

# Center for American Progress



**A PANEL DISCUSSION:**

**“THE FUTURE OF TAX REFORM: OVERHAUL OR  
MORE OF THE SAME?”**

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BUDGET POLICY, CENTER FOR AMERICAN PROGRESS**

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**2:30 PM – 4:00 PM  
FRIDAY, OCTOBER 28, 2005**

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JOHN IRONS: First of all, welcome to the Center for American Progress. I realize that this is a very slow news week – (laughter) – so I’m glad everyone can come out to listen to a little bit on taxes. My name is John Irons, and I’m the director of tax and budget policy here at the Center.

I want to first draw your attention to two new products that the Center’s releasing today. The first is called “Tax Complexity by the Numbers,” which is included in your packet, which looks at several measures of how complex the tax system has become. The second piece is called “The Five Easy Pieces Scorecard,” that’s also in your packet, which looks at the conservative strategy on taxes and some of the tax changes that have taken place over the past several years. And the report also suggests several different approaches to tax reform. Like I said, both of these documents are included in your packet. This is one of the thicker packets we’ve had here at the Center, and all these materials are available online, I believe, as of about an hour ago, so you can get these all electronically as well. Finally, there are copies of the American Progress Tax Plan that was released back in January, which were available out on the table as you came in.

I’m very happy to introduce this distinguished panel today to talk about the President’s Tax Reform Commission and about tax reform more generally. Last January, the president appointed a bipartisan panel to develop tax reform recommendations. In the executive order that created the panel, the president requested recommendations that would be revenue neutral, that would recognize the importance of incentives for charitable giving and home ownership, and that would share the tax burden in an appropriately progressive manner. The tax panel later took this to mean that the reform (proposal?) should be distributionally neutral as well.

On a positive note, this guidance prevented the panel from taking further steps in the wrong direction. The president’s recent tax changes will cost trillions of dollars in lost revenue and have given disproportionately large tax cuts to those with the highest incomes and with the most wealth. However, the panel was already two massive steps behind, since the president’s revenue-neutral mandate was relative to a baseline that already assumed that Bush tax cuts would be extended beyond their current expiration dates. This means that the panel’s recommendations effectively lock in low levels of revenue in the Bush deficits, and they also lock in tax changes that benefit the highest income earners.

The panel also appears to have done some serious work, and what we know of their final recommendation shows that they may have some positive recommendations; however, the overall direction of recent tax policy in terms of the overall revenue and distribution, in my opinion, must be reversed. This is something the president’s commission has not addressed that needs to be part of the overall debate.

The president's panel will make their final recommendation to the Treasury next week, but what will eventually come out of the Treasury will not necessarily look much like what the panel recommends. It would surprise me with these proposals are – I'm sorry, it would not surprise me if these proposals are simply cherry-picked for those components that fit this administration's ideological goals and the hard choices that the commission had to make to achieve revenue-distributional neutrality will simply be ignored.

But let me first introduce them – and let me now introduce the panelists and allow them to present their views. First up, we have Howard Gleckman. I'll just introduce everyone and then we'll let them go one out after another. Howard Gleckman, on my right, is senior correspondent in the Washington bureau of *Business Week*. He covers fiscal policy with a special emphasis on taxes. He has been with the magazine nearly 20 years and has been following the president's tax panel quite closely.

Gene Sperling is a senior fellow at the Center for American Progress. He served in the Clinton administration as the president's national economic advisor and director of the National Economic Council. He will soon be releasing a book entitled *The Pro-Growth Progressive*.

Bill Gale on my left is the Arjay and Frances Fearing Miller Chair in Federal Economic Policy and the deputy director of the economic studies program at the Brookings Institution. He also is co-director of the Tax Policy Center. His areas of expertise include tax policy, budget and fiscal policy, public and private savings behavior, and pensions. He has taught economics at UCLA and was a senior staff economist at the Council of Economic Advisors.

Finally, Ruy Teixeira, on my far left here, is a senior fellow at both the Center for American Progress and the Century Foundation. He is the author or co-author of five books, including *The Emerging Democratic Majority*. He also maintains a popular blog on public opinion research and other political matters. The blog is called Donkey Rising for those of you who are interested. (Laughter.)

Each panelist will speak for about 10 minutes, and then we'll open it up to questions at the end.

Howard?

HOWARD GLECKMAN: Okay, thank you, John. As the lead-off hitter here, I'm going to talk a little bit about the substance of what the commission is likely to propose, and then I'll briefly discuss some of the politics, and I'm sure we'll talk about both of those subjects in more detail when I'm done.

I've got a little bit different take, I think, than John. I think on the merits the commission deserves a pretty good grade. I expect the report it will release on Tuesday will be a serious look at tax issues and one that will present some important, well

reasoned changes to the tax laws. It would be a mistake to write this off as just another pre-cooked report by a panel that's in the bag of the president that appointed it.

Next week, the commission's going to lay out two proposals: one will be a reformed and simplified income tax, and the other a consumption tax. There are lots of details we don't know, and taxes more than in most things, the devil's in the details, but we've got a pretty good sense, I think, at this point about where the panel's going.

The reform income tax, which is probably the easiest to understand, would accomplish some very good things. It would clean out the current code's nest of rules for low-income taxpayers and replace them with a much more simple regime. That in itself, I think, is a good thing. The standard deduction, the personal exemption, the child credit will all be replaced with a single, simple family credit. The exceedingly complex-earned income credit would also be replaced by what the commission promises will be a simpler work credit.

Another step, the alternative minimum tax, which I've think nearly everyone agrees is pretty awful, would be repealed. Tax breaks for McMansions and vacation homes would be curbed, so would tax breaks for gold-plated health plans for state and local taxes. These would all be hot-button issues, but the proposal – the panel, I think is onto a pretty good idea here.

The commission would also get rid of dozens of savings incentives that now riddle the code. We all know about the IRAs, SEPs, SIMPLEs, 401(k)s, MSAs, FSAs, education savings. There are – I don't know, two or three dozen of them. The commission would get rid of them all and replace them with just three; a work-based 401(k)-like retirement plan, an individual-based IRA-type retirement plan, and a third plan geared to saving for medical care, education, or buying a house. Each would have just one set of eligibility and withdrawal rules. And for low-income families, they'd also expand the Savers Credit. I think they could probably narrow these down even more, but three or four is certainly better than dozens.

And there are other issues about these savings proposals, and I know Gene's going to talk more about them, but they're very generous, and they allow contributions of up to 10,000 dollars for each account. By some estimates, as much as 80 percent of dividends, interest, and capital gains could eventually be sheltered through such accounts. And that raises real questions about how we're going to tax capital income. It also raises big questions about the cost to the Treasury.

I know Bill Gale has done some proposals on – some estimates on similar proposals and suggested that in the long run the cost could be as much as \$50 billion a year. It's important to note that at least two of these proposals are Roth-type plans, so that you don't see the tax savings for many years, and therefore the Treasury doesn't see revenue lost for many years, probably outside of the budget window when this thing gets scored.

On the business side, the first plan would eliminate most deductions and credits and reduce the rate to 32 percent from the current 35 percent. Dividends would be taxed at the corporate level and be most mostly tax-free to recipients; the same with capital gains, which would enjoy 75 percent exclusion.

There's one big but, which I think is very interesting here. They say that the dividend tax break would apply only to payouts on domestic earnings. And I think one of the things that would be interesting is to figure out how they're going to calculate that.

Plan one would also exempt foreign income from U.S. tax. This is one of these funny paradoxes in the tax law that many economists believe that exempting all foreign income from U.S. tax would actually increase the tax liability of multinational companies.

Finally, the panel members have talked in a general way about another very big change, and that is to more closely conform book earnings and tax earnings. Now, this sounds like real green eye-shade stuff, but potentially it could be hugely important in the way companies do business.

