

**ROUNDTABLE ON
OBAMA'S TAX POLICY: WHAT'S RIGHT?
WHAT'S WRONG? WHAT'S THE FUTURE?**

Washington, D.C.

Friday, April 3, 2009

CONTENTS

Welcome and Introduction:

CHRISTOPHER BERGIN
President and Publisher Tax Analysts

Panelists:

LEN BURMAN
Urban Brookings
Tax Policy Center

CHRIS EDWARDS
Cato Institute

GENE STEUERLE
Peterson Foundation

* * * * *

PROCEEDINGS

(9:00 a.m.)

MR. BERGIN: Good morning. How is everybody? Welcome to the latest in Tax Analysts' series of discussions on key issues in tax policy and tax administration. The topic for today is President Obama's Tax Policy. I'm Chris Bergin, the President of Tax Analysts, the nonprofit publisher of *Tax Notes*, *Tax Notes Today*, *State Tax Notes*, *Tax Notes International*, and many other fine print and online products on federal, state and international taxation.

This is our seventh year of conducting discussions on tax policy. If you are new to our discussions, let me say it's great to have you here. Let me also take just a moment to explain our process today. I will open things up with some brief remarks to introduce our topic. I will then introduce our distinguished panel of speakers. Each of them will address aspects of our topics. After that we will open up the discussion to all of you, and we encourage all of you to participate. Whether you are seated at a table or just a bit away from it, just wave and I'll find you.

We are streaming audio of this event on our Website and we will post both the audio-cast and a transcript there. Also, for media purposes, we are all on the record. So when I recognize you, please tell us who you are. For those of you away from the table, we will have hand-held mikes that we will quickly get to you, but please wait for the mike to get to you, because as I said, we're audio-streaming this.

Before we move to our topic of discussion, I want to say a few words about someone who is not with us today. We have an empty chair at this table, and that is for Don Alexander, a friend to

most of us in this room and a wonderful colleague, and a great supporter of Tax Analysts. I don't believe Don missed a single one of our roundtables. He was a greater adviser to me and was always encouraging me and Tax Analysts to do the right thing. And while we will miss him, in spirit he is still here.

Now on to our topic, which could not be timelier. When he campaigned for President, Barack Obama promised not to raise taxes on taxpayers with incomes all the way up to \$250,000. To find the revenues to reduce our huge budget deficit and to finance healthcare and his other priorities, he would raise taxes only on those at the top. In the budget outline that he released in February, he made good on that promise. He proposed to extend the Bush tax cuts, which are due to expire in 2010 for those earning up to \$250,000. He also proposed to extend his Making Work Pay credit for low- and middle-income Americans, which was enacted on a temporary basis as part of the recent economic stimulus law. He proposed to expand and make refundable other credits, which we used to call in the Clinton years middle-class tax credits. At the same time, President Obama proposed to restore the two top tax rates under President Clinton and to limit the value of itemized deductions to 28 percent for upper-income earners. That would come on top of phasing out those itemized deductions plus personal exemptions for upper-income taxpayers by restoring the so-called Pease and PEP rules. He also proposed to raise revenues by closing corporate loopholes, particularly in international taxation, with details to come later. As we gather here this morning, the House and Senate are working on a budget resolution; they've both passed one of their own, which appear to agree mostly with President Obama's tax policies. Meanwhile, in several weeks, the White House will send further details about its tax-and-spending proposals to Congress.

But our topic today is less about what will happen than what should happen. Please take a look at the chart here prepared by Tax Analysts' own Marty Sullivan. That chart, which I think all of you have and Marty's accompanying article, is a bit scary. As Marty illustrates, the Congressional Budget Office estimates that the President's budget outline would increase the national debt by almost \$10 trillion over 10 years; 10 trillion. Now, I realize that in this age of stimulus a trillion dollars isn't worth what it used to be, but holy smokes! That means if you look at the red line that by 2019, the ratio of debt to GDP would be 82 percent. The administration says that CBO numbers are often inaccurate. Fine. Let us not quibble. Under the administration's own estimate, which is represented by the green line, the president's plan would drive the debt-to-GDP ratio to 67 percent in 10 years. I don't know about you, but that's high enough for me.

So, some questions. At a time when we face record budget deficits that seriously cloud our economic future, should we rely only on those at the very top of the income scale and on corporations to help close the budget gap and to fund healthcare and other national needs? I'm not an economist -- Lord knows we have several brilliant ones in the room today -- but I don't think that gets us there. And as for that pot of gold called the tax gap, even the White House in its recent Fiscal Responsibility Summit throws cold water on how much is actually in that pot.

Question two, where should we look first to close corporate loopholes, and should the revenues from closing corporate loopholes be used to reduce the deficit or reduce the corporate tax rate? What suggestions should the Volcker commission on tax reform be making? Should we change the exclusion for employer-provided healthcare? And if we can't raise enough revenue from the rich and from corporations, are we headed for a broader tax? Dare I speak it? Could it be that behind the understandable lack of details in our new President's outline lurks plans for a value added tax? I suspect that our distinguished speakers will touch on these and other key questions. So let's hear from them. I will introduce them in the order in which they speak, and I want to thank them up front for agreeing to do this panel.

Len Burman is director of the Tax Policy Center, a joint project of the Urban Institute and the Brookings Institution. Chris Edwards is Director of Tax Policy Studies at the Cato Institute. Gene Steuerle is Vice President of the Peterson Foundation. Len, would you help get us started?

MR. BURMAN: Thanks, Chris. Chris asked me to address three questions, what's the plan, why do we need it -- which I think was a trick question -- and where is it going? I'm going to be very brief because I'd like to leave lots of time for discussion.

The plan itself, I think 15 years ago you would have been surprised that a Democrat would be proposing \$3 trillion of additional tax cuts at a time when we're running enormous deficits. It includes extension of most of the Bush tax cuts, \$2.1 trillion over 10 years for that part, and a host of new tax breaks, many of them refundable tax credits. There's the Making Work Pay tax credit, which Chris mentioned was extended through 2010. The earned income tax credit is expanded for larger families and for married couples, and there's a larger credit for single workers as well. The child tax credit, the refundable portion, applies to people with lower incomes than under current law or under law before the stimulus bill was enacted. There are expansions to the saver's credit making that also refundable. Automatic enrollment for IRAs intended to expand pension participation. A new tax credit for higher education, partially refundable, the American opportunity tax credit, which would cost \$49 billion over the next 10 years that was also enacted as part of the stimulus package through 2010. There's a zero capital gains tax rate for small businesses. The proposal would make the research and experimentation credit permanent and expand net operating losses. It would also extend virtually all of the expiring tax provisions, these things that continually are extended one or two years at a time through 2010, and that would add another \$20 billion to the deficit.

There are a number loophole closers, so if there's a difference with President Bush's budgets, in fact there are some offsets in this budget, it would restore the higher tax rates on people with incomes over \$250,000 after 2010, and that is basically letting current law take effect. It would allow the 20 percent capital gains tax rate to take effect again after 2010. And make permanent a 20 percent tax rate on dividends. The 2003 act lowered the tax rate on dividends to the same as capital gains, and this provision would continue the treatment of dividends the same as capital gains after 2010. It extends superfund taxes. It would tax carried interest as ordinary income. It would codify the economic substance doctrine. It would repeal the LIFO accounting method. As Chris mentioned, there's an unspecified set of international tax provisions. The interesting thing is these unspecified provisions are expected to raise very specific amounts of revenue, which is a new way of designing tax policy. We don't know what the policy is, but we know how much money it's going to bring in. And it would repeal a host of oil and gas tax breaks.

One of the most controversial parts of the package is that there is a limit on itemized deductions for higher-income taxpayers. The value of itemized deductions couldn't be more than 28 percent. Under current law, if you take itemized deductions, you get the value of the deduction as your marginal tax rate so it goes up to 35 percent after 2009; after 2010 it would be 39.6 percent for top bracket taxpayers. This 28 percent limit is expected to bring in \$311 billion over 10 years, and that's said to be a down payment on the cost of health reform. The other thing that helps to pay for health reform is an incredibly optimistic set of cost saving measures on the spending side, and those all together, the magical cost savings and the completely politically implausible limit on itemized deductions, would only pay for about a third of the cost of the package.

Why do we need it? That's a hard one. I guess I've been out of Democratic administrations for a long time and I haven't been drinking the Kool-Aid, but maybe we need bigger deficits. CBO projects that the whole package would add up to about \$9 trillion in deficits over 10 years. The administration quibbles with that, but we're talking big numbers whatever it is. We need more refundable tax credits. There's an argument for that and I'm going to get to it in a second, but it is notable that this is a significant change in the way we run the tax system. Basically there are a number of explicit outlay programs that would be enacted and it would add, according to the Joint Committee on Taxation, over \$485 billion in outlays out of that \$3 trillion in net tax cuts.

We need more complexity. Another new education credit, as if we don't have enough tax breaks for education. The idea of making the education subsidies refundable improves the chances that

it would actually help people who need assistance, but we have so many different education tax breaks already that if you can figure out which one is in your best interests, you've probably already been to Harvard. And there's a lot of evidence that these things don't work particularly well. It would make a lot more sense to take \$49 billion we're spending on the American opportunity tax credit plus all the things for the higher education deduction and 529 plans and all of that and put it into programs like expanded Pell Grants or subsidized student loans, which actually are known to work pretty well, at least in terms of targeting.

One big motivation for the administration in their policy overall is that they really wanted to make the tax system more progressive. The Bush tax cuts were notably skewed toward high-income people even though the tax cuts affected a wide range of the population; \$2 trillion worth of the tax cuts are in the Obama budget to be extended. This is a reversal in direction. The argument is that high-income people at least up until the last year or so were getting virtually all of the benefits from economic growth, and very little was going to low- and middle-income people. So it's certainly a plausible argument that redressing that to some extent through the tax system is first of all desirable and second of all makes more sense than other ways of trying to help low- and middle-income people like raising minimum wages or imposing more regulations or limiting international trade, all of which entail economic costs. But the question, of course, is, is this the best way to get it? You could make the tax system more progressive without adding all the complexity and without adding to the deficit overall, and the reason that they didn't want to add to the deficit overall was that they clearly made a decision that tax cuts are politically popular and raising taxes on particularly middle-income people was not feasible, but it really does hamstring the administration in terms of their tax policy.

Where is it going? I'm probably less qualified than a lot of people in this room to make a judgment on that. The fact is as Chris mentioned, the budget resolution includes a lot of the tax cuts that President Obama proposed. One notable thing that was left out of the House bill that was just passed [April 2] is it leaves out the Making Work Pay tax credit presumably because the pay-for for that Making Work Pay tax credit is a proposal for cap and trade, which makes people in Congress very, very nervous. Also, the 28 percent limitation probably isn't going anywhere. If you wanted to design a policy to mobilize the largest number of powerful Democratic interest groups, cutting back on the tax breaks for charity for housing is a good way to do it.

