Serena Allen:

Welcome to the Policy Paycheck. My name is Serena Allen, thanks for tuning in. The Policy Paycheck was born from the idea that all people should have access to factual and relevant economic evidence about the most controversial policy topics we hear about every day. While our intended audience is American high school civics classes, even policy experts may learn something from each episode. Ideally, listeners like you will walk away better informed to not only discuss, but also form your own opinions about the policies as taxpayers we already pay for today.

Today, guest Edward Kleinbard and I will talk about taxation. Kleinbard is the Robert C. Packard Trustee Chair in Law at the USC's Gould School of Law, and a Fellow at The Century Foundation. He was honored as 2016 International Tax Person of the Year by the non-partisan organization Tax Analyst, and is author of, We Are Better Than This: How Government Should Spend Our Money. Before coming to USC, he was Chief of Staff of the US Congress's Joint Committee on Taxation. Awesome. Great to have you today.

So today we want to talk a lot about taxation and I think for a lot of years, that can be a super daunting topic. So we're going to try to simplify it as much as we can, and it might get a little bit complicated, but we're going to do our best for the listeners out there. So to start off, we just want to go and talk a little bit about taxes themselves before we talk about really where they go. So what kind of factors go in to how you decide or for how much you pay? So if I'm a high schooler who's about to pay my first round of taxes, what am I getting taxed on? How does it fluctuate?

Edward Kleinbard:

Well, if you have a job, you're going to find yourself paying two important and different federal taxes. First, from your first dollar of income, you're going to be paying payroll taxes. You won't be writing out a check because it's just taken out of your wages, but those payroll taxes go to fund your eventual Social Security benefits, Medicare benefits, other healthcare benefits. In addition, if you earn enough money you'll become a federal income tax payer and you'll join about 150 million other tax returns paying an income tax. It's separate from the payroll tax, but the base, the amount on what you pay tax for somebody who's just earning wages at a job is pretty much the same.

The difference is that the income tax gives you as a single person, a $12,000 for the free income on which you pay no income tax and then above that, you start paying income tax at what we call graduated rates. So your first dollars after the first 12,000 are taxed at 10%, and then if you earn more and more each layer of the cake gets taxed at a higher rate. The bottom layers tax rates don't change, but the subsequent layers do all the way up to the 37% layer of tax if you're fortunate enough to be earning more than half a million dollars a year.

Serena Allen:

Right. So if you're making under $12,000, let's say I was a summer lifeguard, I made $3,000, they still took the money out of my paycheck, right?

Edward Kleinbard:

That's right, because they don't know how many jobs you have.

Serena Allen:

Oh, got you.

Edward Kleinbard:

You could have six short-term jobs.

Serena Allen:

Right. So if I still filed my taxes then would I receive money back most likely?

Edward Kleinbard:

Exactly you would get a refund, not for the payroll taxes, unless you've ... Well, payroll taxes are a little bit complicated but if your total income is under $12,000, you file the income tax return and you get a refund. What's more, if your income is at the low end, you'll qualify for the Earned Income Tax Credit, which is a big word, the EITC, but it's very important. It's very important to low income families because it's designed ... the catchphrase is that it's designed to make work pay. It's designed to make it more attractive for people to enter the workforce at the bottom on the theory that they'll work their way up to the top.

So for lower income Americans, their earned income tax credit not only can reduce any tax liability you have, say above, if your income is above the 12,000, but you can actually get a refund of taxes you never paid, in fact get a subsidy from the government. Now, the EITC, which is very important for working families is not so important for working teenagers in general, because it is very kid focused. So if you're a single person with no kids, the EITC is not very large, but it's something and for a family with kids, it can range up to a five or $6,000 in cash in your pocket.

Serena Allen:

Definitely. Yeah. I know a lot of my friends, my freshman year of college had worked over the summer and didn't file their taxes and so they lost 300, $400. So I'm sure that for families, it's even a larger sum.

Edward Kleinbard:

Yeah. You save $1,000 of the EITC. So you have these two things going for you. You have $12,000 standard deduction it's called where you pay zero tax as a single person, 24,000 as a married couple. On top of that, you have the EITC for lower income levels.

Serena Allen:

Wow. So what I'm hearing is, listeners should file their taxes definitely, especially at this age.

Edward Kleinbard:

Listeners should get into the habit of filing their taxes because it's a crime not to, and it would be a shame. It would be a block on lot of future career paths to have that as an open issue.

Serena Allen:

Definitely. So after they tax all of the American population, where is that money going?

