGS: Peter, you had – the other Peter had something –

MR. ORSZAG: Yeah, I want to make just two quick points about higher education, given the context of the discussion that we have had.

First, a lot of people know that the return to education has gone up significantly over the past couple of decades. I think there has been less attention paid to the fact that the return to education has also become riskier; that is, the average payoff has gone up, but the spread has also increased markedly, and that I don't think has received enough attention.

The second point is I think our system of financing higher education in the United States is under very significant strain primarily because three-quarters of students attend public universities. State governments have historically been the primary funders of public university, and state government budgets are increasingly under pressure because of Medicaid. And there is a lot of evidence about money being crowded out from Medicaid into higher education subsidies.

The problem comes that since those subsidies had played such a large role historically, you cut them by 20 percent and you need to raise tuition by 40 percent to make up the difference. State governments have not been willing to do that. And so what has happened is that spending for students at public universities has plummeted relative to private universities at top-tier public and private universities. Twenty years ago assistant professor salaries were about the same. Now they are 10- or 15-percent lower at public universities.

I think you can live off of that for a while, but ultimately the system of financing higher education for the majority of college students needs to be reexamined.

Q: Many states and local governments fund their services using the sales tax. And I guess my first question is what impact would the VAT have on local and state government use of sales tax? And maybe a supplemental question to that would be have any of you looked at and compared the U.S. federalist system to European states that don't operate with the same kind of inter-local competition, particularly as it relates to service provision.

MR. PENNER: I think there is a big difference between state sales taxes and value-added taxes. And that is that state sales taxes are typically on physical goods, and very often, exempt services. And as a result of that, they are eroding; they are not keeping up with the GDP as services expand. So in a number of states they have had tax commissions that actually are toying with having real value-added tax, which has the advantage that it will keep up with state income.

MR. SPRIGGS: Itai, do you – no, Itai, did you want to –

MR. GRINBERG: And you raise a very important question, which is, how does one integrate that with a sales tax. And that is a genuine challenge, but it can be overcome. Canada actually has done a remarkable job. That was the subject of serious debate in the late '80s in Canada and basically it works. You can also create incentives for the base of the sales tax and the base of the VAT to move towards one another, similar to what Rudy is describing because sales taxes have relatively narrow bases, and tax-base harmonization is actually incredibly helpful for administration and enforcement for the state, so there are real advantages for states to move in that direction.

And so while there are challenges to be faced, the experience in Canada and just a sense of the kind of revenue gain that states can see by moving in that direction suggest that it is possible.

Q: I recently saw some very interesting OECD data on social expenditures, indicating that the tax burden between the U.S. and the welfare states of Europe is really not that different because the welfare states clawed back, so speak, a lot of their taxes from the benefits they are providing. I don't know to what extent this is really the case or to what extent the U.S. could reap some tax revenue from the benefits that it is providing. But it clearly suggests that the Europeans are getting even more bang for their buck than the panel indicated.

MR. LINDERT: She is referring, I believe, to these claw-back studies that the OECD did about six years back. And here is what that means. The people doing these studies correctly point out that you pay taxes on many of the benefits you get in the high-spending welfare state countries. Like, you would pay taxes just on even welfare and unemployment compensation, things like that. It is sort of surprising to an American that you would turn around and pay it back again.

But I'm afraid that their interesting result that we were not that different is overstated because I believe they did accounting conventions that went something like this: they say, oh, for pensions, which is a big item, the Americans don't actually get taxed on that part of their paychecks, whereas in many European countries you do. But if I'm following the way those calculations were done, they are missing the fact that you are going to pay it later in life at the benefit phase. And so the Americans are clawing back about the way the others were.

I think – I was first struck by that too, and in some early manuscript drafts, I started to make that point, but then I backed off because I am in doubt about the way they actually did the numbers.

MR. SPRIGGS: For Peter Orszag, in looking at the way we do unemployment insurance, have you explored our decision to actually tax unemployment benefits?