I want to comment a little on what we should do and give a little note of optimism on why we might get there. Obviously there's a huge need to simplify the tax system. The tax code is so complex that people don't really understand how it affects them. Adding a bunch of new tax breaks is just going to make it more complicated. And people perceive the tax system to be unfair and that fosters noncompliance. We need to raise more revenue. The administration proposes a fair amount in the way of additional spending, but even if the budget were more restrained in terms of spending, we're not going to get anywhere near balance by 2019. The deficit in 2019, presumably long after any economic recovery has occurred, is going to be close to \$1 trillion, according to CBO. That's scary, especially when you consider that over the long term -- I think Gene is going to talk about this -- our budget situation is going to get dramatically worse. We need to figure out a way to raise enough revenue to pay for government without taking an undue economic cost and in a way that people perceive as fair. The other thing is that the administration has made a big deal about its commitment to the environment and reducing greenhouse gases. They did make a proposal for cap and trade which looks like one of the first things that's likely to die in Congress. The best way to do that would be to put in place a carbon tax. All economists know that. All politicians resist it like the plague. But some way of internalizing the cost of global warming in the cost of fossil fuels would make a lot of sense, and it could raise a lot of revenue which would help with the budget problems. Obviously, some of it would need to be spent on offsetting the regressivity, but that needs to be a priority.

So why should we be a little bit optimistic? One thing is that we've sort of set a scenario where there could be a significant tax reform in 2010 assuming, and this is a big if, the economy is

clearly on its way to recovery by then. Obviously nobody is going to talk about any kind of tax increases before that. The major Obama proposals were enacted through 2010 as part of the stimulus bill. The only thing that really needs to pass between now and then is something needs to be done about the estate tax. President Obama proposes to extend the 2009 parameters permanently. Under current law, the estate tax is going to disappear in 2010 and then be reinstated in 2011. Now, economists love to see how people respond to incentives, but this maybe is one experiment we don't want to engage in. The other thing is we have to fix the [alternate minimum tax] for another year.

The ideal thing would be to call for a moratorium on other tax cuts through 2010 while we do a top-to-bottom reevaluation of the tax system. The president has called for a commission to study tax reform as a part of his overall -- I don't remember what he called it, the Economic Stimulus Group, the Volcker Group, and he's actually put limits on them which almost guarantees that you couldn't get sensible tax reform because he says you can't raise taxes on people with incomes under \$250,000. But if he were to rethink that over the next two years, then possibly that could be the basis for significant reform. The other cause for optimism is that Beth Garrett was just nominated as assistant secretary for tax policy, and she was on President Bush's tax reform panel and she's a well-known advocate of fundamental income tax reform. The Bush tax reform proposals would actually be a good start for the work of this panel. The discouraging thing as my colleague Roseanne Altshuler pointed out is that the Obama administration decided that the tax reform panel's Web site should be hidden from public view because, of course, those were Bush tax reform ideas and since Bush was old thinking and Obama is about change, we have to do something completely different.

MR. BERGIN: Thanks, Len. Chris?

MR. EDWARDS: Thanks a lot, Chris. Len gave sort of a balanced presentation. Now I'm going to give the presentation telling you everything that's wrong with the Obama budget and tax policy, sort of a more unbalanced view. I appreciate your holding the event, Chris. I'm a huge fan of *Tax Notes*. I couldn't have written my book on tax policy last year without the enormous resources in *Tax Notes International* and Marty Sullivan's articles, and it's really a fabulous resource.

MR. BERGIN: Thanks, Chris.

MR. EDWARDS: The United States is going in the wrong direction on two issues I'm going to talk about: the size of government and just about everything in Obama's tax policy. So, first, the first of government.

The CBO shows that total federal spending under the Obama plan will rise from about 21 percent last year up to about 24 1/2 percent by 2019, but in certain ways that's sort of optimistic. It doesn't include the Obama health plan, it assumes restrained discretionary spending growth. More realistically, if we follow through on Obama's proposals, I think we'll be up around 27 percent or so a decade from now, which is rather extraordinary. Some people might sort of still believe that the American government is smaller than governments in other industrial countries and we can afford -- and we've got lots of room to grow. But in fact the gap between U.S. government and governments in other industrial countries has been shrinking at least since the early 1990s. The OECD's most recent data puts total size of government in the United States, total federal/state spending, at about 39 percent of GDP. That's without the stimulus. The average for the OECD is not that much above that, about 43 percent, so the United States now has bigger government than Japan, Australia, Korea, and some other countries.

Some people think in Washington there is sort of this aura of inevitably of bigger government, but the reality is government can be shrunk, and Australia and Canada provide two good examples. Canada's total government spending peaked in the early 1990s at 53 percent of GDP and has

shrunk dramatically now to just 40 percent of GDP, getting close to the size of American government. So the United States is no longer a free-market island in a sea of socialism as people used to conceive it. America is just another mixed economy, and I think a mixed economy with a less-competitive tax system than a lot of other countries.

All this spending, of course, is creating a lot of pressure in a desperate effort to find new revenues, and the purpose of Obama's tax changes it seems to me is just to raise more money. I don't think Obama has tax policy in his budget. He has revenue policy. He wants to raise money kind of any way he can. While past bipartisan reform efforts such as 1986 tried to simplify the code and tried to make the tax code more conducive to growth, Obama's policies in my view would complexify the code and damage economic growth.

What's striking, it seems to me, is that in Obama's tax and fiscal policy so far, he repeatedly stresses how federal spending on various programs can boost growth, but his budget document and what he and his advisers say is completely devoid of any sort of understanding that tax policy also affects growth. So if you go back and look at President Clinton's 1993 tax increase, which was sort about the same size as a share of the economy to Obama's tax increases, at least Clinton had sort of a theory about why he was raising taxes. He was raising taxes to lower the deficit and thus to lower interest rates so that there was an economic theory there. Obama in my view is a sharp break from Clinton. He just wants more money for more spending.

So the Obama administration theme is that spending affects the economy but taxes don't, and you can see this, for example, Christina Romer and other folks in the administration come up with these detailed ideas about how spending multipliers will grow GDP, if the government spends another dollar, GDP will grow by a dollar-fifty, but they completely ignore in my view the negative effect of tax policy on economic growth. So for example, *Tax Notes* had a great article a few years ago by Martin Feldstein with new estimates on the U.S. tax system and how tax changes affect deadweight losses at the margin and he argued that a dollar of additional taxes would increase deadweight losses by about \$1.76. So it seems to me that the Obama Administration, whether or not you buy their dollar-one-point-five spending multiplier, clearly once taxes start rising, if they do in 2011, it seems to me the negative effect or the deadweight loss effect of the tax increases will nullify and reverse out any positive effect of current spending, and that is not really taken into account by the administration.

So I think the Obama administration shows no appreciation that U.S. tax policy must be considered from the perspective of long-term growth and from the perspective that we live in a global economy, and I'll just sort of describe some proposed Obama changes with respect to the global economy. Obama wants to raise the top personal rate from 35 up to 40 percent, which would put the typical or average U.S. federal and state top personal rate at about 46 percent. The average OECD top personal rate is now 43, to the United States would be in a situation that's more socialists, if you will, than the average in the OECD. So it's striking to me because there are lessons that other industrial countries with left-wing politics, with conservative politics, they have learned these lessons that you can't have high marginal rates in a global economy, and it seems to me that Obama is not taking that seriously. The Obama budget is strewn with phrases or sentences such as "Prudent investments in education, healthcare and infrastructure were sacrificed under Bush for huge tax cuts for the wealthy." In my view, that is not a serious statement. Government spending on all those areas that he mentions in that statement are at high levels. Bush cut the top rate from 40 down to 35 percent, of course, but 35 percent is seven points above the bipartisan number reached in the late 1980s after the Tax Reform Act of 1986.

On the corporate tax side, again I think Obama kind of just uses the corporations as kind of a whipping boy. It sort of seems like corporations are a good prop for his rhetoric. He would hike corporate taxes by broadening the corporate tax base. And note that his colleague in the House, Charlie Rangel [D-N.Y.], has a much more serious kind of idea. He would broaden the corporate tax base and use the revenues to lower the rates. That's more of a serious proposal, in my view.

Again as probably a lot of you know, the U.S. sort of average federal and state corporate rate is at about 40 percent now. The average in Europe is 23 percent. I noticed reading *Tax Notes International* in recent weeks that Taiwan is going ahead and cutting their corporate rate from 25 to 20 percent. So if you're a semiconductor maker or a laptop maker, would you want to locate in the United States with a 40 percent rate or Taiwan with a 20 percent rate?

An interesting example is the global pressure to lower corporate taxes, I noticed in Canada last week that Canada's large province, Ontario, which is ruled by a left-of-center government, is enacting dramatic corporate tax cuts. It's lowering the provincial corporate rate in Ontario to 10 percent. The federal rate in Canada is dropping to 15 percent. So the combined Ontario average will be 25 percent. Again compared to the U.S., sort of an average of about 40 percent. Ontario is also eliminating sales taxes on business purchases, which lowers the effective rate further. So again I mean if you're Honda, Toyota or Ford and you're thinking about closing an automobile plant, now if you're thinking in the long term, you're thinking, Maybe I ought to close that Ohio or Michigan plant and keep my Canadian plants open because the rate is lower.

Obama said over and over he wants to eliminate tax incentives for companies shipping jobs overseas, but in my view the main pressure doing that is our high statutory rate. And Obama would increase incentives to ship jobs overseas in various ways. Ending deferral or partly ending deferral seems to me will help push U.S. headquarters jobs overseas. And Obama has got all these others tax increases on corporations, oil and gas, and tax increases like the LIFO inventory change. It seems to me there's no economic thinking there. It's just a grab for money.

It just seems odd to me that finance ministries around the industrial world in recent decades are taking globalization seriously, and again whatever the politics, it seems to me other countries are saying we got a global economy, our corporations have to compete, let's cut our corporate tax rate. That message is just not penetrating in the United States, and we certainly see that with the Obama administration.

To close my comments and to underscore that point: Obama has formed a task force, to study major tax reform. I guess they plan to report by December. The task force according to comments by Peter Orszag and others in the media, is designed to close loopholes, combat tax evasion, and simplification. I say what about economic growth? That's been a goal of every past sort of tax reform method, it seems to me. What about economic growth? That's what the administration is missing.

MR. BERGIN: Thank you, Chris. Gene?

