THE BROOKINGS INSTITUTION

WASHINGTON COURT HOTEL

ECONOMIC FACTS ABOUT TAXES:

RATES, REVENUES, AND REFORM OPTIONS

A HAMILTON PROJECT POLICY DISCUSSION

Washington, D.C.

Thursday, May 3, 2012

PARTICIPANTS:

Welcome and Introductions:

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Former U.S. Treasury Secretary

Overview of "A Dozen Facts About Tax Reform":

ADAM LOONEY
Senior Fellow and Policy Director, The Hamilton Project
The Brookings Institution

Panel 1: The Economic Case for Tax Reform:

Moderator:

ZANNY MINTON-BEDDOES
Economics Editor
The Economist

Panelists:

MARTIN FELDSTEIN
Professor of Economics, Harvard University
President Emeritus, National Bureau of Economic Research
Former Chair, President's Council of Economic Advisers

LAWRENCE H. SUMMERS
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Former Assistant to the President for Economic Policy
Former U.S. Treasury Secretary

PARTICIPANTS (CONT'D):

Panel 2: Key Principles for a Successful Reform Effort:

Moderator:

MICHAEL GREENSTONE
Senior Fellow and Director, The Hamilton Project
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Panelists:

JOHN PODESTA
Chair and Counselor
Center for American Progress

JAMES POTERBA
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Professor of Economics, MIT

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The Honorable John Engler
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Former Government of Michigan

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P R O C E E D I N G S

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MR. RUBIN: Good morning. I'm Bob Rubin, and on behalf of all of my colleagues at The Hamilton Project, let me welcome you this morning to our program, which, as you know, will be a discussion entitled "Economic Facts About Taxes: Rates, Revenues, and Reform Options."

The Hamilton Project began about six years ago and it brought together a truly distinctive group of policy experts, academics, and practitioners. In that context, we don't endorse specific ideas. What we do do is, we organize serious discussions around issues that are critical to our economy. And in that respect, we have events like we have today with academic and policy experts and practitioners.

When we have papers, those papers are subject to rigorous peer view. We believe that the objectives of economic policy should be growth and competitiveness, broad-based expansion of living standards and opportunities, and economic security.

And we also believe that they can be mutually reinforcing.

We support market-based economics, but we believe equally that it is vital to have a strong government to perform those functions that markets, by their very nature, will not perform. The hardship that many Americans have been experiencing and continue to experience requires a serious commitment by policymakers, and in support of that commitment, The Hamilton Project has had a number of discussions and events around short-term policy challenges. But our primary focus continues to be long-term economic policy.

We believe that our country is well positioned in transforming global economy because of our enormous long-term strengths, but we also believe that in order to realize that potential, we need to put our fiscal situation on a sound basis, we need to have strong public investment in areas critical to our economy, and we need reform in the areas that are so central to our economic success, including health care, immigration, and tax reform.

And that takes us to today's program. There is widespread agreement that our tax system is badly flawed and badly in need of reform for the future of our economy. Beyond that, however, the agreement breaks down. There are many different views as to the purposes of tax reform and as the changes are necessary to accomplish these purposes.

Our objective today is to better understand these different views, the effects of various proposed tax reforms, and the criteria for evaluating tax reform. In that respect, let me make a few brief comments as framing observations with respect to discussions to follow.

Number one, major changes in our tax structure and in the level of taxation, for example, increased revenues that increased confidence, could promote growth, reduce inequality, and contributes substantially to establishing a sound fiscal trajectory, and that was my point for -- about increased revenues contributing to deficit reduction, with room for critical public investment.

Number two, having said that, there are vigorous debates about what purposes tax reforms should have, what the affects would be of particular changes, and what the level of taxation should be.

Number three, any substantial tax reform will have major winners and major losers, and that creates a very difficult substance with respect to tax reform and very difficult politics.

Number four, any substantial tax reform will inevitably have multiple affects on our fiscal position, on inequality, and on growth.

And finally, as we all know, the post-election period of 2012 and the first few months of 2013 will pose fiscal issues of enormous importance. Whether that leads to constructive action or the political system kicks those issues down the road remains to be seen. But it’s our view that tax reform at least has the potential for helping catalyze a constructive response and could play an important role in that response.

With that, let me outline our program and briefly introduce our panel members. And as you can tell from looking at the program, this is a truly remarkable set of individuals. And remarkable is maybe an overused word, but I think it clearly is applicable to the group that we have today. I’m no going to go into their resumes because they’re in your materials.