Now let me briefly discuss the second proposal, which some call progressive income tax or consumed income tax or sometimes an X tax, and it's built on a design first crafted really almost 30 years ago by the late economist David Bradford. It's a consumption tax, but rather than paying a tax at the cash register like a sales tax or having it included in cost of goods, like a European-style value-added tax, you'd pay it by filing a tax return as you do today. Sometimes it's a little hard to understand, but when you boil it down, it's really pretty simple. You're taxed on what you spend because you get to exempt what you save. Just think of it maybe as a super IRA. So the tax base is income less savings. To give you the very oversimplified example, my company pays me 100,000 dollars. I save 20,000. I spend 80, and that's what I pay the tax on, on the 80 that I don't save.

In a pure system, capital gains, dividends, and interest would be tax-free to investors, but they would be taxed at the business level. The panel is going to adjust that just a little bit and include a 15-percent surtax on investment income.

It's also important to think about the two proposals as they mesh, and I think because of the very generous savings incentives in the first proposal, in the reformed simple income tax, for most people, the real-world difference's between the two proposals is going to be relatively small. On the business side however, it makes very big changes in this consumption tax. The first one is that the cost of capital equipment would be expensed or written off in the year it's purchased. Today it's depreciated over a fixed period of years, and that's a system that sometimes reward investment and sometimes penalizing it, depending on what you buy.

Second, the whole gaggle of highly-targeted corporate tax breaks that we know fondly as corporate welfare would disappear. The R&D credit, all the tax breaks that we

saw loaded into the recent energy bill – all that stuff would be eliminated. Third, and this is the difficult part for corporate CEOs and corporate tax directors, companies would lose their ability to deduct all of their interest costs. This is a big deal because today companies pay trillions of dollars in interest, all of which is deductible and which often can lead to a company never paying any taxes. Losing the deduction is the price business would pay for getting to expense capital equipment.

On a consumption tax there are also three very big issues that I think the panel is going to punt on. One is the taxation of financial institutions, which are a world unto themselves, but which also of course are an increasingly large piece of the U.S. economy. Another is taxation of foreign income, which is a hugely controversial issue that Congress wrestled with as recently as last year in a big debate over FSC/ETI – couldn't resolve it then. I think the commission feels it probably can't resolve it now either. And the third one, which may be the most important, is the transition from the old system to the new one. It sounds very technical, but it really could be the biggest single obstacle on the road to a consumption tax. There are something like \$3 trillion in unused business tax breaks floating around the system today. If they're lost, companies would take a huge hit to earnings.

And that brings us finally to the politics. Let me just raise a couple of points. The first one is when you think about the politics of tax reform, always remember three words: winners and losers. There's going to be lots of both in what has to be a revenue-neutral reform plan.

I do expect that Bush will embrace tax reform as a top domestic priority for next year. After all, he needs to inject something new into what's a very difficult agenda and some very difficult politics, as we've all seen today. Like John, I don't think he'll propose either of the plans that are offered by the commission. He may go for a modified version of Plan A or he may call for broad reform in the most general terms and leave it to Congress to fill in the ugly details. If the president does put reform on the table, I think his biggest challenge won't be selling it to Democrats, but it will be selling it to conservatives and to the business community, which are already deeply divided over broad-based reform.

Many conservatives who prefer a tear-it-out-by-its-roots retail sales tax are already deeply disappointed in the panel's recommendations. And business, as I suggested earlier, is going to be badly divided. And insurance companies, mortgage bankers, real estate agents are all going to hate these proposals. A reform plan could also pit importers against exporters, and capital intensive companies against firms that rely more on brain power than big equipment. The business community, which was a reliable ally in Bush's first term tax cutting agenda will be deeply torn over revenue-neutral tax reform. In many cases, Bush's biggest fight won't be with his political rivals, it will be with his friends. That's why I think that in many ways tax reform may be the Harriet Miers of fiscal policy. (Laughter.) And with that, I think I'll turn it back to John.

MR. IRONS: Gene?

GENE SPERLING: Thank you. They were having a discussion today on the radio about whether she would become like Borked, but then they were saying it was confusing because “Miered” was already – (laughter) – “Miered down, Miered” – in any case, thank you.

First, let me, I guess, emphasize one point that Howard just said, which is this is very difficult because you have – if you really are serious about revenue neutrality, you inevitably have winners and losers. And the political rule that seems to be is that once losers are identified, they are 100 percent sure that they will be losers. And winners, even if they are a greater number, are very speculate – are very uncertain that they will actually get their gain. And so you get a very intense negative reaction from those winning and a speculative uncertain reaction from those who are winners who feel like they are often promised tax cuts that they never see or feel ever materialize. And this makes it a very serious challenge for anyone, regardless of the – of what you’re trying to accomplish.

So even when you’re looking at a particular individual, and you’re trying to explain that they will lose the following deductions – mortgage deduction or something, but they will gain with lower rates and that they will on net be (overall?), many people upon hearing that will think that they will lose their home mortgage deduction and doubt they will get a compensating benefit. And this is not – this is not to be critical of citizens; I think anytime that you have something you know that is positive, you are asking – the policymakers are asking you to trade something that you know helps you for an unknown that may help you. And this is a challenge across the board.

Now, anybody who doubts that this is difficult should remember that Republicans have often trumpeted tax reform, have been in control with just one exception for 11 straight years of the United States Congress, and have never thought to put forward their own tax reform plan – a sweeping tax reform plan by the majority. And this is unquestionably a reflection of what Howard was talking about. Now, this is a challenge.

Now, that said, these were all the arguments that people said in 1985 and ‘86. And this may be another part of the discussion, is that what is the political way that something can come out and gain the kind of support that gets a momentum that prevents this more targeted lobbying. That’s for another – perhaps for later in the discussion.

What I want to talk about for just a few minutes is the savings portion of this. First let me say that I think there are some big things we would – many of us would still like to see from the panel. They claim that it is distributionally equitable or neutral and revenue neutral. The revenue neutrality is certainly a reasonable aspiration, but I think a lot of us would like to see it. I think a lot of us look and see certain elements that are back-loaded and want to make sure that it is actually revenue neutral over a very long period of time and not just over the next 10 years. And that has a lot to do with the way the savings is done where it asks one to do more of a Roth IRA form where you pay your

taxes now, but you do not pay taxes that are now expected in the baseline later on. So I think a lot of us would like to see that first.

On the distributionally neutral, a lot of us feel – I feel that that as a goal is a bit of underachievement because, one, I think we've seen significant less progressivity over the last few years, but even more importantly I think we'll see more as people react and change their compensation packages in light of the changes in 2003. And I think when high-income individuals figure out how to do more in the dividend and capital gains rates, the 15 percent rate, we will see perhaps more distributional inequity, so I'm not sure that in itself is of a (unintelligible).

That said, I want to echo one thing Howard said. In light of what we have seen over the last five years, this was certainly the most serious panel we have seen. These were serious people. It was not like Social Security privatization where the bipartisan shift was really – not that there weren't a couple of Democrats, but everybody had to sign a blood oath as to what they agreed on before they started.

And finally, this was the first time in a major way in Washington in the last five years we've seen people proposing real pain and real (trade off?). Anybody who looks at this whole thing, whether it's revenue neutral or not, understands that they were – that there are hard choices here. There are painful choices since this is the first non-free lunch presentation we've seen in fiscal policy in half a decade, and I think they deserve to be noted for that.

One thing that goes throughout the discussion on reform, whether it's this or others, is the notion that the ultimately best thing for our very weak net national savings rate, and particularly our personal savings rate which is the lowest since it's been since the 1930s, is the most sweeping reform possible that would move our tax code closer and closer to a consumption tax. Even – many people on all sides would argue this would lead to a greater degree of savings. And in this proposal they do not go the whole way, but that is a driving presumption behind much of what they do.