MR. ORSZAG: Well, whether to tax a particular transfer is complicated. One attribute of taxing it of course is that in a progressive income tax system, you make the net benefit more progressive because for higher-income recipients, they are going to pay back more of it in tax revenue. That is actually operable in the Social Security system where benefits are partially taxable and will become increasingly so over time because the thresholds are not indexed for inflation. I don't have a universal answer to give you, but obviously that is one important attribute of the decision whether or not to tax a benefit.

Q: It's pretty well known that minimum wages don't keep up with GDP growth. The history in this country of the minimum wage is one that is haltingly increased on an ad-hoc basis and usually doesn't keep up. In addition, wages in general at the lower part of the income distribution don't keep up with GDP growth. And furthermore, income needs, as defined in minimum terms, by the population also don't – well, they do as a deferent of norms, they do keep up with GDP, but we seem to have a very big problem in increasing our standards of need at the lower end. Would anyone care to comment on these facts?

MR. SPRIGGS: Peter?

MR. ORSZAG: Sure. First, it's not necessarily true, that for example, low-income wages or earnings or incomes don't track GDP. They have in various historical periods and have not in other historical periods. And I actually think that one of the central puzzles that we face in the U.S. today is this significant disconnect between productivity growth and median real wages or median real family income.

The economic students, you know, are taught to think that productivity and real wages or real income should track each other very closely, and that is not what is happening in the U.S. economy today. Why that is not happening I think is one of the central challenges of the day, and should be the subject of sort of more exploration – well, it's now receiving increasing policy attention, but it's obviously a huge issue.

You touched on a variety of other things, including the minimum wage but for the vast majority of the population that disconnect is, frankly, more important than the minimum wage, even though the minimum wage is obviously also important.

Q: I'm a student from the Howard University. And one of the basic things that interests me has to do with this important question, which I think should be addressed. What is the importance of these social and health insurance policies to young people, including students, because I hear a lot about old people? And how can young people be involved in these programs?

MR. LINDERT: Suppose we were thinking of the young person just a student, not yet with family and children. In this case, the healthcare issue is an issue for which you have less immediate concern than anybody else because you're in the healthiest phase of life. It is not going to hit you. Now, have a kid – (chuckles) – and that is a different matter. And that is what I was referring to in my statement about infants.

Basically – different healthcare systems – not ours, but other healthcare systems in the rich countries spend relatively more on just basic preventative outpatient care, prenatal and all of these kind of simple, almost ground-level things – are you sure you are getting a checkup, et cetera. And these are lifesavers for infants and for others under 65. That is America's relative disadvantage. We don't do that as well. So I think the best answer would be that if you're just a healthy 20-year-old, the wolf is not at your door at the moment relative to other people, and that is why the elderly are talking about it so much. But for America, we have this problem that we have relatively undervalued broad simple preventative healthcare for the young, especially for infants.

MR. ORSZAG: How many people are from Howard here? It looks like there are – there we go. So for all of you who have really bright futures, which you do, you have to realize that there is – I know people don't like to hear this – but there is unfortunately some risk associated with that really bright future. You could get sick. Lots of things happen in the course of life that you don't anticipate now, and social insurance provides a backstop to you that you might not appreciate until it's too late, but believe me, when that stuff happens, you appreciate it like you wouldn't believe.

For example – and I hate to be the bearer of bad news – but you folks who are in college now have roughly a one-third probability of becoming disabled or dying before the retirement age of around 65. It's a non-trivial risk of two major threats to your well-being, obviously dying being a particularly extreme version of that. (Laughter.)

Similarly, your career looks like it will turn out well now but it may not. The Social Security system provides a form of earnings insurance to you that you can't buy on any private market. If your career doesn't turn out as great as it now looks, Social Security, because of its progressive-benefit formula, will partially make up the difference, and you can't buy that kind of earnings insurance.

And I could keep going down the list – but there are a whole variety of ways in which a system of social insurance provides you protections that you can't buy on private markets and that you might not value right now, but if bad things happen you will learn to value quite heavily.