We’ll begin with an overview of The Hamilton Project’s well-received and illuminating paper, “A Dozen Economic Facts About Tax Policy.” The paper will be presented by Adam Looney, policy director of The Hamilton Project, senior fellow of The Brookings Institution, and one of the nation’s leading experts on the economics of tax policy.

Also, if you look at the extraordinary working group on the front page of the paper that helped guide this paper, it’ll give you a sense of the truly distinctive strength of The Hamilton Project in being able to bring together such an extraordinary group.

Then we'll turn to our first roundtable titled "The Economic Case for Tax Reform." And again, this is a remarkable group for this discussion. The discussions will be Martin Feldstein, professor of economics at Harvard University, president emeritus of the National Bureau of Economic Research, and former chair of the President's Council of Economic Advisers. And Lawrence Summers, Charles W. Eliot University Professor at Harvard University, former president of Harvard University, former secretary of the Treasury, and former assistant to the President for Economic Affairs. The moderator will be Zanny Minton-Beddoes, economics editor of *The Economist*.

I said I wouldn't comment on the participants' resumes and I won't, but I would like to make a few personal observations. Marty Feldstein and Larry Summers are friends with whom I've had the opportunity to discuss economic issues, in Marty's case, for many years, and in Larry's case, for decades. Both are excellent listeners, though challenging, who -- they are challenging, but they also are excellent listeners who process what they hear, are open to changing their minds, and then give you reasoned conclusions with strong grounding.

So in addition to their preeminence, they are exceedingly well-suited to the reason discussion that tax reform needs so badly, but so seldom gets. I've also had the privilege with being on panels with Zanny, and she is not only an incisive moderator, but she frequently knows more about the subject at hand than the discussants. And when I'm on the panel, she surely knows more than the discussants.

Our second roundtable is "Key Principles for a Successful Reform Effort." The discussants are the Honorable John Engler, president of the Business Roundtable and former governor of the state of Michigan; Jim Poterba, president and chief executive officer of the National Bureau of Economic Research, professor of economics at MIT; John Podesta, chairman and counselor of the Center for American Progress and former chief of staff at the White House; and Alice Rivlin, senior fellow at The Brookings Institution, former deputy director of OMB, former vice chairman of the Federal Reserve Board.

The moderator is Michael Greenstone, director of The Hamilton Project, senior fellow of The Brookings Institution, and 3M professor of environmental economics at MIT, and the former chief economist of the CEA. As I said in the beginning, it is a really remarkable group of people.

Again, I'm not going to go into their resumes, but again, I'd like to make a couple of personal observations. John Engler was a committed Republican, but he also worked effectively across the aisle with both parties, and that is the spirit that we are going to need both to accomplish tax reform, and more generally, to move forward on the issues of our country.

I was in the Clinton Administration with John Podesta, and arguably, the chief of staff is the most difficult job in the government, other, of course, than being President. John was an outstanding chief of staff, as well as a friend, and he's since been a major force with serious policy by founding the Center for American Progress, and also advising members of Congress and the administration. I also had the opportunity to serve with Alice Rivlin. She was always an effective and thoughtful colleague and has been a major voice for what arguably is our country’s most fundamental economic problem, or economic policy challenge I should say, and that is reestablishing sound fiscal conditions.

Jim Poterba has what is thought by many to be the most important job in the American economic profession, and he has accomplished the enormous challenge of successfully succeeding a giant in the profession, Marty Feldstein, and succeeding a giant is never an easy task.

By the way, in terms of the head of the National Bureau of Economic Research being the most important job in the American economic profession, Marty was that, and I asked Marty if that was true, and he said yes.

Finally, Michael Greenstone, who is the

outstanding leadership at The Hamilton Project and has also provided frequent tutoring for me and so many members of our project, has really done a remarkable job, as you can tell from this morning’s program.

Today’s program will give all of us the opportunity to listen to and engage with preeminent thought leaders on the economic issues of our country. For developing the intellectual construct and for bringing this program together, I would like to thank in particular Michael Greenstone, Karen Anderson, the deputy director of The Hamilton Project, and Adam Looney. I’d also like to recognize Les Samuels, partner of Cleary, Gottlieb, Steen and Hamilton, and former assistant secretary for tax policy at the Department of Treasury.

And key, as always, to the work of The Hamilton Project, I thank the enormously talented, committed, and hard working staff of The Hamilton Project, without which nothing that we do would happen. With that, Adam, I turn the podium over to you. Thank you very much.