Edward Kleinbard:

Well, the money flows obviously into the US treasury, into the federal government, but really you need to take a step back and recognize that taxes are the way all of us together fund projects that all of us have decided to pay for. Government is not separate from us, it is simply the mechanism by which we all collectively act. So federal taxes go to the US treasury and from there, money is spent in accordance with the spending priorities that Congress has set. Congress controls the purse strings of the federal government, Congress sets the spending, and Congress sets the tax rules.

So if you are angry about taxes, don't blame the IRS, blame Congress. So money comes in, right now for 2020, just to give you a sense. Tax revenues, total tax revenues will be on the order of $3.6 trillion, trillion with a T. So that's $3,600 billion of tax revenues coming in, which sounds like a pretty big number. The only thing bigger that I can think of is that the spending for 2020, government spending will be $4.6 trillion, so that we will spend $1 trillion more in 2020 than we take in tax revenues.

Within that 3.6 trillion, it's pretty easy to break that down. It's about half of that say 1.8 trillion is from the income tax that I just described. And again, the income tax is not very important to most teenagers, unless you're a very fortunate one. But the income tax becomes quite significant as your income goes up. Then about $1.4 trillion in these payroll taxes that I described eventually translate into Social Security and Medicare benefits and the remainder, there's a tax corporations pay, a corporate income tax separate from the regular income tax. Then there's some, this is and that is, that add up to about 3.6 trillion in tax revenues.

Serena Allen:

So where's the other $1 trillion, where are we getting it to spend?

Edward Kleinbard:

Excellent. So the answer is we borrow. So when you hear about the deficit reaching a trillion dollars, what that means is that we're spending more than we're taxing, and the difference has to come from somewhere because in fact governments writing out checks. So in effect it's like the government using a credit card and racking up a credit card bill that they can't pay down at the end of the year, and that $1 trillion is financed by going to investors, including individuals in the United States and saying, "We'd like to borrow money," and the government issues treasury bonds, which are just debt, promises to pay with an interest rate to fund the deficit.

The result is that over time we've run deficits basically every year in the modern era, except at the end of the Clinton Administration. So the total debt outstanding at this point is on the order of 16 or $17 trillion of debt that the government's racked up which is a nice way of saying that we are ... our spending levels are systematically exceeding our tax levels. To my mind numbers like 3.6 trillion and 4.6 trillion are incomprehensible, they mean nothing to me.

Serena Allen:

Same.

Edward Kleinbard:

I think that's probably the same for a lot of your listeners. So I like to try and scale those numbers by looking to maybe three metrics. One is how much does the country make? We tax ourselves 3.6 trillion. So we in effect as a country, all of us acting together have agreed to reach into our pockets and set aside $3.6 trillion in 2020 for federal programs that our Congress on our behalf has chosen. So the first question ought to be, well, how much money do we make as a country? There the most usual number that's used is dross domestic product. GDP, and for 2020 GDP will run about $22 trillion a year. So that's an effect for our purposes today, how much income the US economy as a whole has created. So 3.6 trillion is a lot, but it's I think about 16.5% of 22 trillion, which is the overall national income of the United States measured by GDP.

So that's one way of looking at things, and it's very important if you get into this and you want to become an honorary budgeteer, I think they like to call themselves, to not think so much in terms of numbers because they're meaningless, but percent of GDP. So when I say that we're tax at 3.6 trillion in 2020, another way of saying that is, well, we're going to pay about, I think I said 16.5, 16.4% of GDP in taxes. So that then enables you to ask the question, well, how does that compare to earlier years? Is 16.4% high tax or low tax? The answer is its very much at the low end of what the federal government has collected over the last 50 years. So by looking at things in terms of percentage of GDP, the numbers start to make a little more sense, and you can get comparability because of inflation across different years. Just by virtue of inflation, taxes go up, total collections go up and so on, by looking at percentage of GDP, you get a better sense of historically, where are we.

Another way of looking at things that I think is terribly important and I've tried to emphasize in my first book, We Are Better Than This, is to benchmark the United States against other rich countries. So are we a low tax country or a high tax country? I know what we think we are. We think we're a very high tax country and we whine. We are the number one country in the world at tax whining, but that's not exactly the same, and it turns out believe it or not, including state, including local United States is a low tax country compared to our world peers.