MR. STEUERLE: If I had to describe the administration's tax policy, I would say it reflects the same nervousness as Chuck Nevitt, who was a basketball player for Jim Valvano, who was very nervous one day at practice and the coach asked him why he was so nervous, and he says, well, his sister was about to have a baby and he didn't know whether he was going to be an uncle or an aunt. I don't think this administration has defined its tax policy. It certainly hasn't even had anybody in place in the tax policy office, but as I'll reflect on in a moment, we really haven't had major charge of tax policy for some time, for perhaps at least two decades.

But before I get into the specifics of tax policy, I'd like to make a broader point: which I think the nation is basically going through a fundamental turning point. And by turning point I don't necessarily mean that our current crises are worse than ones we've had in the past, it's certainly not worse necessarily than the hyper-inflation of the 1970s, and it's certainly not worse than some of the major wars we've been in or depressions or stuff like that. But I think fiscally we are in a very, very unique period of time, and I can only find two analogies in the past that really work for me. One of them is at the nation's founding, when basically the state governments had these debts. We weren't paying off the debts. We couldn't borrow from abroad. We were trying to found

a government. And basically we had to do something to get resources into the federal government to be able to do the things that had to be done, in that case in terms of establishing the nation. And eventually you have these great compromises that are fostered by [Alexander] Hamilton among others, which include, thinking about it, such things as moving the national capital from Philadelphia to Washington and other things like that. So these are not minor compromises that took place to make this happen to be able to in this case absorb the state debts, create a tariff, create a Treasury Department.

The second fiscal turning point that I do by way of analogy, and it depends on how late you the make the period, but I relate it to the start of the Progressive Era. At the end of the 19th century, basically we were an industrial economy. There were large forces at home, powerful industrialists. There were powerful forces abroad. We did not have a powerful or strong central government. You could argue a strong central government would have all sorts of problems, as indeed World War I and World War II would show, but nonetheless, in that world the federal government had to grow. It had to be a competing power with these other powers at home and abroad. And you see such things as the establishment of an income tax, the establishment of the Federal Reserve, antitrust policies and so on.

In each of these cases, what's going on to me is an attempt to try to find the resources to do what the nation has to do to move into the modern period. And each one is unique, and there are some people who are going to say that's just the story of just rising government and larger government, and that's not quite what I mean by getting the resources to do what we have to do. What we've got today is a government that is so committed, it is so locked in, it is on such path to dependence in so many areas, that it has already spent the future. If you were to take the budget today and project it out 100 years from now, we've already spent more than all the revenues we're projected to get for our government, including, by the way, the value added tax that Len and Chris already talked about. So you've got this extraordinary set of promises where we've put in place policies for a world we don't even know yet including, by the way, policies that didn't allow us to react well to the current recession, if you want to talk about it as well.

Never before in our history have we had that type of commitment. We've been profligate in the past. We've made mistakes in the past. We've had wars and the Louisiana Purchase in the past that gave us temporary deficits. But if you looked at our long-term budget, we didn't have long-term budgets until very recently, but if you had done one in 1960 or much less 1930 or 1870, the long-term budget would have been in balance. That is, at a point in time today, the future revenues would have grown with the tariff or the income tax, the spending would have been discretionary, and you would have had this slack in the budget. Now I'm not saying we did well with this slack or surplus, but you had the slack. It's the same way with households. We don't sign contracts today because we think our wages are going to grow. For all the housing and yacht cruises and everything else we're going to do 40 years from now, if you're a business you don't sign a contract for the plants and the equipment you're going to buy even though you hope you're going to have the money to do it, but that's not the case with the federal government.

The federal government is locked in, and it's locked in in such a straitjacket that Marty's numbers -- the problem with Marty's numbers is not so much even the deficit increases and in the short run, it's that they just keep growing. And by the way, I've done the numbers. Those of you who are interested, give me your card or something and I'll send you a little piece on it. If you take the budget that either CBO or OMB analyzed and you look out 10 years and you say what's the biggest change 10 years from now? The biggest change is the increase in interest cost. That's the biggest change. That's the transformation.

The second-biggest change is one that's already automatically built-in which is the old Social Security, Medicare and Medicaid stuff. Peter Orszag brags on his little blog that nondefense discretionary spending by the end of the 10th year will be at its lowest level since 1962. So what you have is you have this gigantic spike in spending followed by this gigantic turndown in

spending, I'm not saying that's what's going to happen, because a lot of these things have their own built-in momentum, but that's how they even tried to start to get the budget in order and they never even got there and they never even got to the European level of trying to get down to a 3 percent of GDP deficit, which, by the way, is bad.

So we have to figure out ways to create slack in this budget and tax policy is just a piece of this puzzle. And quite honestly, you don't get there just by raising taxes because if spending is always growing faster than the economy, you never ever catch up. So I mean you may want more spending, and the interesting thing is the administration seems to think it wants more spending for things like education and infrastructure and stuff like that. But they're only doing it for a couple of years, and the thing that again dominates in the long run is more spending that basically allows us in this room, particularly those of us who are in late-middle age or beyond, to retire and constantly have growing retirement and health benefits -- which is where all the growth that's built-in besides the interest cost.

So how does this play through with tax policy? Chris and Len really said it well. In some ways, if you had to define the tax policy of this administration, it's basically they want to increase the progressivity of the tax system. And let me say the tax and spending system, because as was pointed out, a lot of it is actually -- it's even in the formal budget on the outlay side of the budget because the refundable credit is counted as outlays -- and it's to hide spending increases in the tax code.

I'm going to give a third one which they only do it in a small way: it is also to hide any impact on the middle class somewhere else. Is that a new policy? Not really. We've been doing that for 20 years at least, 30 years. It's not a transformative policy, and it certainly doesn't deal with the larger issues that I've talked about. In fact, quite honestly I am just sick and tired of debating whether the tax rate should be 30 percent or 40 percent. I mean, we've been having this two-and-a-half-decade fight over that as if that defines tax policy. Forget about horizontal equity or -- equal justice, forget about all the efficiency aspects of the code, much less, God forbid, simplification. Forget about all that stuff. We're defining whether we have good or bad tax policy by what happens to this top rate. It's absolutely silly if you really think about it.

There's a complication that becomes even greater. If you're interested in what we stalwarts of tax policy often call real tax policy principles -- which means we're going beyond the progressivity issue and the revenue issue and we're going again to the horizontal equity, equal justice, efficiency, simplification issues -- is when the progressivity issues and the revenue issues dominate the agenda, the latter issues almost always fall off the tail end. That was actually one of the little tricks or secrets of the Tax Reform Act of '86. When we put out the Treasury study in '84, and there were historic reasons why we did it, we said we're not going to debate progressivity and we're not going to debate revenues. In point of fact, there was some debate about progressivity, but at least it was pushed down enough that we could debate the other issues. It's going to be very hard to bring these tax reform, tax principles into this discussion as long as the fight continues to be over justice over progressivity or, as in the current case, very likely to be revenues.

Let me state also one of my problems with the way we report the budget. I think we make a mistake reporting taxes as we do. I think we should report taxes as equal to what we spend. If we're a household and we spend money, whether we pay the bill now or we borrow and pay it later, we still have that bill to pay, and we should just list the taxes equal to the spending level. It's what we currently pay through current taxes and the taxes we've left until the future. We have to pay it. It doesn't matter if you think there's growth in the economy and that offsets it and you think it's an investment. That's fine. You still have the bill, and that's the way we should start listing it. Which by the way means that if you do things like adopt a value added tax but you cut back on the growth of entitlements, that could be a tax cut relative to what we've got build into the current system.

I mentioned that there was a third aspect in terms of what does the middle class pay. Indirectly the administration is willing to let the middle class pay, but so far it says it's only willing to do this indirectly. So let's take the cap-and-trade proposal. Most analysts I know -- I think Marty has come to this conclusion in his articles and many others -- have concluded that a direct tax is better than a cap-and-trade system. That's partly for practical reasons and it's partly for administrative reasons. It's also because in part in a cap and trade system when you give these rights to people, they become like property rights and it's very hard to either add to or subtract from people's property rights when you get it wrong: whoops, I got the wrong level of environmental pollution, I've got it too low or I've got it too high. Well, either way you're going to be affecting people's property rights in ways that they don't want to. A tax, as hard as it is to enact for political purposes, has a number of advantages. But the middle class can get hit indirectly here, the same way if you went with the limitation on itemized deductions. Whatever you think about it as a proposal, and, by the way, it's pretty much -- I know some people tend to like it, but it's really a crude, crude instrument -- think about it with respect to something like interest payments. You have an interest receipt and you have an interest deduction but your interest receipt is taxed at one rate and your interest deduction is taxed at another, and so you start playing the games to figure out where you take one and where you don't take the other. There are just certain aspects of trying to convert a deduction into a credit that don't work very well in a lot of areas. Even though I tend to favor credits in some areas for progressivity reasons, there is a lot of tax policy and administration involved in figuring out how to do it.

But take the charitable deduction. Who are the losers in the charitable deduction? Among the losers are the middle class and sometimes the poor, unfortunately it's not enough of the poor, who aren't going to get benefits from the charitable deductions. So they pay directly, but as long as they pay indirectly, it's not listed the same way. So the administration is willing to tap into the middle class a little, an issue that Len raised, but not very much and only indirectly and that's going to create problems down the road.

All these complaints that I'm making about the tax system you could actually make about Social Security, you could make about the healthcare system. You could make it across the board. The tax system as I say is just a piece of this broader puzzle of how are we going to really take ourselves into the new world fiscal era.

I'd like to make one last comment on this, and that is the increasing weakness of the Treasury Department and the Office of Tax Policy, something that many of us here, especially alumni, really have great problems dealing with. Don Lubick has this great line in which he says that each administration he has served in has been better than the last, I'm sorry, better than the next. A little twist on words. Don came in in the Kennedy administration for those of you who don't know, the Kennedy-Johnson administration, then later was assistant secretary under Clinton -- under Carter and then assistant secretary under Clinton, and each time what he's saying is that the tax policy process got worse in terms of what I'm going to call the power of the first draft. The Treasury Department at one time, and perhaps it wasn't through most of our history, but at one time it largely had the power of the first draft. Congress would change things, the lobbyists would come in and react. It often lost the battles. But by having the power of first draft, at least the first draft came to reflect a nonpartisan effort to try to do what was in the public interest. I'm not saying Treasury got it right, but at least you had those constraints on how it was enacted.

In recent years, look at energy policy or pension policy or even tax policy or budget policy. When the lobbyists come in, they don't even go to the Treasury Department, often they go right to Congress. They get to a member of Congress, they draft the provision, and it gets lumped together in these gigantic bills, and that does not reflect good tax policy. And I think, by the way, it's a threat in areas like health policy where the administration says we've learned that we didn't do it right under Hillary Clinton by taking to the White House so now we're just going to throw it up to Congress to draft health reform. I think they're going to have to rethink about regaining control over some of these major issues. And I think the one place in the government that has the power

or the ability to do this if it's strengthened is the Treasury Department, but I don't see any movement toward getting there.