MR. LOONEY: Thank you for that warm introduction. Since the last major tax reform in 1986, the tax code has become more complicated, less efficient, and increasingly it's viewed as less fair. Advocates for tax reform would tell us that by broadening the tax base, we can have a simpler system with lower rates.

But increasingly, that's not all they tell us. To some, tax reform is an opportunity to reinvigorate economic growth, to unleash economic activity, to create jobs, a way to boost revenues without raising rates, and to help solve our deficit problems, or increasing a way to do all of those things at the same time.

And so today we wanted to provide the foundation for a discussion of what tax reform should accomplish, but also to put up guardrails on that conversation, to keep it grounded in the evidence of what tax reform realistically can accomplish. And so drawing on the expertise of the many distinguished tax experts, among its advisory council, The Hamilton

Project has put together a dozen economic facts about tax reform to facilitate the policy discussion, and I hope you've all picked up a copy on your way in.

Our starting point is the observation that the economic context today is far more challenging than in earlier tax reform eras. And it's not just a statement about today's unemployment rate, the political situation, or the tough fiscal choices we must make by the end of this year, but it's also about the fact that we face at least three important long-term economic issues that relate closely to tax policy, the rise in budget deficit, concerns about growth and competitiveness, and rising inequality.

Any tax reform is likely to be judged, at least in part, in how it impacts those three issues. And so the first issue, if I can get to it, is the daunting outlook for the federal budget. The basic purpose of the tax system is to raise revenues to pay for government services, and in that regard, the U.S. system comes up short.

For instance, in 2015, the federal

government is projected to spend about $12,400 per American, but to receive only about $9,700 per person in tax revenues; projected to collect less in revenues as a share of the economy over the next several years than we have spent in each year over the past four decades. And that comparison understates the challenge as an aging population, and continuing rise in health care costs will increase federal spending well above historical levels.

It’s just difficult to envision a scenario in which revenues are not part of the solution to deficit problems. And to that end, and to examine the role of revenues in the broader fiscal debate, the document provides evidence about how tax revenues in the United States compare to those in other countries. It examines how various tax reform options effect revenues, and contrasts the scale of popular budget options to the magnitude of a future deficit.

A second long-term economic issue is that increasingly international competition for business activity, the rise of more educated and capable work forces around the world, and other economic changes have contributed to reduce economic opportunities for many Americans and challenges at many businesses.

One sign of the impact of these trends is a stagnation in earnings for many American workers over the past several decades. Concerns about competitiveness have encouraged greater scrutiny of having rules, regulations, and tax provisions effect or impede economic activity. And the tax reform has wildly been counted as an opportunity to boost economic growth. In the document, we summarize economic evidence regarding how the current tax system distorts or impedes economic activities and how much we can expect tax changes to improve our economic prospects.

Finally, there is the issue of growing income equality and its relationship to the tax code. Pretax incomes have risen by more than 250 percent since 1979 for households in the top one percent of the income distribution. At the same time, households in the middle and bottom have experienced much weaker growth.

Change in the tax system over the past 30 years have tended to exacerbate these inequities. The very people who have received the biggest income gains have also seen the largest tax cuts.

It’s already clear that issues related to inequality will be paramount in discussions about the tax system. And to inform that debate, we provide evidence on how alternative reform options effect the progressivity of the tax schedule.

The document expands in these three areas and provides facts on a dozen individual aspects of tax policy. Just to peak your interest, I’ll highlight just two. Fact nine examines how individual tax rates effect the employment and earnings of workers. A key consideration in tax reform is how much tax rates hold back the U.S. economy, how much lowering rates would spur economic gains, and whether those increases in income can help offset losses from lower rates. The figure in your text illustrates how a 10 percent cut in marginal rates would affect the employment and labor supply decisions of a typical American family, drawing on the evidence from 23 published studies.

The average estimate across all of these studies suggest that this family would increase their pre-tax earnings by roughly $450 off a basis of about $70,000. That's an increase of 0.7 percent. Yet that same 10 percent tax cut is predicted to reduce federal income taxes paid by 8.6 percent.

In short, the evidence suggests that that type of tax cut has large affects on revenues, but relatively modest affects on labor supply.

Fact six examines the limits to what a base broadening tax reform can accomplish in terms of lowering tax rates. We often hear of tax plans highlighting their low top rates, 28 percent, 20 percent, 15 percent, even 999. But those plans are sometimes light on details of how they affect revenues or how they change the tax burdens that fall on different groups.