Serena Allen:

Wow. That's very interesting. I think that's really sums up well up, there's kind of the simpler end of taxes for to set a baseline to talk about. I want to talk about something that's often viewed as non-partisan, but really is because it's just simply some facts. But there's this great video and I'll link it on our website for listeners to view and it's called Wealth Inequality in America and it's from an organization called Politizane. In this video they explain basically the wealth gap, and they say how a CEO makes 380 times more than their average, not their lowest employee. The average worker has to work for a month to make what the CEO makes in one hour only. So this is kind of an insane wealth gap, and if you want to know more about that, go ahead and refer to the video, but how did this wealth gap happen?

Edward Kleinbard:

Well, I'd say also, if you want to know more about this drilling down with a lot of the numbers, I modestly suggest that the book We Are Better Than This, goes through this in great detail.

Serena Allen:

Definitely.

Edward Kleinbard:

It turns out that how you measure inequality, whether it's income inequality, or wealth inequality, how you measure inequality keeps hundreds of economists arguing with each other around the clock. So there's a range of views about how to measure these things but the basic facts are clear that the United States has, as you just said, very big inequality. Whether you look in income or wealth, and wealth inequality always is worse than income inequality, because you need a high level of income before you can save anything.

So you don't have any wealth if you're spending all of your income. So wealth inequality is even more concentrated than income. I think that the top 1% of wealth holders controls from memory and I hate to rely on that, about 30% of the country's wealth. It's just extraordinary how concentrated wealth is. When it comes to income, like the difference between the CEO and the average worker that also is a very high gap and it's grown. There's no question about it.

Inequality is very large in the United States and inequality has grown. Inequality has grown from the top end. That is the top end is running away from everybody else. That it's not that the bottom end has sunk into feudal serfdom. So the top end is running away. Why is that? Well, nobody has a perfect answer, but I think there are two clusters of answers that I find compelling. The first goes back to the fact that we're a low tax country and you can sum it up in different words.

One is to stress how much we rely on the private economy, on the market economy and how much we dislike any kind of government intervention, and I call that the market triumphalist view of the world. So whatever outcomes come from the market must be good outcomes because that's what the marketplace produced and therefore we should not interfere with them. So the market triumph is a very important way of thinking that infects a lot of people.

The second, very interesting hypothesis is tax rates used to be allowed higher at the top end. When I first started practicing law many years ago, the top tax rate was 70%. Now, it's 37%. In 1986, it was reduced all the way to 28%, and so the theory has been that when tax rates came way down for individuals, they became a lot more interested in trying to grab whatever they could, because they got to keep most of it. If you earn $100 and it's taxed at 70%, we only keep 30. Well, if you earn $100 and it's taxed at 30%, you keep 70, and so the motivation to use whatever levers you have to collect more money became much more powerful.

There is finally a connection with both of these, I guess. So a theme that along the market triumphalist lines that the market takes care of its own and CEOs can negotiate whatever they can get away with because in theory, shareholders would object and demand that the CEO be fired. But as we talk a lot about in law schools, the governance, how corporations are governed is really of a disreputable business and corporate governance and the abandonment of norms as to how corporations would conduct themselves also explains a lot. You see this in a completely different context in 2020 in some of the statements made in the impeachment process, or just the conduct of the president.

You see what had been norms, that is nothing official, but just the way people behave, when those norms are broken, there is no safety net, so the same thing with executive salaries. Once the norm of restraint is broken, then all hell breaks loose, I guess one kind of interesting insight. One of the ways CEOs managed to ratchet up their pay over the last few decades has been through a little bit of a game with compensation consulting firms. So the compensation consultants get hired by the board of directors, the people who run a corporation, and they say, "How much should our CEO get paid?" And the consultants say, "Well, she's a little bit underpaid. You should increase her salary."

Okay. Then the same consultants get hired by the next company, and the consultants say, "Well, look what she just got. Your guy should get even more," and so the consultants go around and around in a circle so bidding against themselves to egg up the salary of the CEOs. The role of the compensation consultant, it sounds like a little bit of a joke, but in fact, it was one of the mechanisms by which CEOs justified their ever increasing salaries.

Serena Allen:

Interesting. Yeah. So it's not necessarily even coming from ... it doesn't quite seem like it's really anyone's fault. I think a lot of time when we talk about the 1% or the rich, a lot of people have a very negative view of who these people are. It seems in some ways that they're being paid based on what someone else is telling them and it's not really anyone you could pin down as the culprit, but rather government's job to check in and to make sure that it's a more fair system and that's really what government should be doing and has been failing at.

Edward Kleinbard:

Well, exactly, exactly. This is a really important point. I don't think that you can run a country on the basis that people shouldn't be greedy. Yes, that's true. If they had good mothers, they wouldn't be so greedy, but none of us listened to our mothers, and so we are greedy and we just have to accept the fact that, that's how people are. Norms held people back because they would be shamed in the old days if they were viewed as excessively greedy. Once those norms dissolve, then you need to ask, well, what is going to restrain this kind of behavior?

