

CENTER FOR AMERICAN PROGRESS

**PROGRESSIVES AND THE NATIONAL DEBT:
Raising Revenue: The Options**

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MICHAEL ETTLINGER: This session will be Jane Gravelle who is a senior specialist in economic policy in the government and finance division of the Congressional Research Service. She specializes in the economics of taxation, particularly the effects of tax policies on economic growth and resource allocation and has done a wide range of papers on a wide range of topics in that space.

In addition to her work at CRS, she is the author of numerous articles in books and professional journals. She is the author of a book, "The Economic Effects of Taxing Capital Income," and co-editor of the "Encyclopedia of Taxation and Tax Policy," both of which have places on my bookshelves and one of which I have completely read.

She is the editor of the Tax Expenditure Compendium, published every 2 years by the Senate Budget Committee. She holds a Ph.D. in economics from George Washington University. She is past president of the National Tax Association and received the NTA's public service award in 2007. So welcome Jane and the panel. Thank you. (Applause.)

JANE GRAVELLE: Hello. I have been asked just to begin with a few words about where we are in tax policy. But first, I have to say that the very few things I will have to say are not the views of the Congressional Research Service necessarily.

Historically taxes have been between 16 and 21 percent of output. Right now they are actually 15 percent. They are pretty low right now, a lot of that because of the recession. And the CBO projects that they will go up to about 20 percent of GDP, which is not as good as it has been in the past, but up towards that end. But that depends on the expiration of the Bush tax cuts, not fixing the AMT, not extending any of the things that were – provisions that were acted in the recent recovery act and other extenders that we have.

If those are all extended, then the CBPP has estimated that it will fall to 17.4 percent. So facing the spending challenges that you have all seen here today were actually unless we can avoid extending those tax cuts are not going to be even in the good position historically. And even if we do extend them, we are still lower than we have been in the past. So that creates a lot of challenges for revenues.

Out of those sources of revenue, the payroll taxes have been about constant with respect to GDP, a little over 6 percent. And they look to stay that way. The corporate tax continues to be at a historical low partly because of corporate tax burdens at a historical low, partly because there is enormous amount of business income channeled through the non-corporate sector and perhaps there is a loss from profit shifting abroad.

But the big decline that could be expected from policy in the next couple years would be the individual income tax, where we would lose about a quarter of the projected revenue if these various income tax cuts are extended. So like everything else, it is kind of a gloomy picture here. But I hope our panelists are going to tell us how to fix that picture.

Our three panelists – I will be brief with the introductions – they are all very well-known in Washington and in the tax community. They have all written widely. They have spoken widely. And they have provided policy advice both informally and in congressional testimony. They have written books and papers and all of that, so I won't go through all of that. It is all in your – some of that is in your bio.

I am just going to introduce the three speakers in the order they are going to present and then I won't be saying anything else. The first speaker is Bill Gale, who is the Arjay and Frances Miller chair in economy policy at the Brookings Institution. And he is also co-director of the Tax Policy Center, which has become a marvelous, invaluable Washington institution. I am a consumer of their numbers, so I urge them to keep going with that. They provide numbers that nobody else does. He is also the director of the Retirement Security Project supported by the Pew Charitable Trust. And in the past, he used to be a professor at UCLA and worked on the Council of Economic Advisers.

Our second speaker is Ed Kleinbard. He is currently a law professor at the Southern California Law School. But previous to that, he served as the chief of staff of the Joint Committee on Taxation. And prior to that, he was a partner in a New York law firm. And I told him at lunch, I wish I knew everything that was in his head about corporate tax. I just wish I could kind of funnel that all in.

And our third speaker is Lily Batchelder. She is a law professor at New York University. And she is also affiliated with the Urban-Brookings Tax Policy Center. And before that, she was with a private law firm.

So I will just ask them to speak in that order.

WILLIAM GALE: All right. Thank you very much, Jane. It is a pleasure to be here. I do want to note this was a historic occasion. Jane said she was going to say what she said and she wasn't going to say anything else. (Laughter.) So we are going to hold you to that.

This has been a great conference. It is the right topic at the right time. And don't get me wrong, the lunch was really good. But when I think about tax policy these days, I think about the joke about two inmates in a jail eating food in the dining hall. And one of them said this food is really lousy. And the other one says, yeah, and there is not enough of it. (Laughter.) And that is sort of our tax system. The taxes are really lousy and there are not enough of them.

And so what do we do about that? Well, the way I think about it is that the most useful way to characterize our current tax system is that we have a narrow tax base. Normally you want to tax on a consistent, comprehensive basis. If you are taxing income, you want to tax all forms of income. If you tax consumption, you want to tax all forms of consumption.