And so we've put together a cheat sheet that starts with the constraint of maintaining both current tax revenues and the current progressive tax structure, and from that starting point, then asks how low tax rates can go under alternative base broadening proposals. So under current law, as we see in the top row at the table, tax rates are scheduled to rise up to a level of about 40 percent. To skip to the punch line, it’s only through dramatic tax reforms, eliminating all tax expenditures, including those for health insurance, retirement savings, owner occupied housing, preferential rates on capital gains and dividends. One can lower rates even to 27 percent.

That analysis illustrates a broader takeaway of the document, which is just how difficult it is to achieve those efficiency enhancing lower rates before revenues fall, the tax code becomes less progressive, or popular tax preferences are dramatically scaled back.

And so I encourage you to look over the dozen facts, and we hope it’s useful to you in your future conversations. Thank you, and I look forward to a very interesting first panel.

MS. MINTON-BEDDOES: Just sorting out a few technical issues. Larry, I think you should sit on the left here from the audience's perspective. Seems the appropriate place to be.

Welcome to this first panel. The topic of tax reform has been on the agenda in Washington pretty much since -- as long as I've been following U.S. economic policy, which I hate to say is now getting on for two decades. The complexity of the U.S. Tax Code, its distortions, have again and again brought calls for reform. There have been debates over the past decades of a flat tax, tear up the whole code, wholesale reforms, nostalgia for the 1986 tax reform, but even as that has happened, the tax code got more complicated as politicians have added more pages to it and more deductions to it.

It seems to me that the debate today is taking place in a whole new context. It's in the context of large deficits, a weak economy, widening inequality, and there is an immediate spur to action with the expiration of the Bush tax cuts at the end of this year. So not only is tax reform back on the agenda, I think it's back on the agenda in a way that may result in action that hasn't been the case in the past.

So this conversation about what kind of tax reform we should be doing has an importance and an urgency that really can't be exaggerated, which is why this discussion is very important. And we have two extraordinary well-placed individuals of different perspectives to discuss what sort of tax reform we should be doing, to debate what sort of tax reform we should be doing.

Bob Rubin has already introduced them, you all know them. Marty Feldstein, professor of economics at Harvard University, president emeritus of the NBER, former chair of the President's Council of Economic Advisers; Larry Summers, also professor of economics at Harvard, former Treasury secretary, former chairman of the National Economic Council, former student of and former boss of Marty Feldstein.

(Laughter)

So I think, Marty, let’s start with you. I want to start this conversation by actually working out what should be the priorities for tax reform today? Because tax reform has all kinds of good priorities. I mean, people talk about wanting to boost growth, boosting American competitiveness, simplifying the code, improving progressivity, raising revenue, but many of these are somewhat at odds with each other, and certainly depending on what your priorities are, you would put forward different kinds of reform. So can you just lay out what you think, given where the U.S. economy is right now, what should be the priorities? Rank them somewhat.

MR. FELDSTEIN: Well, you began by saying Larry and I come at it from different perspectives and that’s probably not quite right. Larry and I come at it from different political party affiliations. But Larry and I have been talking about taxes for 30 years. And so it’s not too surprising that there’s a lot of agreement and I hope that that comes out as we talk about the specific issues.

I think about tax reform in terms of its long-term impact. We've got a serious cyclical problem now. But I think the tax code that we put in place, I hope that Congress puts in place next year, we have to think about for the long term. What are the things it has to accomplish? You're right that there is, in a sense, conflict among them, but there are always trade offs, and so it's a question of picking things that do better at these different goals.

What are the goals? I think there are four basic goals. One of them is to raise revenue. As Adam Looney's chart showed, we need to raise some revenue. How much we need to raise will depend on how well Congress does at limiting the growth of entitlements, but that's not today's agenda. And raising revenue can be done in ways which have good side effects or ways that have bad side effects. And that brings us back to the discussion about tax expenditures.

So the second goal, in addition to raising revenue, is reducing waste, what economists would call inefficiencies or dead weight losses. The tax system hurts productivity in a variety of ways, by hurting savings and investment and by hurting labor supply broadly defined.

A picture that Adam showed us about how it effects ours is just a small part of that. It also reflects the form in which people take their compensation. So we're induced by the fact that all kinds of fringe benefits are excluded from taxable income to taking compensation in ways that are less valuable to us, but on a net of tax basis, are more attractive. And it also reflects the kind of spending that Americans do, because sometimes the spending are tax favored.

A third thing is simplicity, and you mentioned that, and people are just overwhelmed with the complexity of the tax law. It makes compliance more difficult and it makes people feel that probably everybody else is getting a better deal than they are, that everybody else has figured out some deductions to take, some credits to take, some ways of changing their behavior that lowers their taxes. So we need a simpler tax code.