Secondly here, you also see another way of dealing with savings, which is looking at the special accounts that Howard was speaking of in terms of how to formulate them. And I guess what I want to argue as people are looking as this comes out, is that the first enterprise I think is largely misguided. And I think the second enterprise, they did one or two good things, but they did not go nearly far enough. So what I would do is say, what is the actual problem we face in savings in our country and then ask, is the reforms being proposed addressing those as targeted as possible. And I would argue no.

Right now what we've seen for the last four years in our country is declining real wages for non-supervisory workers both hourly and weekly basis, rising debt, people spending based off their home equity. We see that at any given point as many as 50 percent of Americans are not engaged in a worker 401(k) plan. This – these are the workers that are not only not saving, but are the workers that if you gave greater incentives to, they would increase – by increasing their savings, it would be a net increase

in net national savings, as opposed to incentives, either in terms of specific incentives or by just by simply having zero capital gains and zero dividends, that would perhaps affect higher income taxpayers.

In the latter, we see that most studies show, and Bill Gale has done some of them, that people are more likely to just shift assets as opposed to increasing their savings. So if we're actually looking at what is the right way to increase net national savings, the question is, is the best thing to simply get rid of taxation on capital gains and dividends and allow people to save more or is it to give the people who are not saving, not part of 401(k)s now, the incentives to get them as part of the savings pictures?

Now, if you look at the plans to go to simply – to lock in lower capital gains and lower dividends rates here, I think there is very little argument that that is going to do much to increase net national savings or growth. Jason Furman has a paper – at the Center on Budget and Policy Priorities has a paper coming out showing exactly how minuscule the savings at the growth would be over this period. So I think that we should be focusing much more on doing what we know works best, which is how to get people to take automatic deductions out of their checks at work with a matching incentive that is automatic. This is what – for 88 percent of the Americans who are in 401(k)s, they do get a matching incentive. And again, to – not to preempt Bill Gale, but him and Peter Orszag have done work with H&R Block, which he can talk about later, but which really shows what we all understand is that the matching incentive component is a huge element of savings.

So I think the right type of tax reform we should be doing is we should be asking at each point, when it comes to savings is it actually targeted on the people who are not saving now and would increase our net national savings? And I do not believe the move towards a sweeping consumption tax or even going halfway there is the right thing.

What would I do? Well, I would have a flat-tax incentive for both – for savings. In other words, instead of the upside-down system we have right now where if you're in a higher rate, you get a 35 percent deduction, but if you're in the 10 percent deduction, therefore the more well off you are, the higher that the incentive you get, I would try to make things flat.

Let me put it a different way. If you are well off in this country, you are a three or four-time winner in our savings game. Number one, you're more likely to have a 401(k) at work with matching tax incentives – with matching incentives, so when you give, you get a matching credit. Number two, you get a larger tax incentive by being in a higher bracket. Number three, you are eligible for a variety of different accounts from the 529 – I always get confused, 529, 527 (unintelligible) accounts, higher if you're a political person, I guess. (Laughter.) Your triple – and then you get a fourth win as well, which is that you have a chance to pay on the gains either zero, if you were to go to a complete consumption tax or 15 percent bracket.

Now compare that to the working American, somebody making \$25,000 or \$30,000. They're less likely to have a tax – excuse me, a work-based savings account. If they do have one, and if they do put away money, they are unlikely to be able to – they get a 10 percent deduction. And third, the capital gains and dividend rate reductions are virtually irrelevant to somebody who is not saving.

So two things that we could do, is one we could have a flat-tax incentive. We could give a 30-percent, refundable credit across the board. Secondly, we could have a more of a universal 401(k), which would give everybody the same matching credits. If their employer did not do it, they could get it directly from the government. This would target our resources towards the people who are not saving. I think this would do more to increase savings and increase equity and increase progressivity.

And the thing I want to – I know my time is up, but the thing I want people to look at is that while in the president's commissions, they do take a couple of good steps simplifying, unifying the accounts, number one. Number two, the fact that they have – that they go to a more automatic system where you are soon – if you are at a job, you are more assumed to automatically have to contribute, and you have to opt out. These are all positive steps, but the refundable credit that they offer, which is their big gain, is a very small one, 25 percent, up to \$500. It is a tiny gesture, right at the place what is – which is the greatest heart of the problem.

And at the same time, these different accounts that Howard mentions allow a family of four who has income to put \$10,000 in each of these accounts for each person. Now, right now there are only 5 percent of Americans who even max out on their current incentives. So when you allow a family now to go beyond the current limits and put \$10,000 here, \$10,000 there for themselves, their spouse, their children, all you're doing is looking out at the world and seeing the five – seeing 95 percent of people without cake and deciding let's have a let-them-eat-icing plan. It's how you can give more incentives to the top 5 percent.

So do not be fooled by the simplicity or the generosity of that initiative. It will simply allow the 5 percent who are maxing out to get – be more – do – have more benefits in this triple or quadruple winner system. And all that's happening to the group that's not saving, that's not part of the 401(k) system, that doesn't get matching incentives, is they get a tiny refundable credit. So I think that they've approached the right issue, our low national savings rate, but they've done it in a way that I think is more likely to lead to inequity, less progressivity, while doing the least to actually help our net national savings issue and to spread wealth creation through the general population.

MR. IRONS: Bill?

WILLIAM GALE: Thank you for inviting me, and thank you all for showing up instead of watching the indictment. It's always hard to follow Gene, but let me say my wife is a psychologist and she tells me it's always important to start by saying something positive. So in the spirit of better late than never, let me say that I want to thank the tax

reform panel for giving me something positive to say about tax policy and the Bush administration. This is a nice – this has all the makings of a very nice report. And really – yeah, we don't know the details yet, and that's a caveat on everything we say. As Howard said, the devil's in the details. But it's looking like it will be a landmark document – a very responsible, serious, substantive document (in debt?).

It doesn't go to the extremes in sort of pure tax systems or canonical tax systems, if you will. Instead, what it does is sort of stretch the boundaries of the public debate and say, if you want to move to a system with characteristics X, Y, and Z, here's how you would do this. Here's a prototype. It's much more realistic than the blueprints for tax reform, which was in 1976, which really designed a sort of idealized tax system. So I think it has the chance to make a serious contribution.

I would summarize the proposals as consisting of three parts. One is they get rid of the AMT; second is to cut the tax rate on capital income – the effective tax rate on capital income; and third, they shut down a whole bunch of deductions, credits, exemptions, exclusions, et cetera, and along the way make the tax system simpler. Okay? That's not exactly what I would do, but that goes a long way toward what I would do or would want to do. In fact, I'm actually surprised that five or six of the major components in the tax reform panel report are stuff that I've proposed in the past. I'm not saying that they did it because I did it; I'm saying that tax economists with a wide variety of views generally agree on what sound tax policy looks like, and so that's an encouraging thought.

One thing that no one's mentioned yet that I'll just toss out is the report would get rid of the distinction between an itemizer or a non-itemizer. There's no standard deduction. Everyone has access to health deduction, mortgage, charity, et cetera. I think that was done to combat the notion that, gee, those rich guys get deductions that I don't get or that the working family doesn't get. But it also makes it harder to do things like return-free filing, which depends on a big standard deduction, so you'd have less paperwork to deal with. So that's kind of an aside.

I think we should impose a \$5 penalty, John, on anyone who describes this tax reform as revenue neutral. Okay? It is not. It is a \$1.5 trillion tax cut relative to current law. The only person that thinks its revenue-neutral is President Bush because he already has enacted in his own mind his own tax cuts. Okay? If we pass this law, these reforms, revenues would be lower by \$1.5 trillion than they would be under current law under the next 10 years. So they can call it revenue-neutral, but I can also say, if I abolished all taxes that would be revenue neutral relative to a baseline that had no taxes in it. Okay? That's the sense in which it's revenue neutral. It's not revenue neutral in the sense of which we normally use the word.