That is not what we do. We have a lot of loopholes in the system. There are types of income that are just not taxed. There are an enormous number of deductions, exemptions, credits, exclusions, et cetera. The result of that is you get very uneven tax burdens across different types of income. Some income is taxed twice. Some income is not taxed at all. Some

is taxed once at the regular rate. Some is taxed once at a non-regular rate. Some is probably taxed three or four times if we look carefully.

So in some sense, we don't even have – I mean, we call it an income tax, but whether it really qualifies as an income tax at this stage, I think, is open to question. So on top of the loopholes and the uneven tax burdens across different forms of income and different forms of spending, the narrow tax base causes you to need a higher tax rate than you would otherwise need because you have a narrower base. You need a bigger rate to get the same amount of revenues. And on top of that, the narrow tax base generates a complicated tax system.

With the exception of capital gains tax rates, almost all of the complication in the tax system comes from the base, from the definition of the base. Generally once, you know, you go through all these machinations to get to taxable income. Once you do, you can look up your tax on the table and then apply the credits and stuff like that. But most of the complexity is in the tax base.

So what is the problem with this? Well, it undercuts everything you want to do in tax policy to have a narrow tax base. It reduces revenues, obviously, because there are loopholes and exemptions and exclusions. That makes it harder to finance government and government spending given the size of the economy.

The second thing is it reduces the size of the economy. It causes uneconomic allocation of resources and activities and effort. So even if you kept taxes as a share of the economy the same, this distortionary tax system, the issues created by the tax system reduces the size of the economy, which again makes it harder to finance government spending.

Third, and this is a really important point, and makes the actual system less redistributive and presumably less fair than you would think just looking at the tax rate numbers. Right? The official tax rates don't give you a good guide to who is paying how much in taxes, what the redistribution is because there is so many exclusions or exceptions to the notion that we tax income.

And fourth, I think it is fair to say that it undermines support for taxes in general. And that in turn, implies undermining support for government spending. You know, taxes and spending are flip sides of the same coin. I am going to talk about that more in a second. But if you have a tax system that people hate, it is going to be very difficult to do anything on the spending side no matter how valuable that spending is because it is going to be – it will have to be financed by this tax system that is undesirable.

So what needs to happen? Well, I say four things. First of all, it is shocking to me how distinct the discussion of government spending and government taxes are. Government spending creates a necessity to tax either now or later. The only reason we tax is to spend, right? So you would think that spending and tax debates would occur at the same time. But for some reason, they don't.

And I think that one of the things that could be done to raise the level of public awareness and presumably get better public policy is to have the American public understand better what they are getting for their tax dollars because if you look at surveys, if you ask people would you like a tax cut, 80 percent say yes roughly. If you ask them would you like a tax cut if it meant the government would have to cut education or health care or retirement or environmental efforts, 80 percent say no. So the linking of the spending side and the tax side could be sort of a quantum leap forward in tax policy debates.

And the second thing we do, we have to, have to, have to simplify taxes. I honestly think and I am sure I will get mail about this, but I honestly think that most people understand that they need to pay taxes, but they just don't understand why it is so complicated. I have been a tax expert for 20 years. And I have that feeling every year when I fill out my tax return. So we need to simplify taxes.

The third is we need to focus on the redistribution of the whole system, taxes and spending, not individual features. The notion that every single thing the government does has to redistribute income from high-income to low-income households is a mistake and it gets in the way of good policy time and time again. And I will come back to that in a second.

And lastly, we need to stop talking about tax cuts and start talking about raising revenues. So how do we do that? There are only three ways to raise revenues. And the first one is to make sure the economy is in good shape. There is this unfortunate split between people who think about the economy as a whole and people who think about the budget. And it is unfortunate because you will never get where you need to go on the budget if the economy is not strong. The economy is more important than the budget. And a strong economy is a necessary, but not a sufficient condition to generate fiscal responsibility. So it is absolutely essential, especially right now that we keep our eye on the economy, even more than we keep our eye on the budget.

The second way to raise taxes is to clean up existing taxes. And this is what Ed and Lily are going to talk about a lot, so I will just skim over this. Basically, you can close the loopholes. You know, if the concern is that there are loopholes, the obvious answer is close the loopholes. Or you can reform the way the tax system uses deductions, credits, exemptions. And I will just leave it at that, except to say that – two things.

One is there is a lot of money in these options that can be raised. And two, these are much better ways to raise revenue than raising tax rates. In fact, I think they are under discussed in the policy debate. And I am glad that Ed and Lily are going to follow up on this.