Finally, let me make one just last comment on the tax reform panel. As far as I can tell, in addition to the constraints that Len put on the tax reform panel, there's another little one on it. It doesn't have any tax experts unless you want to count Marty Feldstein, and even Marty I would say is not into the weeds as much as some other people in terms of tax policy. So this is not to me a scenario for really getting good tax policy. It is a weak Treasury Department, a tax reform panel that does not have some really good tax experts in it, and actually lack of integration of tax policy into these broader fiscal issues we have to address. Thank you.

MR. BERGIN: Thank you, Gene. Let me just say a couple things. Good panel, huh? But apparently we can't find anybody to think that this tax policy we are currently looking at is very good. Let me remind everybody just say your name, and if you're out here, there's plenty to talk about, just wait a microphone to get to you, please. And let me open it up for questions. Mr. Sullivan? Pretend you don't know me and tell me who you are.

MR. SULLIVAN: I'm Marty Sullivan.

MR. BERGIN: Thank you.

MR. SULLIVAN: Good morning, Chris. And Gene, I want to know where you'd like to relocate the capitol. I was thinking about Detroit myself.

MR. STEUERLE: Kearney, Nebraska.

MR. SULLIVAN: Nebraska. When I got up this morning I thought I was the only one who was this critical of the administration, and after these three sets of comments I see I'm a lightweight.

The budget is clearly unsustainable, that's the idea of the diagram, and I think the administration and the Congress are in denial about this. I would like to see them stop being in denial about this. They are using various tricks such as saying the budget is uncertain so you don't really have to worry about it. Or, you know, spending really helps the economy, it stimulates it, and that's the most important thing. I call that the left-wing Laffer curve, just keep doing what we want to do and everything will be all right. Then of course I hear this from my teenagers all the time, just take care of it tomorrow. The next budget will take care of it. Right now are on a path to fiscal hell, and I don't think I'm exaggerating this one bit.

There's four options. One is we can cut spending. Two is we can raise taxes, and I'm going to dwell on that for a second. I think I agree with everything Chris said, we can't raise individual income tax rates much more. We can quibble a little bit around the edges, but we can't use that for broad-based revenue increases. And we can't increase the corporate tax rate. If we do corporate tax reform including LIFO and international, which they should be used for lowering the corporate rates, so there's not big revenue, and Michael Graetz I think says this.

The other thing, the third option, is we just let the deficit grow. Chris says 67 percent is scary. Maybe there are some smart people here who can tell me why 100 percent is just fine. We really haven't as economists explored what the proper level of debt is, so maybe we shouldn't be worried. But I think we really should be extremely worried, but I'm just going to say there is no economic -- there is a lack of economic research on this and we need to be very, very clear about what our goals are on the deficit and debt side, and we just don't have that. We're just rudderless right now.

The fourth option, which is the really scary one, and which the administration and Congress repeats over and over again, is we'll just hope that things get better next year. These budgets, every year they change. Don't worry about it. So why do we have a budget? So I think all the options -- of the four options, cut spending and raising taxes, those are really hard. The other two options, let the deficit grow and hope for better times, are really scary. I think we're in an unprecedented period. We need to do something very different. I just want to -- I think it's safe to say we need to -- ultimately we need to be looking at broad-based -- of all these options, what is realistic is we need to be looking at a broad-based tax increase that does affect the lower- and middle-income folks if we want to go on this path. Would you agree with that? And what would you propose along those line? That's my general question. So would you favor a VAT? I'm not going to let you off the hook. Or would you just -- how would you go to get us where we need to be?

MR. BURMAN: Are you asking the three of us?

MR. SULLIVAN: Yeah, anybody.

MR. BERGIN: Who wants to go first? Len?

MR. BURMAN: I think a VAT is inevitable. I mean, there's no way we're going to be able to raise enough revenue to pay for government 10, 20, 30 years from now without coming up with a new revenue source. Gene and Chris made the point that there are limits to how much we can get from the income tax. And Chris always puts out these nice volumes talking about all the ways in which he could cut government back to its bare bones, and there's probably like 10 percent of Congress that would vote with him on all of those things. And half of them would get voted out the next time they came up for election.

The issue of progressivity, I am sympathetic to the administration's view on the issue of progressivity. I think it is a serious problem that economic growth has left so much of the population behind. Ideally you want to do structural things like raise people's education levels and figure out ways -- obviously if the tax system is more conducive to economic growth, you have more of a chance that some of the income would accrue to low- and middle-income people, but the history over the last 20 or 30 years hasn't been that great. We've had enormous growth up until the current recession, and virtually all the benefits have gone to the very, very top. So how do you reconcile a VAT, which is regressive, with the desire to make the tax system more progressive? There are a number of ways you could do it. One, Michael Graetz suggested a system where you expand refundable tax credits as an offset to the regressivity of the VAT. I noted that Chris was using Canada as a model that we should follow, which surprised me a little bit, but in just about all the rest of the world they have value added taxes and they also have government-provided healthcare. I think ultimately government is going to be paying for healthcare anyway, and if you paired a value added tax with a voucher for healthcare or something like that along with sensible ways of limiting the cost of health provision, that that would be progressive. Low- and middle-income people in particular would get way more in benefits from healthcare than it would cost through the VAT. The concern about the VAT by conservatives I think is that it would be a money machine and it would enable all sorts of profligacy on the part of the government. I think one advantage of dedicating the value added tax to pay for healthcare is that in fact this would have low- and middle-income people have a stake in the game for fastest-growing source of spending for the federal government. If healthcare continued to grow faster than the economy and you could keep the linkage between the VAT and healthcare, and that's a big if, then people would see that the VAT rate would continue to go up and up and up, and I would argue that that would create more possibilities for consensus for sensible things you could do to reduce healthcare costs. And by the way, I have a paper on this that was just published in the "Virginia Tax Review" and we're going to post it on our Web site sometime soon.

MR. BERGIN: Chris or Gene?

MR. STEUERLE: I'm probably somewhere between Len and Chris. I did a recent piece also. I think I mentioned it. If anybody is interested, I write this little column. Can I mention this, Chris?

MR. BERGIN: Yes, you certainly can.

MR. STEUERLE: Give me your card or something and I'll be glad to put you on my list if I don't have you on there already. But if you try to think about not where you want to go in the next year, 5 years or 10 years, but you think about 30 or 40 years from now, the simple fact is that once government is fairly large, I'm not quite sure where, Chris, you're getting these numbers of over 40 percent of GDP, I'm thinking more of like the BEA numbers close to 30, but maybe you can explain that later. But once you're at that size, the main way that government gets additional revenues to finance what it wants to do in the future is through growth. So over 40 years, let's say that the economy quadruples, revenues quadruple, and so whether or not you bump up tax rates, federal rates now from about 18 percent to 23 percent or something, is actually a relatively minor issue relative to what you do with that quadrupling, or bump it down from 18 to 14 if you want. So to me I guess I feel that we may be boxed in to having to have a tax increase. I'm not actually convinced that in terms of the long-term good of the nation or the government that that's necessarily the best to go.

What drives it, and that's what we're not discussing very much, is again back to this issue of basically the health and retirement entitlements. The average person now retires for a third or more of his or her adult life, men retire for 18 years, women 21, they're the longer living of the two, if they're a couple, 26. That's a lot of years to support. The healthcare costs are going out of sight. This average-income couple gets about \$900,000 in benefits now. That's what you need in an IRA or 401(k) just to finance your Social Security and Medicare benefits. And over 30 years, that's growing to about a million and a half by my calculations. That's a lot of money. And if what we're financing out of an additional tax are programs that are anti-growth because they're encouraging us to retire earlier and not to work it seems to me I might not agree fully with Chris on how far I want to go, but that's clearly -- together it's really an anti-growth scenario. And so it bothers me just saying we've got to throw in the towel and that tax increases are going to solve it. They're not going to solve that problem, and we've got to get at them.

Having said that, if we're going to go the tax route increase, I sort of fall into Rudy Penner's camp, and he may want to speak here, which is, if I interpret you correctly, Rudy, is he's looked at Europe and said why has Europe actually not had a lot of the negative consequences, has some, but not all the negative consequences of higher tax rates? It's in part that they've actually adopted things like consumption taxes and their income taxes aren't really that much higher than ours are so they don't have quite all the disincentive effects that you might expect from higher tax rates. That does lead me toward where Len is in thinking that probably an efficient solution is a VAT.

But now let me give you one other caveat, is I'd be quite willing to do extraordinary base broadening of the income tax as well as an alternative, which means even things that I like I'd be willing to sort of give up. I'm not sure I really want to add another tax system on and hire another 30,000 IRS agents to administer a VAT. However efficient economists may think it is, I'm not sure that's more -- and the complication with the VAT is most countries have concluded that to make it efficient, you need to be at about a 15 percent rate. But nobody is ever going to adopt it at a 15 percent rate, so you're going to adopt it at like a 5 percent rate, which means it's very inefficient relative to base broadening.

MR. BERGIN: Chris, I'm going to give you a chance.

MR. EDWARDS: I think there is going to be massive resistance to a VAT. I think Len's right. It's going to be on the agenda. There is no doubt about it. I just think that there's going to be massive resistance. I mean, the one thing that the Republicans, for all their mistakes and errors over the last 15 years or so, they are completely united -- whether it's the social conservatives or across the spectrum -- they're united against tax increases. And I think they know that that's their political bread ticket and I think going forward that there will just be huge resistance to a VAT.

Canada is an interesting case. Canada brought a VAT in at 7 percent. It was hated. It was hated. And so they now have chopped the VAT to 5 percent. One of the things Canada did was they pushed a lot of the federal spending down to the provinces, and I think that's a good way to go for the United States. With [Gop. Rep.] Paul Ryan's budget plan, he would block-grant essentially most of Medicaid. That's the type of change I think that we ought to be thinking about for the federal government, is to block-grant just about all kinds of spending for the states and chop off state grants, then let the states figure it out, but it seems to me the federal government has got a much bigger problem than the states, so I think it's fair to start cutting them off from the federal subsidies.

MR. BERGIN: Sheldon? I'll let you say your name.

MR. COHEN: Sheldon Cohen. Nobody talks about administration.

MR. BERGIN: That's why we have you here.

MR. COHEN: And of course -- gee, thanks. And nobody talks about the fact that Lyndon Johnson ran a balanced budget his last year in office. Everybody forgets that. So it's not what the rate is, it's what the effective rate is, and when people talk to me about the gross rate, we had a 91 percent rate when I first came to the revenue system and we still collected around 20 percent of the GDP. So it's stayed virtually the same.

MR. BERGIN: It's a good point, Joe. Rudy?