And finally there's the important issue of fairness, and fairness is more than just, in my judgment, more than just a question of productivity or tax rates, it's also the tax base. Fortunately, inflation is low now, but even in today's low inflation, individuals pay capital gains taxes on nominal gains. Even when there are real non-gains or real losses, I think people rightly feel that that's unfair.

So I think there are a lot of things about the way in which income is defined for taxable purposes which add to the unfairness of the system. But that's my four-point --

MS. MINTON-BEDDOES: In that order or --

MR. FELDSTEIN: I don't think of it as in an order. I'm not going to say we get revenue and it doesn't matter what kind of fairness we get, or we get fairness and it doesn't matter what it does to revenue, I think you have to think about any given change in terms of what does it do for each of these four things.

MS. MINTON-BEDDOES: And can I just press you on one of them, the question of fairness? Do you think in light of the fact that pre-tax income inequalities have widened so much, the goal of narrowing them, creating a more progressive tax code, should be a goal of tax reform?

MR. FELDSTEIN: Not particularly. I noticed in the background material one of the things that was suggested was combating inequality, and my feeling has been for a long time that our problem in the income distribution area is poverty, and we should be concerned about combating poverty, not about combating inequality. If somebody -- if a couple makes $250,000, which is probably not hard to do at The Hamilton Project or at Harvard University, that's not something, to me, that needs to be combated.

MS. MINTON-BEDDOES: I see. Larry, do you have the similar set of priorities or do you have a different set?

MR. SUMMERS: Overlapping. I would just begin by saying that while it's not our subject today, whether we get this expansion to a sustained reasonable growth rate that is consistent with a return to full employment is the single most important economic issue facing the United States. And we will not achieve any other objective, whether it is sustained fiscal help, the ability to combat poverty, the ability to be strong in the world if we do not achieve that and, therefore, maintain the momentum. And expanding the momentum of demand has to figure centrally in any economic policy discussion going forward and has to have a very large effect on any thinking about timing and phasing in any set of reforms with respect to the tax system or with respect to entitlement, but that's not our primary subject today.

To take your four objectives, Zanny, as Marty points out, you obviously can't rank them, but you can give some indications of their importance. And I would agree with Marty on the central importance of revenue raising.

Doug Elmendorf, the director of the CBO, gave a very effective presentation at Harvard a month or two ago on the nation's long-term fiscal situation in which, after going through a lot of stuff, he reduced it to the following statement: that in order to get to a stable debt-to-GDP ratio, not a balanced budget, but the relatively modest goal of a stable debt-to-GDP ratio, after making what he regarded as being at the edge of credible, optimistic assumptions about discretionary spending cutting, and making the extreme -- very optimistic assumptions about the capacity to cut defense, his conclusion was that you needed either to reduce all entitlement spending by a quarter or raise all revenue collection by a sixth if you wanted to get to the goal, or you needed some combination of those two things. For a variety of reasons, I think his assumptions are a little optimistic, so I think it's a little worse than that.

I don't think it's on this planet that we are in a decade going to reduce entitlement spending by anything like a quarter. And therefore, relative to the baseline, and therefore, I think it is a near certainty that we are going to need a significant increase in revenues. And it seems to me that any discussion of tax policy needs to start there.

And it seems to me that to suggest that from current baselines, it is possible to cut taxes substantially and pay for it with as yet unidentified spending cuts is close to inconceivable and do not represent claims that should be taken seriously in the public discourse.

There's room for debate about what the balance is between the quarter on spending and the sixth on tax increasing, but the idea that we can be cutting taxes, which implies cutting entitlements by more than a quarter, I think is, frankly, laughable. So revenues are at the center, number one.

Second, and here's where Marty and I would have a difference in orientation. I think we do need to address the questions of progressivity, and we do need to address questions of fairness in a central way. There has been a major change in the pre-taxed income distribution that has been generated over the last 25 years. Roughly speaking, a generation ago, the top 1 percent got 10 percent of the income. Today, the top 1 percent gets 20 percent of the income, and if anything, that trend is accelerating.

Now, it seems to me you can -- reasonable people can argue about whether, in the face of a change of that kind, the tax system should operate to offset it or not offset it. But the view that it should operate to reinforce it, cutting taxes by more at the high end than in the rest of the distribution, seems to me very hard to justify on any way of thinking about it.