Lastly, you can develop new revenue sources. And here, you know, the obvious answer is VAT, the value added tax. It is hard for me to see how we are going to avoid needing to implement a value added tax at some point in the future. Although you can get a lot of money out of the existing system through the reforms that Ed and Lily are going to talk about. You really can't get there from here in terms of closing the fiscal gap, even the tax part of the fiscal gap, if you will, if you want to think of it as half and half or some interior allocation. You really can't get there without a new revenue system. The VAT is the obvious choice. It is what countries all around the world use.

Climate change taxes would be also a push – I'm sorry, helpful policy for all the tax reasons, as well as the environmental reasons. And Jane is not talking, but she is telling me to stop. So thank you. (Laughter.)

EDWARD KLEINBARD: Thank you. I would like to begin by reaching out to Charlie Cook's purple voters we heard about this morning, the individuals who fear the encroachment of government in the private economy and in their private lives. To all of them, I would say it is too late. You have been encroached on. You and government are much more intimately connected today than you appreciate. Legislators, whether progressive or conservative, for decades have used the fog of fiscal illusion to give us what we all really want, which is lots of government spending programs while preserving the illusion of our individual autonomy – (inaudible) – markets.

The least appreciated tool of fiscal illusion is the tax expenditure. The concept is very simple. The tax code today is festooned with exceptions to its own general rules. These deductions, credits or income exclusions function exactly like spending programs. In operation, tax expenditures behave as if our government collected more tax revenues from a broader, simpler tax code and then devoted those revenues to certain spending programs, except that unlike other real spending programs, these are invisible in our budget because they operate simply to reduce government revenues.

So thinking in tax-expenditure terms is directly responsive to the new ways of thinking the bill described a moment ago by understanding the scope of these spending programs that are baked into the tax code, we can have a tool to understanding the real size of the federal budget, to grasping a complete picture of the allocative and distributive impact of government and to shattering the invidious fiscal illusion that targeted tax relief, in fact, is a tax cut.

Targeted tax relief is just another name for government spending in which taxes extracted from those of us who are not targeted fund hidden spending on those who are. Tax expenditures are not loopholes. They are deliberate forms of government spending. The question is, are they smart spending? Can we afford that spending? And is the program itself well-designed?

The tax-expenditure phenomenon is far larger than is usually appreciated. Jane's colleagues at the Congressional Research Service recently published an analysis that concluded that federal tax expenditures in 2008 totaled over \$1.2 trillion for one year. Now, this is a simple sum of many individual items. And economists point out that that is not strictly fair because of the interactive effects across all of these different items.

But if I were to be permitted to amend the Congressional Research Service report by concluding the tax expenditures in 2008 amounted to a trillion-ish dollars – (laughter) – I think you would still agree with me that that is a considerable sum of money. In fact, \$1.2 trillion is more than the entire amount raised by the individual income tax. We give away more in spending than we raise in the individual income tax. And so you can get a sense of just how distorted our picture of the budget is. It is as if our budget were 150 percent the size of the budget that we all decry in the papers today.

As a percentage of GDP, tax expenditures are now at a level that we have not seen since immediately before the Tax Reform Act of 1986. Many tax expenditures, of course, are both well-known and serve useful purposes. You know what? The same is true of government spending.

The charitable contribution deduction is an obvious example. But even tax expenditures that serve useful social goals often are poorly targeted because by burying these spending programs inside the tax code, we have not paid enough attention to the details of how they are implemented.

For example, benefits may be awarded to many people who would have engaged in the desired behavior without the government subsidy. The first-time homebuyer's credit is a probable example of that. Other tax expenditures like the largest one, the tax exclusion for compensation paid in the form of health insurance premiums through inattention to the design has led to systematic overconsumption of the desired good.

By designing all of these programs in the form of tax expenditures, the only evidence of them in our budget is a reduction in government revenues. And as a result, we have not devoted the requisite energies to reviewing and thinking about how those programs are designed, implemented and whether in fact, they are delivering a bang for our buck.

Most troubling to me, some tax expenditures are simple subsidies to politically favored businesses. The CRS study that I mentioned a minute ago listed for 2008, \$118 billion in business tax subsidies. That is \$118 billion worth of the government's heavy hand on the scales of the market economy. And it is about one-third of the amount of revenues that we raise through the corporate tax system.

LIFO inventory accounting, tax-exempt status for credit unions, tax credits for energy from renewable sources, tax-exempt private activity bonds or things more exotic like from my old practice like the inventory property sales source rule, which sounds tedious and innocuous, but, in fact, accounts for tens of billions of dollars and which reduces the tax liability of U.S. multinationals by decreeing that certain U.S. income will be magically treated as foreign income.

These are all examples of the heavy-handed government subsidies injected unevenly into a market economy. And with the exception of a few subsidies that address an authentic externality like arguably, R&D credits, all of these business tax subsidies can be summed up in one word, stupid. (Laughter.)