MR. PENNER: I think there is another risk for the young, and indeed even for the middle-aged, that really has to be discussed, and that is the risk of what happens in this fiscal train wreck that is coming if we don't reform the program. So in terms of planning your own future and retirement, I think it's extremely difficult to know what you should think about all of this. We do see polls that suggest that numerous younger people don't expect Social Security to be there at all. Now, that is clearly wrong because as I noted, there is no problem keeping it at the absolute levels it is today. But what will it be? And this is yet another reason to try and resolve these problems as quickly as possible just for the simple fact of allowing more rational planning on the part of younger people and middle-aged people.

MR. SPRIGGS: Jack, did you want to comment briefly? You had a very interesting stat that people inside the debate know very well, about the disparity in Medicaid between the share of participants who are children and the actual cost that children are to the program. That is an unusual disparity that I don't think a lot of people know or think through the implications. Did you want to expand on that a little bit in terms of why younger people who are soon going to have to worry about issues of children should care?

MR. EBELER: I think it's been touched on. Young adults in this country are the group that is statistically most likely to be without any health coverage at all. And you enter that risk category. That is because this is a group of people that has fallen in the gap between our public and private programs, and also because young adults typically mistakenly think of themselves as immortal, so question why they might need insurance.

Medicaid, again, I think Peter touched on. We want to have, and we do have very promising lives, but sometimes things don't work out every year. Medicaid really is the backstop for an enormous amount of care for children in this country. The truth of the matter is providing healthcare to children is cheap, with high cost exceptions that I hope your families never encounter.

But it doesn't cost a lot to provide a very good benefit package to a lot of children because for the most part it is well-baby care, and treatments of colds, and things like that. There are of course enormously expensive neonatal care needs out there. But you can provide coverage to a lot of children for little money.

In contrast, when you provide health coverage to someone, whether they are middle age or elderly, even the exact same benefit package, that person is more expensive because they have higher health needs. And when you get into the Medicaid side of long-term care, the needs are greater and it gets much more expensive per person. But again, many of us advocate covering all kids in part because it's a relatively low -cost transaction.

MR. SPRIGGS: Okay, another question?

Q: I wonder if the panelists could address the issue of political culture. When I have been to Europe to talk to European experts on social policy, I'm really struck by the European construct of social solidarity, which is something that seems quite foreign to Americans. For example, among the myriad reasons why it's impossible to imagine George Bush as the leader of a European country, it is his championing of the privatization of social risk that is hard to imagine any European leader doing. So I wonder if we could talk a little bit about that political culture, and how it interacts with the possibility of having a more robust and equitable welfare state.

MS. MORGAN: Yeah, certainly the phrase social solidarity is one that is very commonly used in the European social policy discourse; that is absolutely the case. Whether or not that is cause or consequence of these welfare states I think is an open question.

I mean, the fact that these are universal welfare states that encompass everybody, really treat everybody as part of the same community, what the Swedes call the same people's home – it's how they refer to their welfare state – one can think of that as really kind of constituting and reinforcing this sense of solidarity and the sense of connection between people. The idea is that everybody shares the same basic risks in life and that we might as well all share the costs and pool those risks across the wider society. Some people would probably say that was, in fact, part of what created these welfare states in the first place.

I think an important difference to keep in mind that is more of a political difference than maybe a cultural one has to do with the ideologies of the political parties in Europe compared to the United States. This is true historically and true today: in addition to having strong social democratic parties linked to trade unions, which are currently and always have been much more to the left of our own Democratic Party, European welfare states were also very much shaped by conservative or Christian democratic parties that differ from social democrats, but never really espoused the kind of free market ideals that have so strongly influenced politics in the United States.

So you don't have the same kind of emphasis on and attachment to markets and private actors, and nor has that been very strong through much of the 20^{th} century. That really influenced the growth of the welfare state, this kind of consensus around the role of the state in the economy and therefore in providing for these various social risks that people face.

MR. ORSZAG: I actually had a question for Kimberly. Some people throw around the concept that there is a significant difference because of ethnic and racial variation, Europe being more homogenous, the U.S. being more heterogeneous. Does that have any legs in the political science literature?