MR. PENNER: I think we have a more profound problem here, and that is that the congressional decision-making system is broken, in my view.

It's not that the rules are perfect, but the more profound problem is that the Congress is waiving the rules more and more when it comes to budgeting.

Len talked about using a VAT as to a dedicated revenue source that might curve Medicare growth, but look what we've done recently. It used to be the gasoline tax put some limits on highway spending. We've waived that. We've driven general revenues into the Highway Trust Fund with barely a debate. We had a trigger mechanism that was badly designed in Medicare. Fans of trigger mechanism require that Congress -- or requires the president to make proposals for Medicare, and for the Congress to judge them on a fast-track basis. In the dark of night, they pass the rule that waives the obligation to do a fast track or consideration of Rules Committee, very often that has waived all possible points of order regarding a budget.

Now, what I don't understand is whether the rules are breaking down because the budget is irresponsible, or the budget is irresponsible because the rules are breaking down. But I rather favor the first point, and I think it really goes back to what Gene said. We've made these gargantuan commitments out there, and they give the Congress so little flexibility and put so much pressure on the budget decision-making system that it just hasn't been able to withstand it.

I mean if you look at the chart, we did a lot of good things between 1946 and 1974 when the debt reached its trough. If you look at the history of that era, there was much bipartisan cooperation. People really felt it important to get the budget under control, but entitlement were just trivial at that time, giving the Congress enormous flexibility. So I think until we get the root of doing something of these extraordinary commitments we've made to the future, the system is just not going to work.

MR. BERGIN: Joe?

MR. MINARIK: Joe Minarik, Committee for Economic Development. I think first of all we should have the record state that Don Alexander in the empty chair just agreed with Sheldon Cohen. It's not socialism I'm worried about, it's debt. And with respect to Chris Edwards, there will be enormous resistance to a value-added tax. There will be an enormous resistance to anything responsible that is proposed in this city, be it on the revenue side or the spending side. We're behaving like a bunch of adolescents.

And, Marty, I don't know if your children ever told you that, you know, they were going to take care of cleaning the room tomorrow with economic growth. You made me remember the one time my younger daughter told me she couldn't go up to bed because she was too tired.

I think we ought to exchange stories sometime. I think we'll have some winners.

The problem with the long-term budget; we can talk about making long-term commitments. I mean really it amounts to one commitment, and that's healthcare. By the time you're done, Social Security is batting practice compared to healthcare, and the rest of the stuff is extremely small. We really need to solve the healthcare problem, and if we do that, a lot of this will become much more manageable.

I am concerned about the short-term pileup of debt, but, you know, realistically speaking, I think almost every economist around this table would say if we're faced with the macroeconomic situation we are now, we do the things that we have to do to have this economy find a bottom and start to grow again. We pile up some debt doing it, I'll take it, and I'll deal with it. It's basically the healthcare situation in the long term that we have to worry about.

Realistically speaking, when you look at the healthcare situation, though, we have to face the reality that even if we did the optimal healthcare reform tomorrow, by the time the U.S. healthcare establishment changes enough to be a lot more efficient and to be actually saving money -- given that we have invested in a lot of buildings, a lot of devices, a lot of specialized human capital which in the ideal world we don't need but we're going to have to keep paying for it for some time -- the healthcare problem is going to burden us no matter how well we address it. And it doesn't look right now that we're addressing it very well in the way the legislative process is going. So we're going to need more revenue.

And we're going to get that revenue only if we start to behave in a much more responsible fashion. Permanent tax cuts at this time are irresponsible. We need to recover more of the 2001 tax cuts than we are proposing to do, and I guess that takes me down to my bottom line, and Marty mentioned four alternative ways of addressing the problem. I think if you slice the orange on a different axis, you could say that there are two ways to solve this problem that we will address:

One is leadership and the other is crisis. We will either grab a hold of the situation and deal with it, or we will wait until the situation deals with us, and then we will make do in whatever way we can.

The second choice is a lot less attractive than the first, but we're not seeing anybody in this town exerting the kind of leadership we need to deal with what ought to be staring us in the face.

MR. BERGIN: Let me just remind everybody just away from the table a bit, we want you to participate, too, so feel free to raise your hand.

MR. LOBEL: I'm Marty Lobel. I think we've got to step back. What's the function of a tax? It's not to do social welfare. The IRS does a terrible job at it. They don't have, as Sheldon pointed out, either the talent or knowledge to do it. We ought to look at the tax code as a way of raising revenue, and then if Congress wants to spend money on a particular program, let them do it to the appropriation process where it's at least reviewed. And once it hits the tax code, it's buried there and is there forever until the next crisis. That's No. 1.

No. 2, it seems to me on listening to the geniuses around the table -- and they are geniuses -- is that they're also caught up in the minutia of the tax code and that simplification seems to have gotten lost. Let me give you just one example:

Everybody complains about the corporate tax code. It's too complicated, it's an honor system, the international companies abuse it, and you've all heard the litany.

What would happen if we trusted the corporations, they report to the SEC their profits, under oath, criminal penalties, and just impose a flat tax on that amount and let them do whatever they want with the money. Simple. Politically acceptable, probably not. I talked to a friend of mine on Ways and Means, and I said, "Hey, what about this idea?"

And he said, "Well, how will I fund-raise?" And that really is where we are right now. We've got a crisis here right now of both spending and taxation, and if we went back to the basics -- I remember in 1986 when I was involved in that -- we scrambled the eggs so nobody knew who was losing and who was winning. And that's the only way you're ever going to get any political reform.

And, quite frankly, the reform we really ought to do is separate social programs from the tax code. Tax code should be used to raise revenue, and Congress and the president should be in charge of how that revenue is to be disposed of. And I realize that would put a lot of people in this room out of work, but, you know, they need greeters at Walmart.

MR. BERGIN: God, I'm getting cheered up by the moment.

MR. KEIGHTLEY: One comment. I think those are almost words out of Don Alexander's mouth. He fought hard when I was there to really make sure the code only did tax collection, and I watched him design the disclosure provision, and the disclosure provision built this wall around the IRS, and it was very difficult for any nontax agency to get near the tax information. And -- but that has been over the years, just been, you know, taken away. But while that's a nice theory, I'm afraid that's long gone.

And I'll make another comment, having watched it for years or more. There really is no tax policy, it's all budget policy. There's no overview saying this is the way the tax system should work. That's why you never see any focus on simplification, and, you know, of course, you get to the political and congressional changes which have, you know, dramatically changed it, including when, you know, they first changed to far more subcommittees, and you lost the Senate Finance Committee dominance and, you know, you had all these platefuls to negotiate, and then you see all this, you know, proliferation of complexity and difficulty.

But anyway --

MR. BERGIN: Just give us your name, please.

MR. KEIGHTLEY: Jim Keightley -- I'm sorry.

MR. BERGIN: Len?

MR. BURMAN: I just wanted to respond to a few -- a couple of things that were said. One point that Sheldon made, which was that refundable credits aren't administered by the IRS, well, nonrefundable credits aren't either. The issue isn't really refundability; the issue, as Marty said, is that, you know, we're running all the spending through the tax cut. I wouldn't go as far as you would. I think -- I think we should be clearer. I mean I think every year that tax expenditures ought to be included, that they actually ought to be part of the appropriations process.

But there are some things that are relatively efficient to run through the tax code, and I understand that it gives people at the IRS headaches, but you don't -- there are no perfect spending programs either. The earned income tax credit, I think by most accounts, is way more efficient than any direct welfare program. And actually a lot of the problems in administering the EITC are because of all the restrictions that Congress wants to put on it that the IRS has no way of monitoring. And a program agency would have a hard time doing that as well.

So, you know, my colleague Eric Toder and I tallied up individual income tax expenditures, and we came to a mind-boggling total. It was over \$750 billion, 6 percent of GDP, and this is a bipartisan compromise: Republicans like tax cuts, the Democrats like spending programs, all politicians like bringing home goodies to their constituents, so they compromise on spending programs and run them through the tax system. Most of them don't work very well, and that's really what the problem is.

I mean give the IRS the resources to administer the programs run through the tax code that you can reasonably infer from information that could be reported on tax returns or through information returns, and run other things through spending and make it transparent.

I guess, actually, that's all I had to say.

MR. STEUERLE: Could I just add one amendment thereto or corollary?

MR. BERGIN: Sure, Gene.

MR. STEUERLE: I've been fighting for 20 years. I think I've said this many times, I've said this to the Restructuring Commission, I've said it recently to the -- to another IRS panel. But I think IRS is remiss with respect to these programs. You know, it complains a lot about them, but it does not provide the public with data, and it is given the authority to do it, you know, GPRA, the Government Performance and Results Act, tells IRS that they're supposed to analyze these things, and if they could put out a report, I think they could put out a report that they could say they're legally required to do, that even OMB couldn't stop them putting out, that says:

Here's the administrative data. Here's what we know about the program. Here's the beneficiaries, and, by the way, they should also say: Here's what we don't know, because there's a lot of cases they don't know anything about, which is one of the reasons you don't necessarily want the program administered that way. But they should say that.

Here's our 47th -- at least if you put an earned income credit in the Food Stamp Program, you'd at least have reports coming out on -- no, actually, I should theoretically clarify that example because they actually do now put out reports on earned income credit. But they don't put out reports on most of the programs that they've got under their jurisdiction. And I don't think it requires a lot of people, and I'm not asking to do an economic analysis, just put out some data on it, just put out some audit figures on it, just put out -- at least have one or two people go out and analyze who's getting or not getting it, and put out whether there's any analysis at all as whether these programs are working and which cases there isn't any.

I think IRS could actually -- maybe we're getting more knurled in terms of the Obama policy, but I think the IRS is not totally immune from the problem because they're not reporting enough on the problem.

MR. BERGIN: Jim?

MR. WHITE: Jim White at GAO. Following up on one of Len's points, total tax expenditures, the aggregate amount of tax expenditures if you add them up, and there are some technical problems with adding them up, but if you add them all up in spite of those technical problems, you get something that's about the same order of magnitude as total discretionary spending now. That's kind of how big tax expenditures are.

And on the data issue, I agree with Gene that this is a real problem. IRS, of course, argues that their responsibility is to administer the tax code, and they view that in a very narrow sense and don't regard collecting data or asking taxpayers to provide the data as necessary for the tax code or necessary for administering the code. They view this extra data collection as burdensome.

And I'm not sure that IRS is very well-positioned to decide what data ought to be collected to analyze the effectiveness of the code, and so my question is whether Treasury, for example, ought to have responsibility for deciding what analysis ought to be done of tax expenditures, what data would need to be collected to do that analysis, and then order IRS to collect the data.