To me, it is ironic that a publicly owned health insurer can be viewed by so many as unfair competition to the private sector, but that these other interjections to support favored businesses go wholly unchecked simply by calling them targeted tax relief. Tax-expenditure analysis is the tool that dissipates the fog of fiscal illusion in which the subsidies lurk.

If we can force tax expenditures to the sunlight by subjecting them to the full rigor of the budget process, we can make better choices both as to the substance of how much money we

spend and the design of how we spend it. But improving the budget process by itself will not, in my view, lead to a comprehensive review of all the tax expenditures already hard baked into the tax code. For that, we must look, I think, still using tax-expenditure analysis, but to use it in a different way as a wedge to force a major review from a zero-based beginning of the entire tax system in order to accomplish what Bill has described before as the fundamental base-broadening exercise.

LILY BATCHELDER: So that is a great segue for what I want to talk about, which is how to raise revenue and further progressive goals at the same time. And I want to argue that tax is essential to everything that progressives care about. Our tax system is one of the most important ways we express our values as a country. It is necessary to raise revenue in order to fund and maintain and create social programs.

If we want to help people who are less well-off, we need to have a progressive income tax. And by progressive, we have a particular meaning of progressive in the tax context, which is that tax burdens as a share of income rise with income. Of course, you can have a more demanding view as progressives, but that is sort of our technical term for progressivity. And right now we have a mildly progressive federal tax system, but it could be much more so.

And then finally, as Ed explained, there are a number of ways that we deliver spending programs through the tax codes. And these are huge spending programs. They are almost all regressive. And that means that if we want to cut spending in a way that doesn't hurt low- and middle-income families, then the tax code is the place to look.

So what I want to talk about is particularly tax incentives for individuals, where the benefits and burdens are clearest. And I will first give a basic primer on how to further progressive goals through reforming individual tax incentives. And then I want to put out some brief reform options that are worth consideration.

So there are four reasons why we may want to have tax provisions. And the first is measuring income or how well-off households are. The next is allocating tax burdens and potentially redistributing based on that measure. Some tax provisions are also meant to limit complexity. And what I want to focus on is provisions that are intended to create incentives for behaviors that arguably have social benefits. These can overlap, but I will try to create a rough taxonomy for you.

So what I want to do is go through different forms of tax incentives by how regressive they are and move from the most regressive to the most progressive. And just by way of background, I can't tell you how often I have very committed, very smart, very progressive friends come to me with an idea that they are really excited about. Say, they are working on education or disabilities and they say why don't we create a new tax provision that allows people to save in tax-free savings accounts for whatever cause they care about?

And I have to tell them this is a horrible idea. (Laughter.) I want to emphasize it is not just a mediocre idea. It is basically the single worst program you can imagine to further these

goals on a progressive basis. It ends up helping the affluent the most, doing basically nothing for less affluent people and I want to explain why.

So the most regressive kind of tax incentive is those that reduce or eliminate tax on income from savings. And the reason is that the savings rate rises very rapidly with measures of socioeconomic status. So the share of income that households get from savings is very correlated with their socioeconomic status. And as I will get into, when you eliminate a tax rate, it tends to disproportionately benefit higher-income households.

The second slightly less regressive, but still highly regressive type of tax incentive are itemized deductions. And you choose between either taxing the standard deduction or itemized deductions. It turns out that only about a third of people itemize. And these tend to be people who are very high-income – they are highly correlated with income. So here is a picture of that.

The third is exemptions and above-the-line deductions. So these, anyone can claim. But the problem is that the value of an exemption or above-the-line deduction, it depends on your marginal tax rate. So if you deduct a dollar, it is worth nothing if you are in the zero bracket. It is worth 35 cents if you are in the top marginal tax bracket. And as you can see, people are very spread out. And your tax bracket rises with income.

Fourth are non-refundable credits. These are actually still regressive because most – not most – a very large portion of people do not have positive income tax liability. About 43 percent of households – if you are trying to create an incentive for single-parent households, it turns out to be 80 percent do not have positive income tax liability.

So the only potentially progressive benefit is a refundable tax credit where you can get the credit even if you have zero income tax liability. So here is a list of individual tax incentives that I have grouped by these different forms. And as you can see, there are very few that are refundable. And they cost an awful lot of money, about \$800 billion-ish, if we are going to go by Ed's measure. This is more than we spend on national defense. It is more than we spend on non-defense discretionary spending. It is more than we spend on Social Security, more than Medicare. It is a lot of money.