Corporate governance in my view is a systematic failure and the answer everywhere else in the world is government through the tax system. My favorite example is Germany. Germany has about the same level of inequality in incomes as the United States does. When you just look at market income, what people actually earn pre-tax, after tax and after government programs, Germany has much less inequality, much less inequality in take home pay, in the way people actually live.

Part of that is norms, again, that sort of self-regulate behavior at the top, but mainly it's the role of government. The short answer is that the United States, take a recent example. The United States raised about 26% of GDP, of national income in taxes at all levels, federal, state, local. Germany, similar economy, market-based economy, market success of an economy, Germany raised 36% of its GDP in taxes. Well, that extra 10 percentage points can be applied to an awful lot of government programs, and as I keep emphasizing in my book, government spending really changes people's lives.

It is why we call it progressive in a sense that it benefits poorer citizens more than richer citizens. So the reason that Germany ends up with a more equal society is because it allows a larger role for government to fund programs that are helpful to all citizens, but which disproportionately help those with lower incomes, like free college for example.

Serena Allen:

Right. Definitely. I think that this is something a lot of people pick up on. It brings me to our question of this episode from our high schooler, and this is coming from Elliot [inaudible 00:22:58], and he goes to Christopher Columbus High School in Miami, Florida. He's talking about exactly what you're saying here that the United States is one of the most advanced countries in the world, but there seems to be significantly less social programs like universal healthcare or free college for citizens in comparison to other nations, such as those in Europe and Germany, like you just mentioned. Why do we not allocate our taxes to these priorities? What's different about America, where we just simply seem to not care about these more progressive mannerisms of doing government and taxation?

Edward Kleinbard:

Well, it's very hard to psychoanalyze the national psyche, but the question is right on point, the difference between the United States and Germany is we just spend less, that the government spends less and it collects less in tax and that therefore does fewer things to help its citizens. All the money ... let's go through how we do spend the money we raise, I mean $3.6 trillion, it sounds like it should buy something. The answer is, well, maybe not so much. So maybe two thirds of that $3.6 trillion goes, I mean, the actual number will be about 2.8 trillion, we have to compare it to the 4.6 of total spending.

So 2.8, 2.9 trillion of the total spending budget of 4.6 goes to what are called mandatory programs. Nothing's really mandatory, but by mandatory, we mean programs that are on autopilot, Social Security, Medicare are the big two and then Medicaid and some other programs. So wide off the top, Social Security, Medicare, some of the other programs that are on autopilot soak up 2.8 of our $4.6 trillion budget for spending.

There's $1.4 trillion that the Congress actually has to think about every year, and that's when you hear about, oh, they're having a fight about the budget. What they're having the fight about is the 1.4 trillion of money that they have to what's called authorize. They have to every year pass law, a legislation saying, here's the money we want to spend on this program or that program, the entire military budget, the defense budget is part of that 1.4 trillion.

Serena Allen:

Oh, interesting.

Edward Kleinbard:

... of what we call discretionary spending the Congress has to authorize every year and that's splits down really half and half, half defense spending and half everything else. So if you want to say, how much of the 4.6 trillion is available for programs that have not been set up to run on autopilot and that aren't military spending, it's about $700 billion a year.

The last item is going back to all of that debt that we've incurred, all of the part-money that the government has borrowed, we lay out I think about $300 billion a year in interest payments to the investors who've lent the government money. So $700 billion in non-defense discretionary spending out of that 4.6 trillion. That's the problem. Well, the answer is we have to cut entitlements by which they meant what the government calls mandatory spending. Social Security and Medicare are eating up a large part of our spending, they must be too big.

Again, the only way to answer that question, I think is to benchmark the United States against other countries, and when you do you discover no, no, that's not true. Our spending for the elderly is not too much. It's just, we don't have anything left to spend on everybody else, and we don't because we don't raise enough in tax and we don't therefore have anything available to spend on the kind of programs that would change people's lives, starting from childcare at birth, so that mothers and fathers could go back to the workforce knowing that they've got adequate childcare arrangements to universal 3K, so that every three year old has available to her a school program because the mind is extraordinarily plastic flexible, available to really absorb learning at the earliest stages, all the way up through school and then continuing to free college.