MR. STEUERLE: I don't want to get too bogged down in this issue, but I think Treasury has more of the analytic capability but fewer of the staff, and I think it would get more politicized there. I think the basic report -- just saying who's -- who's in these enterprise zones, who's getting the benefits, just some pieces of the data. They could do it by survey methods; they don't have to do it necessarily with other methods.

They could also do better jobs reporting with their audit rates. When they go out and audit, you know, 30 people who use charitable contributions and give in-kind gifts, you know, let's get some -- let's get some reports on -- on -- a rough report to what happens in their audits 'cause that's what they've done statistically in a valid way. But I think they could report the data. But maybe I'm getting too bogged down in a narrow issue here.

MR. BERGIN: Oh, that's okay. I want to go back to the Obama tax policy, because, Joe, you said something that I thought was interesting: leadership or crisis. And I wonder if anybody would disagree with this statement: I don't think that the first foray from the administration into the tax policy area is leadership. Anybody disagree? Okay, we don't have leadership. Then, Joe, or anybody else who wants to comment on it?

MR. KEIGHTLEY: I'll disagree and will go ahead here.

MR. BERGIN: Oh, Jim, good.

MR. KEIGHTLEY: As long as everybody's just going to trash the administration, let me -- let me say I'm looking at this, you know, and I'm not an economist although I play one at home, but this is a serious financial disaster we're looking at. I mean it's the equivalent of the Depression and the second World War. If nobody did anything, the whole thing was going to come unwound.

And so what you have is the administration attempting to deal with this. With all due respect to all of the economists in the room, I don't think anybody knows what the right answer is. But the very important point is, people -- they need to do something. And I think there was an election, and there was a change of direction, and that's what's this is reflecting, the policy that's being reflected in this tax.

And you can debate a lots of these different ones, and they've been debated for many years, but there's a clear new direction being pushed forward by the administration because that's what they think they were elected to do. And so I listened to all sort of the picking at it, and it's like -- and many of the problems are structural like how Congress deals with things, how the -- you know, how strong Treasury is.

I can remember Ken Gideon's going to some meeting where -- as assistant secretary -- and coming back and saying, "It was all a budget meeting. I didn't have anything to say about tax policy." So those kinds of structural problems have been here for all of our careers, I can assure you. And for those of you who think administration was a nightmare, Sheldon and I remember when the IRS was given stabilization to administer, and we literally read the papers to see what we were supposed to do that day. And that was when I think inflation was 2 percent.

For the economists in the room, that was the crisis of the time! But I just think, you know, too much pickin' around the edges for, you know, is just not appropriate and it's just -- they're taking it the way they should be.

And the other thing is the misjudgment that this is not a huge crisis. It is a huge crisis, the equivalent of the Depression and the second World War. So I don't mind spending the money equivalent to the second World War because I think that's almost what we're in; that is, you know, you can make a decent argument -- again the economists may differ with me -- that it was the second World War that really took us out of the Depression, dramatically and fully.

And that's -- I look at these charts going, okay, we're running the spending up like we did in the second World War. The question -- and consumption's down because people are just scared.

So, you know, I just want to say that I think they're doing, you know -- I don't want to debate each specific ones, but I think it time for something to be done, and I think that is leadership. So I don't -- I don't agree with your comment.

MR. BERGIN: Okay, good. Joe and then Bill.

MR. MINARIK: Okay, defending myself, the first thing I should say is I'm actually plagiarizing Leon Panetta in drawing that distinction, although I've heard other people say it since, that we govern with leadership or in crisis.

Having given credit where credit is due, we were talking about the administration's tax policy. I don't think, as I think I said in my remarks, I don't think any economist around this table would dispute the notion that it is the role of the federal government -- it was the role of the federal government to fill in the output gap which is there and which is causing -- pardon the causational terminology -- but that's the reason why we have falling employment, large unemployment: This is the federal government's role.

That having been accepted, we also have a rising debt. I agree with what Bob Rubin said on his book tour at the beginning of the Bush administration back in the early part of this decade when being asked: Well, you had a weak economy, you had a recession that was starting in 2001, weren't the Bush tax cuts appropriate fiscal policy for that?

And his answer was, "You could have provided equivalent fiscal stimulus with temporary resident permanent tax cuts, and you would not have given away the improvement in the long-term fiscal situation of the United States."

So what we need to do is to make choices in how we accomplish the objective of filling in the output gap. That can be done on the spending side with programs that are explicitly temporary. When you get into permanent spending programs, you better decide that it's something that you believe you really need to do, and that you are willing to pay for in the long run.

It could be done on the tax side with permanent tax cuts, but if you're doing it with permanent tax cuts, you better decide that you think those tax cuts are absolutely essential and that you have the spending cuts to make the fiscal room to do it.

Alternatively, we should have done it, I would argue, with temporary provisions on both sides. We're not doing that, and that's why these curves are heading in such an alarming direction.

MR. BERGIN: Bill?

MR. MISKANEN: Bill Niskanen, Cato. I want you all to recognize that this chart enormously underestimates the death of the federal government, the implicit death for Social Security and Medicare is in the order of four to six times GDP, not 80 percent of GDP, which is on the right hand of this chart. But four to six times GDP is the implicit debt for promises that have been made for Social Security and Medicare.

The real fiscal crisis that we face is that the Obama administration has allowed the debt, the conventional debt, to increase rather sharply, without even acknowledging, let alone addressing, the fact that the deficits and the debt for Social Security and Medicare are just very much larger than anything that they're doing on the budget.

MR. BERGIN: Then that goes back to what you were saying, Jim. I was actually headed for that question, which is, is this the crisis that Joe was warning us about? Or are we currently in the crisis?

MR. KEIGHTLEY: My judgment, as I was saying, my judgment is we're in the crisis.

MR. BERGIN: Your judgment --

MR. KEIGHTLEY: That's the reason we're doing all this stuff.

MR. BERGIN: So that we don't worry about that yet?

MR. KEIGHTLEY: I think the better way of putting it is -- and we've said it -- I think Marty said it also is basically what has happened with the current economic crisis is that the long-term crisis and the short-term crisis emerged into one. So they've now become one. It's no longer the issues that we thought could be delayed -- we didn't think they should be delayed, but could have been delayed a few years --

MR. BERGIN: Yes, that's a thorny subject.

MR. KEIGHTLEY: -- no longer could be delayed, because you've got not only the issue of how do you pay off now the debt that we're incurring in terms of this recession. Now you've got to worry about the -- it's not just the amount of debt that Bill's talking about, it's the rising level of these obligations because they're rising faster than GDP. You've got that debt issue, and the two have just basically merged into one.

I go back to my point earlier about automatic policy. If you look back in any other period of our history, the 10th year would not look like that. The 10th year would be coming back down in terms of the current budget because we would not have all this built-in growth in existing promises --

MR. BERGIN: Right.

MR. KEIGHTLEY: -- that are deterring the turnaround.

MR. BERGIN: Joe?

MR. MINARIK: In terms of what the crisis is, my nomination is the crisis will occur when the economy begins to recover, when T-bill rates which are currently at less than a quarter of 1 percent, increased by a factor of 10 very quickly, and when the price of oil, which currently is down at levels as though nobody wants to drive anywhere will begin to rise. And then we're going to start to see the pressure on the U.S. Economy in terms of international financial markets.

MR. NISKANEN: Let me elaborate on this. That, however, is the crisis, the monetary policy. When this economy starts to recover, [Fed. Chair Ben] Bernanke is going to face the very awkward choice of either tolerating a much higher inflation rate, or a very rapid increase in interest rates. He's got to dump a lot of the paper that he's bought over the last several months back into the market.

So about the time that his appointment expires, which is next January, he's going to be faced by a very awkward choice of somehow living with a high inflation rate. He's more than doubled the monetary base since last August, so the money supply has gone up enormously.

Now, I think that that was an appropriate response by Bernanke, but it creates this problem of the future as once velocity starts to increase again, he's going to have to either live with the high inflation rate or be willing to run up interest rates very fast, and it presents the prospect of a double-dip recession, where we were already in a significant recession. But it presents the prospect of another recession beginning in May 2010.

MR. BERGIN: Howard. State who you are, please.

MR. GLECKMAN: I'm Howard Gleckman.

MR. BERGIN: Thank you.

MR. GLECKMAN: Tax Policy Center and editor of TaxVox. This corner seems to be sort of self-reinforcing one another. I really just want to associate myself with what Joe said. He took the words out of my mouth. I think that it's kind of interesting that this same financial markets that the Government is spending trillions of dollars on the current bailout will be the driver of a change in fiscal policy. When interest rates rise, the same financial markets will demand more money to buy treasuries. And I think that'll happen relatively soon, and when it does, I think we are going to focus rather than on a short-term economic problem.

MR. BERGIN: Sure.

MR. GLECKMAN: Instead, we're going to focus on the long-term issues that everybody around the table is talking about.

By that won't happen until interest rates go up a lot, so I think Joe's exactly right.

MR. BERGIN: Marty?

MR. SULLIVAN: I just want to make a quick --

MR. BERGIN: Yes.

MR. SULLIVAN: -- one about the interest rates. I couldn't agree more that -- well, right now short-term interest rates are an illusion created by the flight to safety all over the world. In fact, the \$10 trillion would be about one-and-a-half trillion higher because CBO reestimated the deficit downwards because of lower interest rates.

So we're just sort of getting a little -- as bad as things are, we're getting sort of a little free pass at the moment.

So, and, oh, let's go back to Gene's point: When you look at the projections, because interest rates in 2013 and 2014 -- only guys like me and Gene do this kind of thing -- you see the interest cost to the government as a percentage of GDP doubling because the debt is going up at a great rate, and the interest rate is going up at a great rate.

So another way of saying that we'd have less fiscal room as we move into the future is that the chunk of the debt of the government spending that goes towards the deficit is just growing and growing and growing, requiring more cuts in discretionary spending on top of the increases and mandatories.

We're just running out of room to run. So I just wanted to make that technical thing.

MR. BERGIN: Thanks, Marty. Len?

MR. BURMAN: You know, the point that we're in an economic crisis and we should do everything we can to get out of it is -- I don't think anybody disagrees with that -- but the thing is we've already passed an enormous stimulus package plus the TARP, and the issue is, you know, under -- the president's budget has \$300 billion in additional tax cuts in 2019 and \$470 billion in additional spending in 2019 relative to the baseline.

Are we going to need \$760 billion of economic stimulus in 2019? If we are, you're right, this is the worst crisis since the Great Depression. But the government's forecast assumes that the economy's going to improve over the next few years, and let's hope that it does.

I want to give a more optimistic view for what they're doing. I mean, clearly, you know, nobody's going to be proposing tax increases right now because the economy is in a serious crisis, and even if everybody in the administration believes that fiscal restraint, cutting back on spending, increasing taxes would be a good idea once the economy's recovered, it's probably not a good idea to talk about them right now. The optimistic view is that the economy recovers over the next couple of years. President Obama officially earned sainthood as the person who had saved us from the Great Depression, and he decides to use all the political capital that he's accumulated and say, "Okay, you know, we're on a disastrous course."