And relatively few of these provisions are refundable, only the green ones there. And they are also highly regressive if you ignore the refundable credit. So this is the change in after-tax income. And without refundable credits, you have an increase of about 11 percent in after-tax income for the top 20 percent of income distribution and no change for the bottom.

And by dollar value, it is even more stark – \$429 for the bottom of the income distribution and 16,000 for the top 20 percent, an average of 104,000 for the top 1 percent worth of tax benefits.

So what I want to do now is provide an example of retirement savings, which I think is an area that is really ripe for reform. The estimates are that we currently spend between 130 and \$200 billion on retirement savings incentives. And these come in several forms. We have defined contribution plans, defined benefits plans, IRAs. There are two different ways that tax

incentives are usually structured on a traditional or Roth basis. But they are generally economically equivalent under certain assumptions and they are structured based on deductions and exemptions.

So the issue is that most retirement savings occurs in the employer context. And the participation rates vary again very heavily by socioeconomic status. This is because employers that offer retirement plans tend to have higher socioeconomic-status employees and also they tend to take up the program more. So when you couple that with the fact that the deduction and exclusion are regressive themselves, you end up with dramatically regressive distribution of incentives for retirement savings.

So in thinking about how to reform this, I want to put out six questions that I think are worth considering in reforming any of these tax incentives. The first is what the precise choice is that is generating social benefits. And with retirement savings, it would seem that if you save enough for retirement and invest responsibly enough, then you are not going to be relying on others or radically changing your standard of living in retirement.

We don't usually hear retirement savings plans justified as a way of encouraging people to give to the next generation. But that is what a lot of them end up doing. If we are only concerned about retirement income security, then we should limit these incentives to savings that is annuitized, which means that you receive a payment over the rest of the course of your life that takes account for – or doesn't vary depending on how long you live, on investment returns.

So the next question is whether the social benefits vary by income. The evidence here is disputed. But in general, I would suggest that low-income households are under saving the most. Then it is also important to consider the responsiveness to any incentive. And again, it appears that low-income households are more responsive because higher-income households are able to shift their income from one kind of account into a tax-preferred savings account.

The fourth question is whether there are ways to increase the responsiveness to retirement savings incentives. And here there are. If you structure it as a match that goes directly into the account, people tend to respond more to that. And people have also probably heard that opt-out plans tend to induce much higher participation rates to the point where it is questionable whether you actually would get that much different results if we just shifted to opt-out accounts.

So the implications here, I think, are that if we want to retain tax incentives, we should create some kind of universal opt-out system that doesn't depend on whether your employer offers a plan. We should have a refundable credit that phases out as income rises and create it as a match. We should condition the match on annuitizing and not issue further matches once you reach an age-adjusted balance cap on the theory that once you have \$1 million of retirement savings, these aren't the people we are really concerned about under saving.

But we also may want to consider repealing them because we may be able to accomplish many of the same objectives or just as much as we are now or more by just creating this universal opt-out system. And you can extend these kinds of arguments in a number of other areas with homeownership. We might want to gradually convert to a first-time homebuyer's

refundable credit. With charitable giving, we might want to convert to a charitable match that is maybe higher if you give to more disadvantaged groups. Life insurance exclusions, I would summarize in one word also of stupid. And higher education is another area where it really does not make sense to be excluding the bottom 40 percent of the income distribution, the families that are least likely to send their kids to college from higher education credits.

MS. GRAVELLE: Thank you. Okay, we will take questions from the audience now unless any of you feel a burning desire to say something about what somebody else said. Anybody? Okay. Yes? Right in the middle here. You. I can't see well enough. Oh, yeah, striped shirt.

Q: Hi, my name is Mark Nadel (ph). And I would guess that almost everybody in the room shares my agreement with the reality that you have presented. My question is the problem with implementing your proposals is explaining these issues to American voters. My question to you is whose responsibility do you see it being to explain these so voters understand it? Is it the high schools or high school teachers? Is it journalists?

We could say other politicians. The trouble is when your opponent says you can have this benefit and more and we can cut your taxes and more, that reality is preferred – that perception is preferred to the reality.

MR. GALE: Well, I think it is everyone's responsibility. You know, like I said – let's put the blame on high school teachers or journalists, god forbid. The issue, though, is more than just whose responsibility. It is what is the message? And that is why I emphasize this link between taxes and spending – not only is there a link that is the only reason we tax is to spend money and anytime we spend money, we have to raise taxes sooner or later to pay for it. So not only is there a link, but understanding that there is a link materially changes often how people think about the taxes they have to pay.

I think that is the –

(Cross talk.)

Q: – people don't understand – voters don't understand that now.

MR. GALE: I think voters understand it when it is framed that way for them. And when it is framed as greedy politicians want to raise your taxes, they sort of get into that mode. So I think it is possible and I think it is very clear that it has happened that politicians and priorities manipulate the framing of the issue. And that has a real effect on how people interpret the issue.