Making the Bush tax cuts permanent is a major, major fiscal issue. It would dig a fiscal hole three times as big as the Social Security shortfall over the next 75 years, which the president himself has called a crisis. And as Gene mentioned, even if it's revenue neutral relative to the Bush tax cuts over the next 10 years, it's not going to be after that

because it's got these gigantic back-loaded savings accounts in them. Your household will be able to put 80,000 a year in these Roth IRAs or the education, housing, health accounts – a total of 80,000 for a family of four.

The issue – the reason that that loses money is not just you're shifting tax revenues from the future to now. What you're doing is raising the amount of sheltering that people can do and so that's where the revenue loss comes from. And it's likely to be a – sort of a half percent of GDP if the estimates we did in the past are anywhere close to accurate. So it's not revenue neutral, and maybe it should be \$10 instead of \$5. (Laughter.) Maybe it should be \$1.5 trillion. (Laughter.)

Distributionally neutral – again, that's the same issue. It's relative to making the Bush tax cuts permanent. That may not be the standard you want to use. In addition, my guess is they're going to do revenue neutrality by quintile or by income level and stop at \$200,000. I have a hard time seeing how this is going to be revenue neutral in the top 1 percent of households. You're cutting dividend and capital gains taxes, you're cutting the top rate and so on. Those things really hit hard in the – at the very top of the income distribution. So I'll be surprised – I'd like to see the numbers, but I would confess to being surprised if it's revenue neutral at the very top.

A couple of other items to note, there's no payroll tax reform options in here. There's no estate tax reform options. They limited themselves to the income and corporate tax. There's no process reforms as far as I know. At least they haven't talked to about them – you know, how tax proposals are raised and scored, et cetera. There's no discussion that I've heard about changing the enforcement regime about giving the IRS more resources. I think that would be an important aspect of any reform. And as I mentioned, there's no discussion of a tax – of a return-free filing system. In fact, they've gone the other way from that, which is an issue that's worth talking about.

All right, I want to focus my remaining time on the treatment of capital income in this – in these proposals. There's two really – there's one really nice thing, one pretty good thing, and two bad things on the saving side. The really nice thing is the encouragement for automatic 401(k)s. Basically, the reform panel would make all 401(k)s automatic in the sense that workers are automatically enrolled unless they opt out. Their contributions would automatically escalate over time as their salary goes up unless they chose not to. Their investments would be allocated through a broad, diversified fund unless they overrode that choice and made some other choice. When they left the firm, the money would be automatically rolled over unless they made a choice.

You can think of this as – well, let's put it this way. If the expression “intelligent design” weren't already taken for another – (laughter) – purpose, this is what it does. It's an intelligent design of a 401(k) system. I was talking to a guy from Staples yesterday and explaining this, and he says, “Oh, that's the easy button.” So I think of it as the easy button for retirement saving. You just get put on the right path, and if you don't do anything, then you're actually doing the right thing. They would encourage that. There's

a paper on the Center's website that I wrote with Peter Orszag and Mark Iwry that lays out this proposal in detail. I'm very high on this proposal, so I'm glad they endorsed it.

The savers credit is the okay proposal here. As Gene mentioned, it's not that generous, but at least they got rid of the cliffs in the current design. So that's an improvement. And then the Roth retirement accounts and health saving, education accounts are unfair for the reasons Gene mentioned: they are big, back-loaded revenue losers and they basically make the simplified income tax into virtually a consumption tax for any household that's paying attention. It will be very easy to avoid capital taxes at the individual level.

All right, one of the interesting things, moving on, is the integration of corporate and individual taxes. And one of the things I like about the panel's discussion is that they link taxing all corporate income only once with the taxing all corporate income. And if you can – right now we don't tax – some corporate income we don't tax at all; some we tax one and a half times; some we tax once at the corporate level, not at the individual; some the other way. Regardless of what your optimal tax system is, that system is no one's optimal tax system. And if we can go to a system where we tax all corporate income, but only tax it once, that would be a big improvement relative to the current system.

So they wipe out almost all corporate subsidies – you know, energy and mining and those things that – the tax expenditures that lobbyists live by, so that's a good move in the right direction. In exchange for that, what Howard was saying was the share of dividends that will be taxable at the individual level is equal to the domestically taxable income divided by the worldwide income. We can talk about what that means. Conceptually it's straightforward, but let me just mention – that links the dividend payment with the firm's actual payments. The shareholders will have an incentive to have their companies file their income in the United States. All capital gains will be taxed as ordinary income with two big exceptions: one is your main residence, and the other is capital gains on corporate stocks, which would get a 75 percent exclusion. That 75 instead of a 100 is meant to be rough justice, I think, for the fact that some corporate income is going to be left overseas and hence, not taxed.

But again, the important thing is to notice the link between – you can tax corporate income only once if you make a real effort to tax all corporate income only once. That's the trade they're making. That's a trade I've been advocating for years. That's a trade I think most responsible tax economists would take.

There's some special treatment of small businesses which are kind of interesting, and let me talk about the international tax rules for a second and then the consumption tax. The panel is going to propose moving to a territorial system, which means that deductions on foreign expenses will not be allowed and taxes on foreign income will not be imposed. Now, that's only active foreign income. If you have money in a bank account in England, the interest on that would still be taxable. It's a passive income – a foreign passive income is still taxable. I think that this is likely to be a better system than

the one we have now. Basically right now, the firms get deductions for all their foreign expenses and they only get taxed on some of their foreign income.

So you can go either of two ways. You can tax all their foreign income and give them deductions for all their foreign expenses or you can take both of them out of the tax system. Think of the farm sector, for example, where deductions exceed come every single year, even though the farm sector has a positive share in GDP, and that's because it's easy to shelter farm income and move money around. The same thing is the case with international income, and the question comes down to, is it easier to shift dividends – I mean, deductions or income? And because people think it's easier to shift deductions around, what Howard said is right. A number of tax economists think we would actually raise revenue from exempting both foreign income and foreign deductions.

Let me make one last point, and that is the X tax. I want to emphasize two things here. One is, if you give the transition relief that Howard was mentioning, you eliminate the growth effects of the tax. The X tax that they're going to propose will not raise economic growth relative to the current system because the transition relief reduces the tax base. It forces you to raise the rates on everything else, and that then reduces economic behavior.

The other issue is – it cannot be emphasized enough – the business community splits on fundamental tax reform every time. And depending on which consumption tax proposal it is, you can tell exactly which way each business is going to go. If you eliminate interest deductions, you're going to have the smokestack industries mad as hell. If you do other things, you're going to have the Intels of the world upset. Businesses don't buy the notion that what matters is the total tax burden or on capital. They care very much what their own bottom line is. And so I think you'll find you've got the serious opposition from the X tax and the removal of interest deductions is going to come from the business community, not from individuals.

Thank you.

MR. IRONS: Thanks.

Ruy?

RUY TEIXEIRA: Thanks. I'll try to do a couple of things here. One, just talk very briefly about what the public might actually want to get out of tax reform, and then secondly, what it is – it appears that they're getting here, and how they might be likely to react to it.

Well, first of all, I mean, how interested is the public in tax reform? (Laughter.)

MR. : Look.

MR. TEIXEIRA: Well, these people are, but the problem is that may not be the median voter out there. Based on – you know, looking at other areas – you know, interest in tax reform is kind of moderate. You don't have a majority of people saying there's a major problem with the system. It's not like the way people feel about healthcare where it's like, let's do something. This is like totally out of control. People would like to see tax reform, but they're not chafing at the bit, I think it's fair to say. If they did have – if we did have tax reform, what would the public be interested in? Obviously, they're interested in the thing that John was just alluding to that the Center puts out that makes that case: simplicity. People would like the tax code to be a lot simpler and it's too complicated. People feel pretty strongly about that.