The UK, which has a similarly market triumphalist government has universal schooling available to all three year olds. The UK technically, well college in the UK is not free, but the government lends not just 100% of the cost, it lends more than that because it also lends living expenses, and the amounts that colleges can charge is fixed rate that would make the administrators of USC blush. It's under $20,000 a year to go to Oxford or Cambridge, the best schools in the UK.

Then when you graduate, you don't have to pay the money back until you start earning over $35,000 as I recall. Then once your income finally gets above that level, you pay back your government loans in the UK at just 9% of your income. If you never pay them back, that's fine. The government expects not to be paid back for about half of the loans they make and that's the system. So in Germany it's just free. So there are all different ways of getting to a more vigorous government that makes for better lives that we simply ignore because we're trapped in this rhetoric of crushing taxes, red tape, and that the government is an enemy. None of this is true.

Serena Allen:

So is anybody benefiting from our current system? It seems that there is ...

Edward Kleinbard:

Yes, the rich.

Serena Allen:

Define the rich though, because I think a lot of people have this almost misconception of opportunity where if I work really hard my entire life, I can also be one of the people that's benefiting.

Edward Kleinbard:

Well since by definition, the top 1% exclude 99% of us, people need to sober up and not live in the delusion that they are the next Bill Gates. That's not a really appropriate model on which to base your own life. It might happen, but let's face it, it probably won't and it's not a useful model on which to base the interventions of government, because 99% of American citizens won't be in the top 1%. So the top 1% have very low taxes relative to world norms. They also have a very large share of the national income, and it's gone up and up.

I have in the new book it'll be out in a year, this very depressing chart where I take GDP over the last 40 odd years and track that on what's called real terms that is adjusting for inflation, holding dollars values constant. So the term the economists like is real, and then I do a per capita because of course GDP goes up simply as the population goes up. But so I ask the question, well, if you look at real GDP and you look at it on a per capita basis, how have we done over the last 40 years? The answer is, hey, we've done pretty well. Per capita real GDP has gone up 80%, so that means we should feel twice as rich as we did 40 years ago.

But then when you look at the wages of full-time male workers, and I like to look at male workers because they seem to me to be the source of most of the anger in the political system, full-time male workers, the medium, that the guy in the middle's income has gone up 5%. So national income per capita has gone up 80%, the middle of the pack worker's income has gone up 5%. Well, that money has to have gone somewhere or that increase in income had to go somewhere, and the answer is it's gone to the very top end and it's gone to the top end for the reasons we identified earlier. The market triumphalist view, the corrosion of traditional social norms that limited behavior, and so higher returns to greed as tax rates came down.

Serena Allen:

Wow, that's very interesting and especially pointing out the fact that even if you're in, I mean the top 3%, getting from the top 3% to the top 1% is even a larger leap than it would be anywhere else on the scale really.

Edward Kleinbard:

Yeah, that's absolutely right. The top 1% has an average income, just from memory of about $1.5 million a year. That's an average income, it might make you feel better to know that you can get into the top 1% by having ... you can be at the bottom of the 1% with an income of around $550,000 a year. So I'm sure that will include many of your high school listeners. But as you start going down the scale, the differences in lifestyle are between being in the 95th percentile and the 99th percentile are very large.

Serena Allen:

Definitely. So I want to talk right now, there's a lot of talk about wealth inequality and all of this going on in the current election that's coming up. So I want to touch on a couple of different things that candidates are talking about. But first off, I want to know what's being done right now. What is the Trump Administration, what kind of taxes are they using to try to combat inequality or if there's social programs? What has changed recently?

Edward Kleinbard:

Well, if you have an inclination for a government that does more for its people, for its citizens, the Trump Administration is pointing in exactly the opposite direction. At the very end of 2017, well remember, it by itself can't do it, but it led the Congress in passing a major tax cut. Now, remember we're talking about a tax cut at a time when we were spending several hundred billion dollars per year more than we were taking in the tax revenues. Nonetheless, the Trump Administration sponsored a very large tax cut that will cost about two trillion with a T, trillion dollars over 10 years in tax revenues that we gave up, and that's a big number.

I mean, it's $2 trillion more of borrowing and the beneficiaries of that tax cut again, were again, were at the very top by and large of the income spectrum, and corporations found their taxes slashed. Corporations traditionally, well in the old days, they counted for a significant share of tax revenues. More recently, they've accounted for about 2% of tax revenues, 2% of GDP out of the total 16.5%, so that should be clear. Their contribution is about 2% of GDP so one eighth of total tax revenues.

Now, as a result of the Trump tax cut, their contributions to government is about 1% of GDP. So the difference is a $200 billion a year difference. So if corporations were paying the same, at the same rate that they were paying in 2017 we'd have $200 billion a year that funds Elizabeth Warren's or anybody else's education programs. It funds a significant portion of all the Democratic candidates wish list except Medicare for all, which is a more complicated story.