MR. KLEINBARD: I would disagree just the tiniest bit in a sense that I do not believe that most voters fully appreciate the power of Milton Friedman's famous aphorism to spend is to tax. That is really all about government spending. The tax just follows from that. And I do think that there is a lot to be said for the idea, whether it is high school or college, a much more explicit focus on a basic economic education with a view to understanding not just supply-and-

demand curves and widgets and gadgets, but also understanding people's relationship to government.

I believe that we have all collectively allowed government for the last 70 years to use fiscal illusion to give us what we want. And I believe that we are now reaping, in effect, that unintended consequence of that, which is this sense of disconnectedness that people feel between themselves and government because they don't appreciate the fact that there are government spending programs, whether in the code or otherwise, that directly support their lifestyle.

So at every level, but including the op-ed pages of the newspapers, including the educational structure, we need to reorient people's thinking. This is not a progressive agenda. You can have a conservative agenda and agree with everything I have said. You then can have the fair debate. How big should government be? Progressives have one view; conservatives have another. But then at least we will all be having an honest debate because we will all be paying for it as we go.

MS. BATCHELDER: The one thing I would add maybe to that list is government. My sense is that a large number of people have no idea what they pay in taxes on that. They have no idea what the value of the home mortgage interest deduction is to them. They have taxes withheld. They get a refund. They don't add those up and figure out where they are on that. And one idea that a couple of co-authors and I have been floating is potentially issuing some kind of report each year. I mean, each year, we get a letter from the Social Security Administration saying this is what you contributed, this is what you are entitled to.

We could say this is how much you got from the home mortgage interest deduction. This is what you got from charitable deductions. There was a tax reform panel a few years ago that proposed changing the home mortgage interest deduction to a credit. And I believe that 80 percent of households would benefit overall. And this panel proposed shifting from an income to consumption tax. It proposed a lot of things. The only headline was this. And no one really believed that they would be better off. So I think getting people to understand how they are doing specifically would help.

One thing that other countries have experimented with is having tax expenditures filed separately. So you pay your normal tax and then you can a month later file for the tax expenditures and see what you are really getting.

MS. GRAVELLE: Yes? I think somebody is coming with a microphone.

Q: Thank you, Professor Kleinbard, for your statements. I think you are absolutely correct and Mr. Gale, as well. I think the message out there, taxpayers come to politicians, politicians can't say no. And they have more programs and more expenses and costs and what have you whether they are right or wrong and a duplication of services as far as taxes go. So it may not be a progressive message, but it is a message the American taxpayer needs to hear today because we are in trouble.

So do you believe – I do believe – and Mr. Gale, you are right – we need some kind of tax reform now. Single people get no deductions except the standard. For charitable deductions, you have got to give a lot of money. And you don't get any health-care deductions unless you are in the higher bracket.

So how would you reform today's tax code to simplify it? And how would you impress upon our elected officials to be able to say what part of no don't you understand? You can't have it all. I know when my attorney has my will, says talk to your accountant. Well, my accountant is H&R Block – thank you very much – it is very good. And I know what deductions I can and can't – I am not in that income bracket. So what do we do? Do you do a flat tax or how do you reform the system? Thank you.

MR. GALE: Well, let's talk about first the question about what do you say to politicians? And then second, how do you reform the tax system? There are two theories that I have about the way that Capitol Hill works. One is that they have no idea what they are doing. (Laughter.) The other is that they know exactly what they are doing. (Laughter.)

And in terms of reflecting the preferences for tax subsidies, I think they know exactly what they are doing. They are trying to get reelected. And that is another way of saying the politicians are the manifestation of the problem and they may be partly the cause of the problem, but the underlying cause is that the American people are sending those people back to Washington. I guarantee you that if people were getting – were losing elections because they were giving their constituents targeted tax subsidies, they would stop giving their constituents targeted tax subsidies. So it is sort of a chicken-and-an-egg issue.

In terms of reforming the tax system – okay, I am going to do this all in one inhale. Okay. (Chuckles.) No, basically, you want to broaden the base, use the revenue to lower the rates, convert the deductions and exemptions the way Lily and Ed have described. And all of us, including Jane, have written extensively on this. It is after lunch. I am not going to start the – (laughter) – 30-item laundry list. But there is the general direction that taxes need to go and can go. It is not an impossible thing in terms of the technical nature of it. It is just impossible in terms of the politics.

(Cross talk.)

Q: – they haven't made any money off of. (Inaudible, off mike.)