He's actually -- he's talked about this. He said, "You know, we're on a disastrous course, you know. We have to change what we're doing," and then there's magic. So what you'd hope is that once he's established all his political capital, say, we are under a disastrous course, here's what's wrong: We need to make some hard choices. We need to cut back on the growth of entitlements. We need to do specific things to get entitlement spending under control, and we're going to need more tax revenues. We're going to need to do something that's politically unpopular.

I can sort of imagine, you know, he's a great speaker and I'd like to hear him give a speech that says: What we're doing right now is we're stealing from our children and grandchildren. And Democrats and Republicans alike care about their children. This policy is immoral. We're going to change it right now.

MR. STEUERLE: This is Gene, could I again, and then Len in a little bit, I agree with you, Len, that's an optimistic scenario, and I hope it's the right one.

But there is this added factor that is the failure to have the long-term policy. A good long-term policy in place right now actually weakens the impact of the short-term policy, so that fact it threatens our foreign creditors that we might not be paying off our debt, or at least that they need to add enough of a risk factor that they should raise the interest rate. It just threatens the actual -- the actual power of the short-run stimulus. And that's -- that's the danger in it.

And the other danger in it is sort of Bill Niskanen's point, and whereas, you know, unless you think that, you know, one or two years maybe we are there. Maybe one or two years from now we've got 5 or 6 percent growth rates and things are really looking good, but in point of fact, my guess is, you know, six months from now we're going to look out, and we're going to say, boy, we got a lot -- even if we're growing, there's a lot of things that we're afraid of, a lot of the advocates for constant tax cuts and spending increases -- I mean quite honestly whether it's the extreme supply side or the extreme Keynesians, you know, we're always in a recession, coming out of a recession, or going into a recession. So there's almost never time for some of these people to engage in this long-term policy.

MR. SULLIVAN: Can I --

MR. BERGIN: Let me get Rudy first -- go ahead.

MR. PENNER: I'd just like to amend something Bill said. I'm not sure Bernanke does have a choice between inflation and knocking down the economy again because I think if we give foreign and domestic investors the least hint that we're going to default on this debt by using inflation, we're going to be in big trouble. So that, you know, one of the many bad aspects of this huge build-up is that it limits monetary policy as well as future fiscal policy.

Just on the point between our leadership in crisis, I think our leaders just missed the golden opportunity here. If you look around the world, other countries have used crises, short-run crises to make long-run fixes. You look at Sweden, had something very much like ours. They used it as an excuse to totally reform their Social Security system. Canada did the similar thing. Germany and Italy were provoked by artificial crises related to the Master Agreement. And I couldn't agree with Gene more; while our current short-run crisis is only remotely related to Social Security and Medicare, our short-run policies are going to be greatly inhibited by this great burden out there, which is going to scare people into causing the debt we're issuing to cause real crowding out.

MR. BERGIN: Thanks, Rudy.

MR. SULLIVAN: I just want to reinforce what Gene said. The short run and the long run are not separable. And this goes back to what Chris said. In 1992, where I'm old enough to remember,

Clinton had a theory. It was sometimes called Rubinomics: We're going to reduce the deficit, and to reduce the deficit -- and that's going to produce immediate economic benefits because it creates credibility in the credit markets and in world markets, and it keeps interest rates low. So there is a penalty to delaying. There's -- let me say I hope, I absolutely hope one scenario is correct, and it may make sense from a political strategy point of view, but there is an economic cost of not having credibility in your current budgets.

And that was the theory of the Clinton success, if you want to call it that. And we don't have that now. There's no rudder guiding us on where we're going in the long-term, and the financial markets know this, and the Chinese know this, and they're worried, and that just as Rudy says, that ties our hands with fiscal policy. We cannot even threaten inflation or we're going to be in a lot of trouble.

MR. GLECKMAN: I just want to respond to what Rudy said. I think it's a really important point. Obama, in fact, has said that the current economic crisis is an opportunity, but it's an opportunity to do a couple of things: In his mind it's an opportunity to cover the uninsured, and it's an opportunity to do something about global warming. It's not an opportunity to control healthcare costs, and it's not an opportunity to fix the tax system, and it's not an opportunity to fix the long-term budget. That's the choice he's made.

MR. BERGIN: Joann?

MS. WEINER: Joann Weiner with Tax Analysts. I don't agree with everyone around the table, but that's not the first time. A couple facts that I've come across on -- this hasn't really come up today, but the sort of middle class, not wanting to cut taxes on the middle class, we haven't yet defined who they are. And if you look at some of these studies by these Berkeley economists, it's really only the fortunate 400 that Joel Slemrod has called who have gotten the huge gains over the last few years.

And a recent Treasury study that I don't think has been published yet shows that in fact these gains in groups of what we call rich people, the attorneys, the executives, the athletes, the celebrities, their sphere of income went up faster under the Clinton years than under the Bush years. And, somewhat surprisingly, the fastest-growing group of with this share of income were farmers. I -- you know, Uncle Joe, I -- a couple -- so -- so that's one thing.

And then, secondly, these, these rich people who are going to be paying higher taxes, there aren't that many of them.

I took a look again at these data, and I've just asked Sheldon here how many tax returns each year? There's about 120 million.

There are only about 15 million of those that are paying more than \$105,000 or whatever. And I don't think someone with making \$105,000 considers themselves to be rich the way that around the table we're calling rich people. So that's another fact there.

MR. WHEELER: Six percent.

MS. WEINER: I'm just back from Europe, and there was a tax conference in Brussels. And some interesting points came out here. This was the European commissioner for tax, Lazlo Kouacs who organized it, and there was the German finance minister and the Czech finance minister there, and some of the facts that came out there were, 1) as Chris, I think, would like to hear, that in fact the corporate income tax is really on the way out in Europe; that 20 years ago the average rate was probably 50, 45 percent, and now it's down to about 12 percent. And it's just the rate. And

there was a study presented by Michael Devereaux of the -- of Oxford University showing that at this time the U.S. rate has really been unchanged except for increasing by one point.

He also made the point that the U.S. is not collecting much revenue, and so we seem to have it backwards in the U.S., a high rate and a very low take on that. We're spending a lot of time going through this.

The British have a different way of dealing with tax people. You mentioned about, well, why don't we just trust our corporations? Well, in fact, the way the U.K. does --

MR. BERGIN: Marty did.

MS. WEINER: Marty.

MR. LOBEL: I'm guilty.

MS. WEINER: They basically didn't have more -- they have more of a principles-based approach. So you know it's going to be wrong to, like, shift all your operations to Ireland rather than the U.S. We say, you know, here's the rule. You have to have 20 percent of your whatever it is in this country. So it's a whole different view, and I think it might work better.

A final point is the German healthcare system is really on its deathbed, and to all you that the Europeans have done it right because they provide state -- healthcare by the state is just wrong. And so that's not going to be the solution.

They have had a VAT, and they have a huge share of taxes as their economy may face the same problems that we do, so I don't think a VAT is the solution to all of those.

MR. BERGIN: Chris.

MR. EDWARDS: A quick point on the rich people. I was just looking at the CBO study they do every year on average effective rights of essentially all -- all federal taxes, and, you know, some people seem to have this conception that if the rich at the very, very top end seem to have got a lot richer, but there isn't a fixed pie. There's no proof or evidence as far as I know that those income gains have come at the expense of folks at the bottom; that people at the very, very top end, sure they've earned a lot more money. And I mean the basic assumption, you know, from economics would be, well, then they must be -- that must be their contribution to the economy with, of course, various exceptions.

If you look at the CBO average effective tax rate data, I mean the people at the very top, you know, if you consider income and payroll and I guess corporate and the other taxes that CBO puts in there, you know, it's about 25 percent or so.

The middle sort of class is somewhere around 15 percent, you know, as a rough kind of number. So, you know, going ahead with all the spending, where is there -- the taxes are going to go up, where's the room?

It seems to me there's no more room at the top. The average effect of rate for folks at the top is already high, and I don't think in a global economy we're going to be able to squeeze much more out of them. I think -- and so I think that, you know, all that spending, ultimately -- and this is why Europe, of course, one of the reasons why it's gone to the VAT, because, you know, it's a big -- it's a big extra source of revenue on the broad middle class, and that's where the pot of money is.

MR. BERGIN: Marty?

MR. LOBEL: I'd just like to respond to that a little bit. I've read Piketty and Saez, and the top one-tenth of one percent of the United States has increased their share of revenue to, I think, extraordinary disproportionate amounts.

Why is it that an American CEO is worth 400 times the immediate income of his employees where in the U.K. it's 40 times? Are American CEOs that much better?

Larry Summers, who's a pretty fair economist -- his ego wouldn't fit in this room, but he's a pretty good economist -- estimated there was an \$800 billion shift during the Bush administration from the middle class to find as the middle three quintiles to the top one-tenth of 1 percent. Now, if that's -- and the classic example, and this is one that really irritates the hell out of me -- is Greenwich, Connecticut, regardless of what the hedge fund guys thinks, is not part of the Cayman Islands. I mean, these guys are earning hundreds of millions of dollars, they're earning it, quote/unquote "in the Cayman Islands," and they're only paying 15 percent when they deign to return it to the United States. That's not what I consider good tax policy. And I think we have to do something both as a public apology for the abuses of the tax system to correct that.

Whether that's going to have an adverse impact, do you think, you know, Schwartzman is going to leave Greenwich, Connecticut, for the Cayman Islands? I mean -- you know.

MR. EDWARDS: They do. I mean if you're an entrepreneur, a high-tech entrepreneur, if you're starting, say, a, you know, an oil services company and most of your clients are abroad in the Middle East or abroad -- you don't set up your company in the United States anymore, you set it up abroad.

MR. LOBEL: We ought to change the international tax system so they have to pay taxes here.

MS. WEINER: And, Marty, another fact about those data -- which is great, facts are wonderful things, as we've heard before -- but it's flat for everyone below those top hedge fund managers, and there aren't enough of them up there, especially now, so if --

MR. LOBEL: It's all gone to the really top.

MS. WEINER: It's all gone, yeah, it does, so that's a separate category.

MR. BERGIN: That goes back to the question I asked in my opening remarks: Can you get there by taxing the rich, whoever they are, and the corporations? It doesn't seem to me you can. Most economists here are shaking their head.

MR. STEUERLE: The TPC ran numbers again and again on, you know, -- dropping, say, the Bush tax cuts for the richest way back when [Sen. John] Kerry was worrying about it, it was like about \$50 billion. Maybe it's \$70 billion now or something like that? I don't know, whatever the number is. But you're talking about hundreds and hundreds of billions of dollars here, or trillions.