Another thing they're very interested in, probably the other main thing they're interested in for tax reform, is fairness. If we're going to muck about with the tax code, let's make it fairer. It is not now perceived as being particularly fair. People generally tend to think that the wealthiest people make out the best. The middle class kind of gets the shaft, and they would be very concerned about any kind of tax reform that exacerbated that situation in their view.

There are other concerns too. People are very concerned about the deficit these days for obvious reasons, and they're very interested in how given their current economic situation they can actually do more, not less, savings. And there are other factors as well, to be sure.

Okay, so given that, how are they likely to react to the plan or plans or many recommendations under discussion here, some of them so complex that it boggles the mind? Well, first of all, let me say there's not a lot of data on these things, you know. It's not like a lot of the things that people that are in this plan have ever been asked about in any form in the previous four or five years. And obviously, there's no data at all on this particular plan, so to talk about this is in a way to get perilously close to what you might call faith-based public opinion analysis, but I'll try it nonetheless.

So there were three things that Bill Gale mentioned as kind of a nice putting things in three baskets. One is the elimination of AMT. How are people likely to feel about this? It'd certainly make things simpler. People like simple. And if you're a middle-class family that in danger of getting hit by the AMT, people would like this. On the other hand, would they see it as fair? Because it would eliminate taxation for a fair number of upper-income people who would wind up paying no tax at all, and that's sure to be pointed out. So there could be that problem, and the associated lost revenue might strike people as not a good idea.

The mortgage deduction – I mean, it's probably fairer the way it's laid out in some of these recommendations. On the other hand, you have a problem where people feel strongly about the home mortgage deduction, and they might not need, you know, the availability of mortgage deductions up to the limit they currently have. On the other hand, if you take it away they may be very nervous about that. It's sort of the estate tax kind of problem in a way. People may not need it, but they might think some day they

would need it, and just generally they're worried about what happens when you muck about with a deduction like that that they really like.

Another similar problem with the health insurance premium, as to changing the tax treatment of that. Again, this would probably be fairer, but would it be perceived as fairer? Would people worry that that might in fact affect the kind of health insurance they would get from their employer? And you could say the same thing about a variety of these other simplifications, some of which do make things fairer, that when they're – despite the fact they might make the code simple, would they be perceived as making it simpler and would they be perceived most importantly as actually making it fair? When people – as Gene was saying, when people net out all these changes in the tax treatment of different things, and the changes in the deductions and the rules, would they actually feel they were going to get a better deal, and that's not clear, even if they would get a better deal.

Finally, the capital gains treatment, change in the treatment of capital gains, does have a big problem in terms of the public view towards this issue. They basically think capital gains more or less should be treated as other income or even taxed at a higher rate, and most people would like to see that rather than being taxed at a lower rate, which is what they will be getting. Again, that just raises the fairness issue very strongly.

So in general, when you look at these basket of changes, and there are many more I couldn't possibly cover, when it's simpler, this tax plan is simpler, these recommendations rules in a simpler tax code, would it be fairer in the view of the public? And even where, you know, in reality it might be fairer, would they actually perceive it as so? And again, we just have this big problem where people's view of what it is and what it is may be two different things, and that has to be treated delicately.

And then you add onto it the problems that Bill Gale was mentioning about is it truly revenue neutral, you've got the savings provisions such as they are – are they really going to strike people as making it easier for they themselves to save more? None of that is clear. So I think overall, despite some – you know, this is, as people have emphasized repeatedly, a pretty serious look at the problem and clearly represents some progress toward simplifying the tax code if implemented, at least in the form they describe it, it seems to me that it would have serious problems being perceived as being fair and fair enough to elicit any kind of real enthusiasm from the public. And then again, you add on these problems with the potential loss of revenue, you add on the sort of murky situation with its effect on personal savings, and what that says to me at least is that it's not likely to generate a great deal of public support and public excitement.

And then when you add that the sort of – the Harriet Miers of fiscal policy problem, it may produce splits in the constituencies that traditionally support the Republicans and that they might try to rely on to put this through. And I think it all says that these recommendations in the form they're being put forward are unlikely to happen. And in fact, you could make the argument that given the nature of these splits that tend to occur in interest groups – lead interest groups, about tax reform, the only thing that could

overcome that would be a tax reform plan that the public was easily able to understand, would definitely see as fairer and making the tax system better in that respect, and in that sense would generate enough juice to overcome the opposition that's sure to come from various parts of the business community and other interest groups. So I wouldn't exactly go as far to say this is dead at arrival, but it may be barely breathing.

MR. IRONS: Thanks.

Before we go to questions from the audience, I think I just might ask if the panelists have questions for one another. No? Okay. Well, we'll just open up to questions. There's a microphone going around here. Please wait for the mike and please identify who you are before you ask your question. I'll maybe go in the back here.

Q: My name is Bill Neal (sp). I'm an author. I write about the future of the Democratic Party, among other issues. I didn't hear anybody address – I was a few minutes late – the concern with the tremendous shift in incidence of taxes away from corporations, meaning as a percent of federal revenue collected, and on to individuals. Is that because the two proposals from the commission didn't address it? Are you worried about it? I am, as a citizen. And second of all – I guess this is a three-part question – off-shore tax shelters, tax havens that people have talked about closing – were they addressed in the umbrella terms you were using? It may or may not have been, but I don't think you clarified that. And then finally, do any of you like or see any future for the Tobin tax which would raise enormous revenues for, depending on how it was cut, designed, and so forth, either international aid to the countries who need it the most or could be broken down into national shares in some way?

Do I need to say what the Tobin tax is for the audience? It would be a tax on the circulation of currency speculation that the vast quantities of sums that flow and transfer every day, it could be currency, it could be fast capital and fund flows – revenues generated from a very light tax would be enormous, the hundreds of billions of dollars, from some of the proposals I've seen. Thank you.

MR. GALE: I'll take a stab. I'm not a fan of the Tobin tax. People forget that a tiny tax on a daily flow translates into an enormous percentage tax on the daily rate of return to that flow, and nothing I've seen tells me that the Tobin tax is a good idea.

On the issue of where the money is coming from, corporations versus individuals, I think the more important – who actually sends the check to the government is less important in an economic sense, though it may be important in a political sense, than the concept of what is actually being taxed and so that's point one.

Point two is I believe that the closing – if we're serious about closing shelters at the corporate level and then taxing all corporate income and taxing it only once, my sense from the estimates I've done is that that would raise revenue, not reduce it. That is, that that's a deal we should take.

And third, the territorial – the international – (laughter) – treatment – the treatment of international income in the proposal, as Howard mentioned and I mentioned, would likely raise revenues because not only would it forego the taxation of foreign income, it would disallow deductions of foreign expenses. And it's much too easy – and it would do it with – as I understand it, with strict allocation rules, so I think that would be a net gain. So – well, let me just leave it at that.

MR. GLECKMAN: I just second what Bill second. I think if what you're concern about is corporations paying taxes, you could hardly do worse than the current system. And I think the goal of the commission is to try to make sure that capital is taxed once someplace. In the current system it's often not taxed at all.

MR. SPERLING(?): I would just say, I have not had as much chance to look on the international side, but I do think that there is going to be greater discussion over the years on the international taxation. And I think that this was raised in the 2004 campaign, and this is – in which the one thing that everybody agreed was that the current system was broken, and people go in very opposite directions as to how to deal with that. But I think we face – you know, I would say traditionally there's a – research kind of would suggest that as people expand overseas they're also expanding at home. Whether that takes place as much going forward I really don't know, but I think it's worth having a degree of humility about. And I think that there is still something troubling that people are going to have to deal with with the idea, still, that when you have two U.S. competitors and one is thinking about whether to relocate a plant in the U.S. or to a tax haven that they actually face a competitive tax advantage by going overseas. And that I still think is – I don't think that conversation will die with this tax reform commission or with the 2004 campaign.