MR. KLEINBARD: In terms of process, I think you need to split the world into two questions. The first is how do you reset the meter? How do we get from the current system to a better system? And then having done that, which people did in 1986, how do you preserve the deal because we saw that we very quickly eroded everything that we accomplished in 1986.

As to the second, I think one, in fact, needs to make explicit changes to the budget process to bring tax expenditures in. And just as we had hard caps for deficits at various points in the budget process since 1974, I can envision a world in which we have a cap on tax expenditures expressed as a percentage of last year's GDP. And legislators are simply told you

cannot – according to the deal that they themselves struck for themselves, we will not allow tax expenditures to pierce a certain cap.

To get there, to reset the meter to broaden the base, obviously, that is a heroic act requiring a major tax reform. The question is whether the expiration of the Bush tax cuts affords that opportunity to force everybody to the table because everybody has a view as to the expiration of those cuts. If that doesn't happen, then obviously, the next opportunity I would have thought would have been in 2013. And as to Bill's characterization of Congress, I vote for plan A. (Laughter.)

MS. GRAVELLE: Another question? Yes, right here. They are coming. Yeah, she is coming.

Q: I am Helen Raffel with Resources for the Future. How do you explain to Congress and its constituents the value of a value added tax?

MR. GALE: The congressman that I have spoken with and the staff that I have spoken with generally understand the value of the value added tax. It is not like we are all sitting here and they are all up there and they have no idea what we are talking about and we have no idea what they are talking about. They can understand very clearly the benefits and also decide that it is a non-starter from a political perspective.

MR. KLEINBARD: You know, Larry Summers had a wonderful response to this question. When asked, he said, look, the problem with a value added tax is that Republicans see it as a money machine and Democrats see it as regressive. So once Democrats figure out that it is a money machine – (laughter) – and Republicans figure out that it is regressive, then we will have a value added tax. (Laughter.)

MS. BATCHELDER: I think the other thing to note is it actually doesn't have to be regressive. In most countries it is, but there are ways that you can structure it to be a progressive tax. And if we want to raise more revenue but maintain or expand the level of progressivity in the tax code, that is very possible within the context of a VAT.

MR. GALE: Yeah, I think what Lily said is really important. And it comes back to this notion that each feature of the tax system doesn't have to redistribute from high income to low income. If you have a VAT and you used it to fund, say, universal health care, I would bet that would be a net positive in terms of redistribution of resources. But if you just look at the VAT, it looks like it hits low-income households more heavily. So there are combinations of policies that are better – you know, the whole is greater than the sum of the parts.

MS. GRAVELLE: I think we have time for one more question. Way in the back. The gentleman with the striped tie.

Q: I am Dan Martin with the National Geographic Society and Conservation International. I would like to ask Professor Batchelder to comment more broadly on her sense of this social value of our country's extraordinarily diverse and vigorous non-profit sector that is

neither commercial nor public, which is significantly encouraged by itemized deductions for charitable gifts. And that sector ranges in its purposes extremely broadly and is something that represents to many people the essence of community and good citizenship, whether it is something like a homeless shelter or an institution like New York University.

What is your view about the social value of the extraordinarily vigorous non-profit sector, which is essentially unlike any other country in the world?

MS. BATCHELDER: Yeah, I think that is a really interesting and complicated question. The U.S. is unique in having this large non-profit sector. And there are a lot of wonderful things about it. But I wouldn't say it is all wonderful. I mean, one of the issues is first, as we talked about, that if it is an itemized deduction, you are only really having the top third of people have any incentive to give to charities.

And there is something, you know, wonderful about giving money. But the problem is that people tend to give money to their same socioeconomic growth. So if you go to NYU, you give to NYU. If you live in a low-income neighborhood, you give to your local church. And when you end up having these incentives, the general empirical effect is that people don't change their out-of-pocket giving. They give the same amount, but then their giving is increased effectively by the government incentive.

So what we are doing is giving thousands of dollars to the charities that high-income people choose and zero government dollars to the charities that low-income people choose. And I think we need to change that. We need to make this – if you think of it as a way of people to express their preferences, maybe we should think of this more in terms of one person, one vote and not something that is linked that dramatically to your income.

The other issue is defining charities. And it is a spectrum. I mean, there are many wonderful non-profits that are here in the room and organized this event. But there are also large non-profit hospitals that it is very difficult to distinguish what they are doing differently from non-non-profit hospitals. There are very large university endowments that one might question whether those should be tax exempt, whether all of the property in a town where a university is should be tax exempt. So I think it is a very complicated issue, but one we really need to look at.

MS. GRAVELLE: Okay, I want to thank the panel for a very interesting presentation. (Applause.)