Serena Allen:

Right, definitely. So yeah, we hear this a lot from the Democratic candidates and how they're going to fund their programs. But from somebody who is listening, that is maybe a Republican viewer and views federal government supposed to be smaller, cutting taxes, what are the pros of not taxing because to me it's kind of hard to see, right? When we're already suffering, when we're already overspending a trillion dollars a year. What are the possible rationale to cutting for the richest people who already well off?

Edward Kleinbard:

Well, there's the unseemly answer, which is that people who do very well are very fond of their money. They believe that they have earned all that money because they have special talents that they alone possess and that they will fight tooth and nail to keep everything that they've earned, which creates a bad political dynamic because they also have the money to spend on political contributions of one kind or another. So they're very visible in political campaigns.

But the nice story that the economists like to say is, well, if we keep taxes low, then there'll be more savings by individuals because they have more money of their own, they'll save more. Those savings will then be put to work by businesses, primarily corporations and corporations will have more to invest in the way of machinery and stuff, and as a result labor, you and me when we work for those companies will be more productive because the company will have all of these extra investments that we can lever in our jobs to be more productive, and so income will go up, and labor, that is you and me in our wages, we'll share. This is the supply side fairytale.

The problem with the United States is we don't have enough capital, enough money invested in businesses, and by encouraging capital investment businesses will do well and because of the investments they make, their workers will be more productive and then businesses will pay workers more. At almost every level the story just falls apart in the current environment. You can imagine worlds in which it might be true, but right now we are awash in capital. So the investment markets, interest rates are at historic lows. Money is not hard to find if you're a business, to the contrary. So I think at this point in time, the idea that by encouraging more capital investment in business will somehow redound to everyone's benefit. It's like pushing on a string. It's just not a plausible story when we already have more capital than we know what to do with and we've seen this in 2017, 2018. For various reasons corporations found themselves with big pots of money. They didn't invest it, they didn't systematically invest it in their businesses.

Serena Allen:

Most of it, right?

Edward Kleinbard:

They mostly gave it back to shareholders, and by doing that increased the wealth of the most wealthy. So the story just does not as far as I can see hold the supply side story. In fact, it's precisely backwards. We do have a supply side crisis, but the supply side crisis we have is supply of human capital, that is how much have we directly invested in ourselves, and there the evidence is overwhelming, that the more that you invest in yourself in the form of education, that's really the only way, the higher your lifetime earnings, the higher your lifetime satisfaction. So if we want to have higher growth for the country and a more inclusive growth, then instead of this round about story of supply side investment in capital, we want a direct story of investment in human capital through education, and by virtue of that investment in human capital, all of us will have higher earnings capabilities and more satisfying lives. So you're really barking up the wrong tree. Our focus should be on education of our citizens.

When you go back to GDP, somewhere between three fifths and two thirds of our national income, that is our GDP, somewhere between three fifths and two thirds is accounted for by labor, by the sweat of our brow and the rest by machines and stuff, by returns on investment. So if you want to put the country on a different growth path and you want that to be shared more broadly, we ought to be focusing on the two thirds of national income that is the result of the efforts of individuals by making all of us more productive, and that means that the only way I know how to do it is education, education and then education.

Serena Allen:

Definitely. Yeah, it does sound like the ... There's a misconstrued idea that these companies are going to donate back into social programs and different things but it just seems to not be happening. As we mentioned earlier, it's when somebody veers from the norm where perhaps government should step in and try to instill a more fair society, which is one of the government's federal jobs within our limits. I want to talk about another person who's on the potential presidential stage right now, and that's something that's been coming up a lot.

We talked a little bit about free college and how Warren and a couple other candidates are supporting that, but I also want to talk about something that I think it's the first time we've really heard about it in election, at least in my lifetime, and that's coming from the candidate Andrew Yang with universal basic income or kind of the opposite of these ideas. You just give everybody free money basically just for being a citizen. So I was wondering if you can explain what that is and why to some people sound super crazy, but why it may not also be that crazy.

Edward Kleinbard:

Absolutely. Universal basic income is an idea that's been around for a long time. It was proposed originally for the United States by a famous conservative economist, Milton Friedman, many, many years ago. It was actively considered at the time and now I'm going all the way back to the Richard Nixon years of welfare reform. Daniel Patrick Moynihan, a famous Senator was a big proponent and it didn't happen and the idea fell into disuse and then disrepute. But the idea of Universal basic income, as you say, is you give everybody a flat amount a year and for them to do with as they choose.