Q: Hi. I'm Sonya Schwartz with the National Academy for State Health Policy. I'm particularly in the cap on the employer deduction for health care expenses, and I wondered if you guys could provide some more information. I think what I saw was that it might be something like cut to \$10,000 with – geared to – and then targeted to inflation, but obviously since health coverage costs are growing much faster than that I think in the short term we wouldn't have a problem in the first year, but it might really change behavior of employers over time. I wondered if anyone could comment more about that?

MR. IRONS: Yeah. I think the two plans have different values for what they're capping. This is I think one area where they haven't exactly specified the area. We have to wait until Monday or Tuesday, whenever they release the plan, to know the exact details. But I think the issue that you raised, which is do you peg it to inflation or do you peg it to health care costs, is very important, and maybe you could comment on that.

MR. : Yeah, and John is right. One of the things they did not resolve at their most recent meeting is what kind of index they want to use. And obviously it makes a very big difference. If you index to inflation, to CPI or something like that, very rapidly people will be paying taxes on their health benefits. If you could index it to health

inflation, well, then you're kind of sitting still. And the average health plan – Paul (unintelligible) is here, he can help me – but the average health plan now is about \$10,500, something like that. So if you index it at \$11,000 or \$11,500, or you set it at \$11,500 then index it to health inflation, well, obviously no more people are going to get caught by the tax. So I think a lot of it is going to just depend on much revenue they need to raise.

MR. : I think what they did say at their briefing was \$11,500 for a family and \$5,000 for individuals, and I think they based that off what members of Congress now receive.

MR. : I'm sorry, let me just follow up. The restriction on deductibility of health care – of health insurance premiums is – if it gets – is a really important first step in the right direction. The two problems with the health care system are generally – well, there are several – but two of the big ones are it costs too much and not enough people have coverage. The tax deduction contributes to both of those. It contributes to the costing too much because to get a tax deduction people buy more of it than they otherwise would, right? There's a lot of stuff that's "medical expenses," that's run through the tax system that does not have an insurance aspect to it at all, like regular dental checkups, you know, that you get coverage for. The only reason that goes through the tax system is that it's therefore subsidized. If we want the tax system to cover health insurance; that is, risky health expenditures, we need to limit that subsidy somehow.

The other issue is that, as Howard mentioned, we get these gold-plated health insurance deductions and that raises the cost of the average health insurance policy, which then makes it harder for someone to buy one on their own. And so it arguably contributes to both of the issues I raised, and capping it has to be a move in the right direction.

MR. IRONS: There's a question up front.

Q: Hi, I'm Laura Granruth. I'm a Ph.D. student and social worker for Catholic University studying economic and tax policy. I'm also a volunteer with the Virginia Organizing Project on their tax committee. If anybody follows Virginia, you know, we went through some interesting things last year.

I'm interested in the last gentleman's presentation most pointedly of what sort of plans there are for outreach to advocacy groups, because I believe with what you said the public gets it emotionally with health care, they get it emotionally with Social Security; you know, start talking tax rates and, you know, you'd lose them. So this is my first time at the Center's presentation. I see that you say that you do outreach through advocacy organizations. I just want to know if anybody is looking at a coordinated plan.

MR. : That's you, man. (Laughter.)

MR. IRONS: I think tax issues are really tough, and there's certainly people in

this room who know a lot about tax advocacy than I do. It's one of those issues that I think people kind of get at a gut level; find it really hard to articulate what they think on the issue because it's taxes and it's numbers and math, and it gets really complicated really quick. You start talking about territorial tax regimes and you lose people. But I think one thing that people really kind of get is the fairness issue. The complexity issue – in my mind the complexity and fairness issues are the same thing. A complex system is a system where people like they're getting cheated. Someone else is taking a tax break that I'm not getting, so I think fairness and complexity are part of the same issue. People get that.

The issue that was raised earlier about kind of the corporate individual level, I think there's a lot of, you know, anger almost about people feel like corporations aren't paying their fair share. And so a system where corporations are actually taxed once and are definitely taxed at one time at a reasonable rate can be something which is both good economic sense as well as something that people can get behind at an advocacy level. So I think from a very practical perspective there is a lot of education that needs to be done. There's also just a lot of what needs to be done to get people talking about these issues. That, you know, their gut is actually right: it is about fairness, it is about raising revenue – enough revenue to do things you want to do.

So, I mean, I think as the Center for American Progress, part of what we do is we try to hold forums like this which hopefully more people will listen to on the web and will read the materials that everyone here is provided, and will kind of feel more comfortable with the details. Once people become more comfortable with the details, then it becomes something that they can think about on a regular basis and, you know, use in making decisions when they decide to go to the polls. So, you know, that's a way of saying that it's actually I think a really hard issue, but one that is essential to have people engaged in at all levels.

Q: Ed Jayne at AFSCME. Everybody kind of mentioned the politics of tax reform, and if I understood all the panelists they all kind of agreed that the entire proposal is not likely to go anywhere, at least not as a whole package. You also mentioned fairness. Given the track record of this president and this congress, if there's a likelihood of cherry-picking some of these things, especially given the current debate about the repeal of AMT, reduction of capital gain, you know, the health care deduction, some of the other things Ruy mentioned, I'd like people to comment on what's likely to happen and how fair that would be and whether this is going to be perceived as just an endorsement of some of those high-profile things that are out there now and whether that's going to be fair.

MR. SPERLING: You know, let me actually say a second, because I think it's relevant, as to how I think you actually would get tax reform in a broader sense. I think it has to happen. You have to have a dynamic which leads to a certain group – bipartisan group of members of Congress who are willing to craft something and then stand by it. I was part of something like that, the 1997 balanced budget agreement. People – you know, almost everybody loved part of that. If you're on the left, you loved the 5 million

more poor children getting covered. If you're on the right, you loved the capital gains. But there was a – something emerged where there was commitment after the shutdown, et cetera. People knew we had to something on Medicare solvency. So you get something where people agree. They get in a process, they agree on something they think is fair, and then they decide they're going to stand by it and they're going to defend it together.

There's just nothing we've seen in the political process in the last five years to suggest that. Partly it takes an enormous amount of compromise. So what you're suggesting is exactly what I fear, which is that we'll all kind of praise this report, whether we like the details or not, as at least – if not being revenue neutral, at least not being a complete free-lunch plan, and yet the free lunch part gets cherry-picked.

And I'll tell you what worries me a little bit is on the savings things that we were talking about. As Bill said, one nice thing about this is you actually get this consensus on the whole automatic 401(k). And this is an issue that many of us – you know, we were working this on our last few years on the White House, our Treasury liked it as probably something that's very popular. So this was an opportunity where reasonable people on all sides could say, "Boy, here's something we know works, the studies show it works, let's recommend it. That's terrific."

But I do want to say it's good if you already have a 401(k); it helps you if you are in a workplace situation. And I want to go to why having substantial matching credits is so important. If you have substantial matching credits and the individuals can get them simply as a refundable tax credit, but they can also – the employer could also provide them and receive that degree of subsidy. I think that encourages more employers to then be able to meet their non-discrimination rules because they know more of their lower-income workers are going to take advantage of the 401(k). Secondly, I think just more workers knowing that if their worker saved \$1,000 they were going to get \$1,000 would feel obligated to do it. Then you bring more workers into the system. They have a refundable match and you have an automatic system. So I do want to say that while I very much appreciate this improvement, I don't think those of us who like this idea should get so excited about it that it becomes something that as long as that's in we accept everything else in it.

And the easy thing to cherry-pick would be to take the automatic deductibility – and they can, you know, quote my book praising every which way of it, and they can promote all the Orszag, Gale, and Talisman (ph) and Mark Eary (ph) studies and say it's very popular. And then say, "Now, by the way, these guys all called for simplification, so we've done it," and then they put the three accounts in which allow people to save \$80,000.