MS. MORGAN: Absolutely. Yeah, I think a lot of people would argue that racial, ethnic and religious divisions have also been part of what has fragmented a sense of solidarity in this country. We have a lot of divisions that potentially fragment the sense of community that we might have here that are not evident in a country like Sweden, a lot of other European countries that are much more homogenous. So many people would say that that has been part and parcel of it.

And the question people pose today is whether or not the growing heterogeneity of European societies is going to have some kind of impact on this sense of political community. That is really an open question because it is absolutely true that European societies are coming to look a bit more like the United States in terms of their diversity.

MR. SPRIGGS: Well, we have come to 4:30. You can have the last question since you stood up – (laughter) – but this will be the last one.

Q: I think it was Mr. Penner who spoke about maintaining Social Security benefits in an absolute sense, and that then there wouldn't be a problem. I would argue that there would be a problem in terms of need. If standards of living go up with GDP, the wage indexing ensures that the initial benefit a person gets at retirement is commensurate with the wage growth during his lifetime, and I just wonder whether you really think that feature of the program should be eliminated.

MR. PENNER: Well, when I said it wasn't a problem, I meant it wasn't a fiscal problem. (Laughter.) You're raising the core of the debate. I think for long periods of history, we did let Social Security erode relative to other living standards; it is a question of values as to how much of a sacrifice you want the taxpayer to make to keep the benefits up with the growth and the wages of the whole economy. And that is a debate they are having in Europe. And in Europe they start out typically with much higher replacement rates than we have, but they haven't felt compunction to keep them there. Regardless of what their level is, they are eroding I think in most European countries.

MR. ORSZAG: One exception is the United Kingdom, which has moved its basic pension to a price index, one that would just sort of keep the real value constant. And there the debate has really shifted to the one that you pointed out, which is an adequacy one, that over time the replacement rate falls and do you wind up with an inadequate pension system as a result.

MR. SPRIGGS: You wanted to say something.

MR. LINDERT: I think that Rudy and I would be very much in agreement on the need to look for just maintaining or even just slightly improving the absolute standard and not keeping them up with the general advance of wages. How do I mean that? I mean, suppose that the share of people who are elderly stays fixed forever. There is no inherent budgetary problem with having elderly benefits keep marching up with the wages, and just be defined as rising needs for a better, more prosperous and civilized society. But you know what is happening. There is going to be twice as many elderly per young person, per wage earner, and that has to give unless you just think that you can march the tax rate up over time. And I just think that is going to be very difficult.

So I think, especially for other countries, and less so for the U.S., you have to pay attention to formulas that shy away from the wage indexing toward cost-of-living indexing and keeping that absolute standard.

For the United States, we don't wage index now for the whole system; it's basically at the very bottom that we do that. And if you were to say get rid of the basic, right –

MR. ORSZAG: No, no.

MR. LINDERT: You would do it for the basic.

MR. ORSZAG: No.

MR. PENNER: Wage index currently applies to the entire system. Until you claim your benefit at retirement and then it's price-indexed thereafter.

MR. LINDERT: Oh, okay, I had thought otherwise.

(Cross talk.)

MR. PENNER: That is what the administration toyed with but they didn't –

MR. LINDERT: At one place the administration had about three different versions of this plan, but at this point, they did want to even cut the base component and make it not be a wage index. Maybe I was reacting too much to that. But, you know, if we were to take the point, as Peter and Rudy have just said, if the entire system were wage indexed, something has to give. That is just explosive in budgetary terms. There are graphs on who is gently changing things or not in the long paper version of what I presented, but as long as that age share keeps going up, you have got to make some kind of adjustment to keep the adjustments being what they have had in the past, which is sensible things that have not cost as GDP. So far so good, but there would be a danger here if you didn't back off a little bit on the growth rate of those pensions.

MR. SPRIGGS: Did you want to say something, Peter?

MR. ORSZAG: Me. No. I'm done. (Laughter.)

MR. SPRIGGS: Okay, it is 4:30; you have been an excellent audience; you have stayed seated through all of this, and so we do appreciate all of the wonderful questions. And we want to thank the panelists again. Thank you very much.
(END)