By doing that, you can in theory, eliminate a lot of so-called welfare programs and enable people at the lowest income levels to have the cash in their pockets, to buy a car, a used car so they can get to work. Right now we have ... There are millions of people who don't have jobs or don't have the jobs which they're qualified because they can't afford the car to get to that job. So that's the theory of UBI, it drives the current political conservatives crazy because of what I call the Jason, the Surfer Syndrome.

Jason the surfer was a character in the 2012 elections that ... you have to remember that we have 340 million people in America. So whatever crazy behavior or pattern you can imagine somebody's living it. I keep trying to remind my students that if you're one in 100, there are 3.4 million people just like you. So Jason the surfer was somebody that I think Fox News found, who claimed he was using his food stamps to buy lobster for dinner. In fact, food stamps just for your information at their most generous, the food stamp program is technically called Supplemental Nutrition Assistance Program, SNAP gives you 92 cents per person per meal, doesn't buy a lot of lobster.

But the story was the Jason the surfer story and people see universal basic income as sort of encouraging the Jason the surfers, that people who are no good will be worse. They'll spend the money on alcohol and drugs, they'll never get a job, and why should people who are not industrious and hardworking like me get rewarded for being lazy. It's a very judgmental reaction and it's very much part of the national psyche that we define ourselves by what we do for a living rather than what we think or the like.

So this strain of thought is the pervades of conservative analysis. But it kind of misses the point that the money made available across the board can change lives for the better. It can enable people to get jobs, it can enable people to hold them or to get better jobs, to go to school, and it's not simply the case that will lead to drugs and alcohol. We have very few, it's interesting. We have very few real life experiments with universal basic income.

Finland tried it for a couple of years and it was a qualified success, but they did it with a narrow group of citizens. Basically the Jason, the surfer population who didn't have jobs, who weren't working. And Alaska effectively has a UBI program because Alaska pays its residents their share of the oil and natural gas royalties that belong to the state of Alaska. So as an Alaskan resident, you get a check from Alaska every year that varies with the amount of natural resources Alaska sells, but it's not trivial and there's no evidence that drug abuse or alcoholism is correlated with the receipt of the monthly checks from the state of Alaska. So I acknowledge though that there are very limited experiments.

The other point that people miss on the right is that you can target UBI to America's least affluent citizens, and you do that by thinking of UBI on the one hand and the income tax on the other. You can adjust how the income tax works to claw back UBI so that we're not paying the universal basic income to Bill Gates net. He gets the check but then he pays more tax, so that net, he doesn't get the UBI benefit, but somebody at the bottom end of the income spectrum does get the benefit.

I think Yang's proposal, which as I recall is $12,000 a year per adult is probably too high. I think it's wrong to construct UBI looking only to adults and not to children because children are expensive. I ran some numbers and came up with a view that a universal basic income program in the range of about $6,000 a year per adult and 3000 per kid could really change lives for the better and it would make the rich less rich. I acknowledge that. But again, first I've limited sympathy given that the rich have now for 40 years enjoyed extraordinarily low taxes and extraordinarily large share of economic growth, that is going back to the numbers I gave before.

The vast lion's share of all economic growth has been captured at the top end. So I've frankly limited sympathy. Again, it is a pathway to more inclusive growth patterns. We just can't get around the fact that we've somehow ignored for the last 40 years that the driver of national income is human beings, not machines. And yes, machines can make human beings more productive. Machines can also just replace human beings, which is another theme that the supply side story kind of ignores. But a more direct way of doing that is by giving money to people, and it's very interesting.

I'm an old crotchety professor, but in my seminar this year, my students convinced me by the end of the seminar that UBI was something actually worth serious consideration because it would improve the lives of so many and lead to more productive lives, not sitting on the beach working on the tans.

Serena Allen:

Right. Definitely. I think that it's something that a lot of people, a lot of high schoolers that are probably listening to this I've heard of and are interested in pursuing because it's one of the most innovative policies we've seen and it's popular and discourse.

Edward Kleinbard:

I appreciate that you guys haven't kept up with Richard Nixon and Daniel Patrick Moynihan but that's where it goes back to.

Serena Allen:

Right. Definitely, and it's good to know that it's been around and I don't even know is being piloted right there in Alaska, so if there's anyone from Alaska listening, we'd love to hear your thoughts on it as well and trying to encourage those inclusive growth patterns. But going into my final question here of the day, taxation is one of the most controversial things in politics. You have one side with Democrats and leftists where they want to tax a ton and create as many social programs as possible because of it.