MR. PODESTA: I am just going to say three minutes worth of closing comments. And I am going to ask Bob to close up. I want to thank everyone who has participated today. I think it has been a tremendous day of learning and a lot of information that has been put out on the table for us to chew on.

I would say that – I am going to tell you what I heard because I thought that there was a lot of consensus. We tried to get panelists that spanned the spectrum at least of progressivism from somewhat more conservative or centrist voices to people more on the left. But I thought there was, in fact, a broad consensus that this is not a problem. The problem we are focused on

particularly with respect to the long-term deficit and debt issues that came about as a result principally or even minorly because of the recovery bill or even the recession, for that matter. It was a problem that was inherited from a wrecked balance sheet, as I said at the beginning.

Second, I thought there was a broad consensus on the center and the left that we shouldn't interfere with the recovery today, that today was not the time to withdraw support for the stimulus or for the economy. But the context of this conversation is what we needed to do over the long term.

Third, I thought virtually everyone agreed that there was a long-term structural problem and that it needed to be addressed. There was some difference of opinion as to the precise timing of an intervention, but the need to stabilize the debt as a percentage of GDP was something that I think all of our panelists agreed on. And that in itself as Bob and I were commenting earlier is sort of remarkable that we all agreed on what the metric of success in addressing this problem might be.

I think most people agreed that it was better to plan at least now for – and to think through progressive priorities and begin to build toward some decision-making that could take place as we come out of the deep recession because a response that is based on the unpredictable, the unexpected event often hurts the people who, I think, we care about the most, the people most vulnerable, as the example that was mentioned a couple of times involving the Carter administration suggested. I think there were some voices who thought that we could put at least that decision-making off for some longer period of time. But I think that the idea of putting the options on the table was important.

Everyone agreed that the first thing that needs to happen, I think, is that we need to get on with health-care reform, that we need to push down the cost curve on health. We need to get the kind of productivity gains in the health sector that we see in the rest of the economy. Or I think as Paul Krugman put it, the rest doesn't really matter.

There was consensus that a path forward, I think, is a combination of spending restraints, government productivity improvements and revenue increases. As the last panel, I think, strongly indicated, tax expenditures are a significant set of policies and supporting that in closing the gap, we evaluate those tax expenditures as we evaluate the way we are spending money. Again, it was mentioned that sometimes these things are blended and it is hard to tell in their economic effect one from the other.

And finally, I think there was some disagreement on whether and when to make an advanced commitment. That is, probably Bob Reischauer was leaning the furthest out and saying we should get out of this and try to actually do something next year to make an advanced commitment to begin to solve this long-term debt problem. Others like Paul, I think, thought we should put that off until the signs of recovery were still much more clear and much more stable.

But I think that the, as I said, almost everyone agreed that getting to that point where we have stabilized debt as a percentage of GDP was an important national goal. And we have to put

progressive ideas on the table in order to be able to do that. With that, let me turn it over to Bob. Thank you all.

MR. GREENSTEIN: Let me start by just noting that while once again here at the end, you are hearing from John and myself, at both CAP and the Center on Budget and Policy Priorities, there are teams of people, each of whom put in many more hours than either John or I did and are the people who have made this conference the success that I and John very much feel it has been.

I very much concur with John that among – I am not going to repeat all the things he said – just to note the notion of casting a broad net, looking at the tax side, looking at the spending side and having a goal of stabilizing the debt, so it does not rise faster than the economy after the economy recovers.

I would also note that John mentioned timing. The timing – and there were some differences in timing. But I think everyone agreed that action is going to need to be taken. And there was a general sense that when the economy recovers, we should do it. There was a little bit of difference as to how quickly to start into that.

One thing we didn't really discuss at the conference, but I would hope there isn't difference on is one thing one can start doing immediately is not making matters worse. This is an issue that is reflected not only in the current health-care debate, where we now have a very clear goal that the legislation on the Hill will not increase the deficit, but that we will be encountering in the next 90 days in debates over whether to, for example, eviscerate more of the estate tax or to get the votes to pass the necessary bill to raise the debt ceiling by adding goodies to it that make the debt bigger, ironically enough.

So for all of these reasons, short term, but especially longer term, I think our two organizations hope and intend that this be the start of an ongoing conversation that continues and that moves forward. If there is another point of consensus that came out of this conference, it is that a great deal is at stake for a great many people.

So let us continue the conversation. For CAP and the center and others, let it not end as we walk out the door in the next few minutes. Let us hear from you any thoughts you have. I think both organizations will have a lot of the material and maybe a lot of the actual video from this conference on their Web sites for people who want to review it subsequently. And let's all think about joint efforts to help the nation move forward on these very important issues. Thank you again for coming and for joining us today. Good afternoon, everyone. (Applause.)

(END)