Now, I want to come back to this. This is – you know, we really have an upside-down system. And I'll tell you, if you're like a policy guy like I was, you know, you worked in campaigns, and then you step out after you've had a job and you get some good speeches, you can really feel how upside-down it is.

When you're a kid and you have no money, you have no incentive to save – nothing. Then you get to the one point in your life where you don't need an incentive to save and everybody is offering you every single thing in the world. It is absolutely upside-down and this will make that that much more upside-down.

So what will happen? Families who have – the few family who have resources will put that money in. I don't think the families not saving now will have much of an incentive, so I very much worry a package of automatic 401(k) with these accounts that will be very regressive – they'll sound good, but they're enormously back-loaded and regressive. That is a bad, bad idea, and I think anybody should start anticipating right now that this could be what's coming down.

It's also to me the most political thing that was in the report because I can't believe what the economic justification for this was. It feels to me like this was their little political bow to the LSA and RSA proposal by the Bush administration, which was largely slammed by economists and serious retirement people, and I think this is the one piece in there that looks – that I find very difficult to justify, and again, it makes me worry that somehow this was – there was a strong argument to have that in so that this could be cherry-picked as a State-of-the-Union proposal.

MR. IRONS: Bill, do you want to add?

MR. GALE: Yeah, three quick comments. One is I think there are two parts to the proposal that could be cherry-picked positively. If they would have just left – one is the automatic 401(k) – not with the Roth stuff, but the auto 401(k), and the other is the treatment of low-income households. The question about advocacy groups earlier is important because this – there's a massive simplification of the EIGC and the personal deductions and the – I'm sorry – the dependent exemptions and the childcare, dependent care tax credit. All of the child credit, all that stuff is vastly simplified in this proposal, and it could be a big boon for low-income households who have a hard time understanding the Byzantine rules on the EITC.

The big danger is exactly what Gene said. Roth IRAs, you know, which are basically just repackaged RSA, LSA – that's exactly right. The dividend and capital gains cuts, the territoriality – there's that word again – without also imposing the dividend rules without also closing tax shelter – corporate tax shelters. That's what I expect you're going to find because – I mean, you know, if you're Republicans right now, you want to change the subject from what you're hearing in the newspaper every day and revenue-neutral tax reform is not going to do that. There are too many losers. You're not going to see cherry-picked proposals that only restrict the mortgage interest deduction, restrict the health insurance deduction, and get rid of the state and local tax deduction. You're only going to see selective choices that cut taxes. And tax cuts are the one thing that unite all Republicans, and so I think there's a real danger of cherry-picking and doing tax cuts.

Having said that, the third point is don't forget the AMT is out there. And if they don't make all these base-broadening changes, they can't get rid of the AMT, even if you say revenue neutrality relative to the Bush tax cuts. So they – you know, I think the most likely scenario for next year is they extend the higher AMT exemptions for one more year and they make an effort to pass exactly the type of passes that – policies that Gene cautioned are bad policies. I bet that's the most likely outcome, but there is a potential to cherry-pick this.

MR. GLECKMAN: Can I just throw in one other thing about the AMT. And actually, first, let me say something about cherry-picking. The commission, including the Republicans on the commission, felt very strongly in its meetings that it would oppose cherry-picking, and they said – we'll see what happens – but they said they would be very critical of efforts to cherry-pick this. On the AMT there's an interesting political issue, and, Ruy, you may have something to say about this, too, but there's an interesting political issue. As Bill has written many times, there are 30 million people who are at risk for paying the AMT, but there are only about 3.5 million who are actually paying it. So what's the politics of saying to people, we're going to take away the state and local tax deduction that you're already paying – that you're already getting, and the home mortgage interest deduction that you're already getting, so that we can protect you from an alternative minimum tax that you're not actually paying yet. Seems like it's a kind of tough sell.

MR. TEIXEIRA: Yeah. No, I agree with that, and that's a good example of the kind of problem that this kind of package is going to face. People can't figure it out. They just don't know how it's going to turn out and whether it's actually going to put them in better or worse shape, and that doesn't strike them as particularly fair because they're already not very convinced the system is fair for middle-income taxpayers. So that level of uncertainty is just very, very difficult for them to handle and feel positively about.

MR. : Let's be clear though. That's not a fault of the proposals.

MR. TEIXEIRA: No.

MR. : That's a fault of the shortsightedness of the political system. I mean, you could say that when they built the levees in New Orleans they could have charged more taxes and built the levees more carefully, but those are benefits that would come way down the road, and people don't want to pay for those things now. I mean, the system would be much better if people did pay attention to what was going on 10, 15, 20, 30 years down the road, and paid attention to it now. So that's not a criticism of the reform panel I don't think.

MR. : No, not at all.

(Cross talk.)

MR. SPERLING: I would say, though, you know, why the disappearance of a president who's willing to have serious bipartisanship, and I mean when you deal with the actual leadership of the other party. You know, it's funny, when you say this now – and I'll be on TV sometimes and they'll say, what would you do to get the deficit down? I say, well, you know, if I were President Bush I'd say I'm going to pull back on the tax cuts for the well-off if Democrats comes and sit around a budget table and do some things that are pretty hard for them. And people say, well – I get two reactions. You know, "Yeah, right. I mean, like that's ridiculous, of course President Bush would never do such a thing." And I always say, "Why? Why would you say that?" Bill Clinton and Newt Gingrich did a deal together in '97. George Bush and Tip O'Neill – I mean and Speaker Foley did a deal in 19 – and George Mitchell in 1990. Tip O'Neill and Ronald Reagan raised taxes together twice and cut benefits in '82 and '83.

And now why is this important in the tax reform context? All of those things – you look at the 1983 Social Security – they're very, very complicated. They could have been picked off, but why weren't they? They weren't because Ronald Reagan and Tip O'Neill had great credibility with their sides as Bill Clinton and New Gingrich did with their sides. So if you could imagine Bill Thomas sitting down with Charley Rangel knowing that George Bush was going to support the proposal, the two of them could do things that could be very serious that would be difficult for everybody to understand, but they would trust that it was actually a fair process.

And when you don't have that, then each side has the ability to politically cherry-pick what they don't like. And I think that – I think until we have that kind of environment or leadership that wants to do this, what ends up happening is you can't do – people don't have the cover to do the pain, so they end up doing the free lunch; the deficit gets larger and larger, and we just decide to tax our kids' future.

MR. IRONS: We have time for a couple more questions, but let me ask if there's any media who have questions?

(Cross talk.)

MR. SPERLING: Donna, I want to say hi. As the one reporter not covering Mr. Fitzgerald today, I want to ask –

Q: And that is correct. I'm Donna Smith with Reuters.

MR. SPERLING: Donna, I just have to say that, you know, I had to do all those briefings during all the impeachment, so there was one day I walked into the room in the middle of all this and I couldn't get everybody's attention, and I said, will Social Security be there Monica Lewinsky turns 65? And everybody turned around. So I was glad we didn't need to do that here. We have a good crowd, so –

Q: But I don't want to ask you – I'm Donna Smith with Reuters. I don't know if I said that, and our office is downstairs. (Laughs.) Although I work on the Hill. Where

do you see Democrats in the tax reform debate? From what I'm gathering here is you think that Bush is going to make a big issue of tax reform, but it might not be the complete package. They're going to take the nice stuff and run with that. So I'm just wondering where Democrats are in the debate?

MR. SPERLING: I have not had a chance to talk enough with some of the people I'm sure I will talk about. I think they're probably taking a look – I think right now there is a very serious trust problem, and I think you saw it in Social Security. I think that there is not a belief that the president will ever compromise significantly. And so I think the Democrats will – many Democrats have already had proposals to support the automatic 401(k) type of things that are out there, but my guess is that Democrats will work on some series of proposals that they will put forward. But I don't think – you know, I think when you have an all-Republican Congress and a Republican White House, you're going to have to get a far more substantial gesture from the White House that they're willing to really work in good faith and compromise on some of their initiatives before you're going to draw in a serious proposal.