Of course, you could maybe double that, too.

MR. BURMAN: I think you can clearly collect a lot more revenue from the rich. You can't close a \$1.2 trillion gap by just taxing the rich.

MR. COHEN: In other words, you don't -- but you don't collect that gap all in one place anyway, so you have to start somewhere.

MR. BURMAN: Let me ask -- I mean the other things that -- I mean, you know, a part of it -- part of it is the rates, but the other thing is, you know, there are tax bases very porous, and the individual especially on the corporate side, and we probably could reform the corporation taxes similar to a significantly lower rate and raise more revenue if we had a broader base.

MR. STEUERLE: Actually, there's another question here. Gene Steuerle again. There's another question here is if --

If we do not call the tax increases on the rich first, what does that do to the prospects for tax reform, if tax reform has to engage the middle class, which actually in this so-called new commission study the middle-class is not supposed to be included except for some simplification.

So, I mean, are we actually deterring the possibility of doing middle class tax reform simply because we've already raised the taxes on the rich?

MR. BERGIN: Okay, I love you guys, but I'm going to get away from the table for a second. That's great.

MS. SINGER: My name is Paula Singer. I'm a tax lawyer, and I own a software company, and I usually have two or three articles in the Tax Analysts magazines each year. I had one in November that had "Common Sense" in the title, and one in "The Year End Review" that had "Common Sense" Tax Reform in the title.

So I'm big into common sense. I am not a -- I'm not an economist, and everything that I do or say is really based on my experience, and I have some very unique experiences.

I started doing tax returns in 1976, so I have to take issue with anybody who says that the 1986 tax act was simplification. And I have a couple of quotes, one from Harvard Dean Erwin Griswold and one from [former Rep.] Dick Armey that say the same thing. The one was Armey was in my "Year End Review" article. So don't hold that up as the what we're trying to do in dealing with simplifying the tax system. It won't work.

When you're dealing with the corporate income taxes, you have to recognize that I think something over 60 percent of profits now show up on individuals' tax returns because of the growth of the flow-through entities, as I address that in my "Year End Review" article. And the reason that that happened was back in the early '90s when they were trying to integrate the tax system, it never worked.

So as a result, you have a tremendous amount of complexity, and a huge amount of tax returns are unnecessary if you change the system to integrate the personal and corporate tax systems, which I think you should do by allowing dividends to be deducted. I think it would be great to focus on the owners for a change instead of the managers, who are the ones that take advantage of all of the capital gains.

I did, in my article, recommend that things that -- such as education and healthcare should be not done through the tax system because it doesn't work well to do it. I think it's right to deal with healthcare now because of the huge cost that's on companies, especially small companies. And I've been involved in the management of two small companies over the last 20 years. I have spent an inordinate amount of my time making sure that we have health coverage for the individuals.

I know a couple of years ago, I have a health -- well, it usually goes up 10 percent a year for the cost of the health coverage, and a couple of years ago with the software company we have fewer

than 25 employees, it went up by \$25,000, and not all of the employees are on the health coverage. So that's money that, if we can solve that problem, it's going to go back into the economy in terms of jobs and salaries and will solve a lot of the problems, plus there are a lot of problems for the uninsured.

And I grew up in a working poor family and had no health coverage most of the time I was growing up. And it causes a lot of problems in the long run, and you learn to put up with things like pain because you can't go to a doctor.

So there's a lot that needs to be done, but you really have to keep an eye on simplification in the process. And I agree with the comments about the difference between credits and deductions, and that's one of the things that I commented on in my "Year End Review" article as well. And what happens when you're dealing with the refundable credits, the nefarious people move in and they start draining revenue through tax rise taking revenue through the credits. So there's a lot of things that you have to bear in mind when you're putting all of this together. It's not -- it's not just at the federal level with all of the economics in mind. You have to deal with all these other things, too.

MR. BERGIN: Anybody? That woman back here?

MS. IVNOVA: Thank you. Anya Ivnova from the International Monetary Fund. Just first a comment, and then I have a question. The comment is on -- there was a comment on German healthcare. I just wanted to point out that it's a public/private healthcare system. It has massively better outcomes than the American -- massively better health outcomes, delivers massively better health outcomes at a lower per capita cost. So I think greater attention to the fact is in order.

The question I have is for Mr. Steuerle. You made a comment about the administration's proposal to limit itemized deductions. Well, that was in part of a larger proposal to general revenues for the healthcare expansion, right? You said that this is ultimately going to hurt low-income and middle class individuals because charities are going to get less money.

But what about healthcare? It's also going to benefit low-income, middle-income people, right? The other thing is, do you really think is, do you really think that the interest deductions on mortgages help serve the economy well?

MR. STEUERLE: Well, it's a fair question. What my point was, that there are many people who believe that we should be converting many types of deductions and exclusions into credits, and my point was that it's actually a more complex issue than that. And the point I made was if you're getting interest receipts on one end and interest deductions on the other, and you're taxing the different rates, you started playing games.

And the reason it's complex there at housing, and I probably don't have time to get into this, is the real tax break is for the exclusion of the imputed rental value, which you could never argue before Congress.

What it means, for instance, if you own your home outright, as many of the older people around this table do, we get all of the tax break because we're getting all of that excluded rent. And the fact that we don't borrow means we don't get this backdoor way of trying to limit what we're getting. And I still probably would limit interest deductions to some extent because -- because there's just things I don't like about it in terms of capping it for second homes, stuff like that. I'm just saying just trying to do roughshod over it doesn't always work.

With a charitable deduction, I didn't say that the lower-income people wouldn't be better off; I wasn't assessing the total policy as a whole. My point was to the extent the middle class gets hit,

what this administration so far has said is it's only being able to do it, are (off mike) the paper sum of what they get. Even if upon net, they're beneficiaries. It's only going to do it to the backdoor and indirectly.

With respect to the charitable deduction, my own view is that you can debate this in the tax system. You could tax the transferrer or you could tax the transferee. The tax system is totally inconsistent in this regard. Principals would expect the couples, if you're married, it essentially treats the spouse as if the spouse gets the transfer from the husband or the wife, and that's how they do income splitting.

It taxes the transferee. And the charitable system, you could debate it, or you could say, well, we either are going to tax the transferrer or we're going to tax the transferee. If you view what's after the charitable deduction as basically a break for the transferee, that you get this charitable deduction that gives you this free visit to the museum, you're the one that benefitted from the income. And what I'm saying is now your benefit will be less to the extent there are fewer charitable deductions.

So, yes, some of the middle class and some of the poor will be hit by the decline in charitable deductions. It doesn't mean on net they're behind, but they will be hit. And my point was that's indirectly you're letting the hits on people come indirectly rather than directly.

MR. BERGIN: When Marty first showed me that chart, I became very depressed, and from some of the things I've heard here today, I think I'm getting more depressed.

So I'm going to latch onto Len -- Len's hope here. You know, I've heard a couple of things. One of the things is, you know, Congress, the budget processes Rudy mentioned is a -- is an absolute mess. The last president we had told us we were in two wars and, yippee, we were going to get a tax cut.

I agree with Jim. I think we're in a major crisis right now, and the current administration is saying most of us will get a tax cut.

I think one of the reasons we're where we are is because the American people don't understand their tax system, and we keep telling them everything's okay, and maybe it's time to go to them and say it is a crisis, and as we did World War II, everybody have to kick in. So I think part of the reason we're here are the people that, you know, a lot of times the politicians to this town don't really think about.

Anyway, Jim?

MR. KEIGHTLEY: I was just going to ask -- I'm fairly optimistic. In the long run there's going to be some crisis that will drive the compromise where you will cut back on entitlements, and you will raise taxes on everybody, and some day somewhere that will be forced into the system because I agree with all of the numbers everybody's doing -- my kids have heard this lecture many times about we're shipping this all to you kids. Well, they like it because then I ship some to them directly.

Anyway --

MR. BERGIN: Joe?

MR. MINARIK: Just a footnote to that, when we react to try to make complicated changes in policy in crisis under time pressure without the opportunity to consider carefully what it is we're doing, we often come up with simplistic solutions.

And it would be much to our advantage if instead we took the initiative and tried to deal with these issues in a more thoughtful way.

MR. KEIGHTLEY: I would agree with that observations, but, unfortunately, in a democracy crisis is what drives you.

And what the economists should be doing is getting ready for that day so you have the proposals ready to go when somebody says, gee, we need this compromise, this giant package. What do we do with it? Because you can't tax all the rich people.

There are not enough of them around. You can take all their money, and you're not going to balance the budget, so it's just a numbers thing.

MR. BERGIN: Right.

MR. KEIGHTLEY: I -- you know, I'm no economist, but I can see the numbers.

MR. STEUERLE: We'll wait for the lawyers.

MR. BURMAN: Here's one more reason for optimism, that one of the odd things that came out of the election was poll results suggesting that majorities of both Republicans and Democrats thought that their candidate would raise taxes, even though McCain proposed enormous tax cuts and Obama proposed ridiculously large ones.

And most people took that and inferred from that, that people just weren't paying attention. They were kind of clueless.

But another possibility is to actually acknowledge that things are out of whack and that eventually we're going to have to pay for it. And if somebody proposed a way to do it that people perceived as fair, and that actually would make the tax system simpler, and particularly if it was framed in a way that it was, you know, that it was -- that it was designed to keep from screwing over our children, they would go along with it. Or at least enough would go along with it that there wouldn't be a political price.

MR. KEIGHTLEY: I agree.

MR. BERGIN: Yeah, I agree with you, Len. I think you're magic. I think your magic is the American people, if it's done right.

This has been a -- uh, Joann, do you want the last word?

MS. WEINER: Sorry. I have a couple of revenue-raising points. The cap and trade, even though it's apparently not very popular, apparently at the White House they think they could get two to three times as much from it as they've said publicly.

So there's a lot of money there. And also, it works in other countries or areas like Europe. So I would not dismiss it, and we've never had a full-fledged carbon tax.

And the other thing is, I recently learned about a Danish experiment, and it's great. Actually, Sheldon would love this. What you do is you can get a lot of money, and they did this -- some Danish economist worked with the Danish tax collectors, which is one point that IRS is not very generous with its data. But they had this study, and they put out these letters to all these taxpayers and said: You're going to have a 50 percent chance of being audited. Now, before you get audited, you can actually pay what you think you owe. And they got an awfully lot of kroners coming in.

MR. BERGIN: This has been a terrific discussion. Let me thank all of you, and especially Len, Chris, Gene, Bob.

Great discussion. Thank you all for being here. We'll have another one, soon.

(Whereupon, at 10:57 a.m., the PROCEEDINGS were adjourned.)