Whereas on the Republican side, they want to try to keep government small and so you use less taxes, so hopefully people will turn around and use their money. Then you have people like the Libertarian Party who just say taxation at all is right out theft. So people have very strong opinions overall. But I think what's important and what a lot of people forget during political discussions is everyone is trying to overall help the country and help the people in the country.

I think that a lot of times we forget about that as our overall main goals as people interested in policy and as citizens paying taxes. So I'm curious, what's your opinion on how we could better approach using tax revenue to serve the American people, but from a non-partisan lens, something everyone could potentially maybe eventually agree upon.

Edward Kleinbard:

You don't need everybody to agree and you never will get everybody to agree on everything. When Richard Nixon was drummed out of office, over 20% of the electorate thought that he shouldn't resign. So again, if you have one in a 100 who disagrees with me, well that's still three and a half million people who haven't.

Serena Allen:

Right, a significant voting amount than perhaps.

Edward Kleinbard:

... who haven't come around to my way of thinking. So you don't need everybody, but you do need a consensus. There I think that the fundamental mistake, and this isn't a mistake that goes all the way back to the progressive movement in the early 1900s, is in fact implied by your question, which is let's argue about taxes, and that's the wrong place to start. The right place to start is let's argue about what programs could make people's lives better and then, hey, can we afford those programs?

Wouldn't things be better if my students at the law school didn't graduate with $200,000 in debt? Wouldn't it be better if people didn't graduate from USC at the undergraduate level with $100,000 in debt? Wouldn't it be better if people had healthcare so that the human machine would be in a better state of maintenance and so on? By focusing on what the money can do, then you can in effect see the positive, and then the question is simply, how do you finance it?

This country is fixated on taxes and of course if the question is how much pain would you like? The answer is as little as possible please. But that's the wrong way of looking at things. Look at what government can do by way of programs and then say, can we afford it? As I say by that standard, what we'd find is we are a small government country, not a big government country. We do less than Germany or Canada or the UK do for our own citizens and it makes, I think for the anger that you see in the electorate in general.

The last thought I'll leave you with is that, I'm finishing the new book. The new book tries to do exactly what you're saying, which is how do you frame these issues in a way that makes these arguments more persuasive? Because a lot of people read the first book and said, "Well, everything you say is true, but preaching to the choir and how are you going to change people's minds." The way I've been thinking about it is that the unifying theme is luck. It's not easy to convince people, but I could make the case that those who are successful work hard or smart or they can hit the curve ball or whatever. They have lots of talents, but so then lots of other people.

To say that I have talent, that I work hard and I have a lot of money and my money therefore is a reward for my special merits, that's false logic. Luck has everything to do with it. We swim in a sea of luck and it's largely invisible to us because when we do well, we say, "Well, that's me. You know, look how great I am." The only time we've focused a lot on luck is when things go badly and then we have something to blame. I think if you think about seriously and reflect on the importance of luck in our lives, starting from birth, thinking about the handicaps that a kid who was born into a poor family has to succeed because he or she doesn't get the same investment in her human capital than a kid born in an affluent family does.

You could say, "Well, so-and-so, look at somebody born into poverty yet have achieved great success." That's a fundamental error in statistics, there are always outliers. The question is why should the people at the center, why should the majority of people born into low income families have worse outcomes than people born into high income outcome families? That's a matter of luck. I didn't choose my parents. I didn't choose my special gifts. My joke in the book is if I could have chosen, I would have chosen to be 10% less smart and 10% better looking, but I didn't get the checklist.

So when you start thinking about the role of luck in our lives, your grip on your own money starts to loosen a little bit and you can start asking the question, what should we do by way of mitigating bad luck in ways that promote the fundamental credo of equality of opportunity? Do we really believe in equality of opportunity? If so, we have to make opportunities equal and that in turn means some of the programs that we've discussed on the show.

Serena Allen:

You just heard Edward Kleinbard talk about the complexity of taxes. Thanks for listening. I've personally always viewed taxation as one of the most complicated parts of American policy. I'm grateful to Professor Kleinbard for simplifying some of these intimidating concepts, from wealth inequality to universal basic income. I learned a lot and hope you have to. Be sure to listen to future episodes where we unpack where this tax money is being spent.

If you enjoyed today's episode, share it with a friend. To learn more about changes in taxation or Edward Kleinbard, please go to bedrosian.usc.edu/paycheck where you can also provide feedback or request topics for future episodes. The Policy Paycheck is sponsored by the

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