This idea of bipartisanship, which is we try to get our entire party together and see if we can pick off one or two Democrats, is not generally reviewed – seen as bipartisan among Democrats. So I think the challenge – I think one thing that's important for all sides is really to stress – I do think stressing the revenue neutrality at a minimum – I mean, we need to be reducing the deficit right now, so I think anything we do it's important on both sides to put that as a constraint, but that constraint leads to losers. And the question is, is either side alone willing to take that on.

I will certainly say the following: if the president came out and endorsed this commission report, even with the things I disagree, I would have to say I would at least – he would improve his respect in my eyes for at least being willing to support some difficult, painful, fiscal discipline measures as each of his predecessors has and he has yet to this day done.

MR. GALE: Well, wait a second, wait a second. I'm going to charge you \$10 now. (Laughter.) This tax reform panel, again, makes his tax cut permanent, okay? That would be an enormous fiscal win for the president, an enormous fiscal loss for the country. So there's pain from restricting some of these reductions, but nowhere near the pain that we need to finance the government that we have.

MR. SPERLING: Bill, you have to remember: I just said it would improve my respect for him on –

MR. GALE: Okay.

MR. SPERLING: – fiscal issues. That's a very low baseline currently. (Laughter.)

MR. GALE: I believe you said the "RN" word. Let me just – I think the

Democrats have an issue of whether they're going to stonewall or participate, and because of the trust issue I don't know, you know, how that will play out. It's possible to think of elements of this tax reform proposal that Democrats will like. The two areas they – two of the areas they will like least are abolition of all the education subsidies that were passed in the Clinton era, and the repeal of state and local tax deductions.

It's very easy to see how compromises could come about. You know, give a 15 percent credit for state and local taxes, reinstate something for the education. Of course, you've got to make the money up somewhere else, but you could see something like that happening. And that's going to be important because I think there's going to be an element of Congress on the far right that is going to say, if it's not a sales tax or a flat tax, no way. And so this is going to have to move to sort of the 30 to 80 part rather than the 50 to 100 part on a scale of left to right. Because I don't think you're going to get unified right-wing support for anything like this. So they're going to have to – if something like this were to happen, they're going to have to make concessions to the moderate Democrat.

Q: I have one follow-up on (inaudible) to alienate some of his conservatives?

MR. : No.

MR. GALE: He certainly is capable of alienating his conservative friends. I don't know.

MR. SPERLING: Well, that's a – you know, it's always a political calculation when you're weakening there whether you try to strengthen yourself in the center or at the base. I'm not too good at predicting them. But I do want to point to one division we have not mentioned which I think will be a major division – I at least hope will. This assumes that we want to repeal the alternative minimum tax on everybody. I do not wake up in the morning with a cold sweat worried about the fact that the alternative minimum tax may hit some of the people in the top 1 percent who have benefited from very generous tax benefits recently, and which the administration never really – I mean one thing that we never say when we talk about the alternative facts is it was made considerably worse by the tax cuts that they did. This is not just an inherited, exogenous problem. They have made this a bit worse. And they were never straightforward with the public on what the true costs are.

So I think one of the divisions that you will start to see is the Democrats will be talking about repealing the alternative minimum tax, and I think the expression you'll hear is for the people it was never meant to apply to, and not a sense that they will be cutting – doing painful things that would hurt the middle class to prevent the alternative minimum tax from hitting people who are solidly in the top 1 percent of the tax bracket.

MR. IRON: And Howard, you wanted to add?

MR. GLECKMAN: Actually, I just had a question for Gene. Do you think that –

this is a follow-up on Donna's question. Do you think that Democrats – assume that Bush does propose something: do Democrats do what they did with Social Security and just say no, or do they get in the game?

MR. SPERLING: My guess is that Democrats will put forth proposals; that they will have more affirmative things to say, but I don't think – so if the question is will Democrats come forward with some tax reform proposals, I think the answer is – my guess – yes, that they will. But I think the real question though – I mean, you know, in 1995, Newt Gingrich and Bill Clinton both had balanced budget plans. They were both in the game, and in their own way were both being fiscally responsible from a very different values point. But the environment at the time led to a government shutdown. In '97 there was a different environment. So I really think, again, the leadership does have to come from the top, and it sounds like an expression, but let me tell you why it's not just an expression. Nobody wants to take these risks unless they believe the president of the United States is willing – first of all, if the minority party is not to believe the president is willing to compromise and that he will support their tough choice. So in other words, in 1997 or in 1983, people knew that the president approved of the negotiation process going on; that he was willing to compromise and that he was willing to sign something that everybody agreed with.

I think if President Bush were to say that he was willing to pull back on tax cuts for upper-income Americans, not for all the tax stuff, but just for upper-income Americans as part of an overall package, if Democrats would come work at the table – yes, that would make some on his far right unhappy, but there's a lot of moderate Republicans who are very worried about the deficit now who wouldn't mind the cover. That would be – so whether somebody is in the – you know, the real question is not, will Democrats have some proposals; they will. The real question is, will a political environment be created that will lead to a real negotiation among leadership types or will it just be dueling proposals and gridlock? You know, if you had to bet –

(Laughter.)

MR. IRON: All right. I think we're about out of time. Let me see if there's any final comments that any of the panelists want to make.

MR. : Just one. On the political side, the calculation that each party does is, would they rather compromise and get something done or would they rather hold out the tax system – hold the tax system hostage and use it as a club to beat the other party in the next election. And the longer the Republicans are in power, the longer the using-the-club strategy works less for them, I think, because when you control all organs of government you ought to actually do something.

The other thing, which is sort of the elephant in the room that doesn't get talked about much in tax reform, is the no-new-taxes pledge. Over 90 percent of Republicans in Congress have signed this. President Bush has signed it. And if taken seriously – and, you know, they signed a pledge that says "I pledge blah, blah, blah," – if taken seriously,

this is a huge constraint on the ability to reach budget compromises. And let me just add one other statistic: 85 percent of the people that signed the no-new-taxes pledge and voted on the Medicare prescription drug bill voted yes. Okay? So they're cutting taxes, they're raising spending. This is not a group that's interested in budget compromise and that itself might be the problem. You may just need a whole new set of actors to get some reason fiscal discipline.

MR. IRONS: Anyone else?

MR. SPERLING: I'd just say I think President Bush has got – I mean he's got some tough issues, but this is a tough one because they have created a significant expectation that they're going to do sweeping tax reform, and I think that if they fulfill that expectation in something that is truly revenue neutral, or even revenue neutral in the way that, you know, I have to pay Bill for – (laughter) – which is revenue neutral assuming the tax cuts for forward –

MR. GALE: You owe me \$6. (Laughter.) Come on.

MR. SPERLING: Oh, that's in 1982 dollars. (Laughter.) But if he – he has created a very high expectation for himself, and so what I'm saying is that if he does it in any sense of revenue neutrality – any sense – he will have to have a significant amount of pain; I think more than it would seem the political system could bear, particularly with his situation now.

If he does sweeping reform without being revenue neutral in any sense, I think he starts to empower many of the moderate Republicans, the fiscal discipline Republicans like John McCain who may feel now they can take more leadership and form a group that can work with the other side, or third, he backs off, which will then be interpreted as an unusual backtracking from a president who's best line in 2004 was, "You may not like what I say but you know where I stand." So –

MR. GALE(?): I just wanted to propose one last political compromise to think about: Republicans yield on taxes; Democrats yield on individual accounts and Social Security.

MR. IRONS: All right, I think we'll leave it with that. I want to thank the panelists for a very interesting discussion today, and thank you all for coming.

(END)