I share Marty’s concern for the poor, but that, it seems to me, is not the only valid concern. It seems to me that something about the health of a society has something to do with the ratio of what those who are most fortunate are earning relative to those in the middle class, what is sometimes reduced in the public debate to the ratio of CEO wages to average worker wages.

And conservative thought in this area actually surprises me a bit. I would have thought that the right pro-market view to take was that you should let the market grind out whatever income distribution it does, not interfere with the workings of the market, and then the tax system, as it collects revenue, should be based on ability to pay in a way that raises the burdens on those who are getting most fortunate given what's happening in the income distribution. And so the idea that you should be reducing the taxes on those who are most fortunate seems to me to be a quite surprising one.

When Marty talked about simplicity, he referred to issues of legitimacy. I think the legitimacy of the tax system and the legitimacy of the government on which it depends depends much more on a perception of fairness, depends much more on the idea that those who are in a position to take advantage of the double-Dutch Irish sandwich, or maybe it’s the double-Irish Dutch sandwich, are paying their fair share of taxes, then it does question simplicity versus complexity. So I would come next to fairness.

I would come third to questions of economic efficiency and neutrality. But here I think I would put less emphasis on these questions right now in the United States than I would have over most of the last 25 or 30 years for a couple of reasons.

For the next few years, our economy is going to be demand constrained rather than supply constrained. If the economy is demand constrained, increasing the willingness to work, if not everybody who wants a job can get one, isn’t actually going to increase the total level of employment. Moreover, whatever has been true in the past, in the current world of two percent interest rates, it slightly strains credulity to believe that excessive capital costs represent a major inhibition to investment in the way that I suspect was true to an important degree at various points in the past.

So, yes, we should level the playing field, yes, we should reduce various kinds of tax biases that are present, and it would be desirable, but I would put less emphasis on that in our current demand constrained low capital cost context.

Finally, simplicity. How can you be against simplicity? But I would just caution that much of what is said about base broadening and simplicity is itself an over simplification.

People always think of base broadening as being about reducing tax expenditures, and that if you don't have the tax expenditure, you have a simpler form, and the whole thing works better. In fact, much of tax -- much of base broadening is about eliminating exclusions from income that increase complexity.

So, for example, the vast majority of base broadening proposals include the repeal of the provision that says that if you sell your owner-occupied house, you don't have to pay capital gains taxes as long as you have a capital gain of less than $500,000. That may be a good provision or it may be a bad provision. I promise, if you repeal it, and everyone who sells a house has to go back and look at what they paid for it, calculate all the improvements they put into it, and drew the calculation, you are significantly increasing the complexity of the tax code. That is not an isolated example.

I am in favor of various things that assure that all taxation is -- that all income is compensated, club memberships, free martini lunches, and all of that. I think we ought to go after more of that, but we shouldn’t kid ourselves that we will have a simpler tax code if we do.

I am sympathetic to ideas that are widely part of tax reform proposals to convert deductions into credits so that they can be claimed at the same rate, mortgage interest for example, it’s 15 percent for everybody, not 35 percent for some people and 15 percent for others. But the result will be that more Americans will be able to take care of -- take advantage of the credit, they use that instead of the standard deduction, and they will find the calculation of their taxes more complicated. And I could proliferate these examples.

It is just wrong to assert that base broadening and simplification are objectives that go in tandem. More likely, comprehensive base broadening is a complexifier. Now, my reality, my sense of the reality is that almost everyone who has any complexity associated with their tax return either does it themselves with software or does it -- or has somebody -- pays somebody to do it with software. And in that context, things that once would have been substantial complicators, the existence of many different rates, for example, add essentially no complexity. You put the information into the software, the software puts the number out.

So I don’t believe that many of these traditional concepts of simplicity are exactly right. I don’t believe that much of what is advocated in the name of simplicity is actually simplification. And I think that we would be better off recognizing simplification for an issue in the way that Marty framed it, which was as about creating a system that has more perceived fairness, and I think a system that has more perceived fairness, I don't find it plausible that simply increasing payments to the poor will entirely satisfy the objective of achieving fairness as long as there is a justified perception that those who are most fortunate often are most successful in escaping taxation, as well.

MS. MINTON-BEDDOES: Well, you've given us plenty to talk about. I hope we've got the next three hours here. It's not clear that you agree on that much, but I do want to start where you both agreed. You both put revenue raising -- you mentioned it first. I think it's fair to say you both agree that needs to be a top goal. Which leads me to a question, why is the debate then as narrow as it is in the U.S.? I mean, for someone with my accent, one could say that a crude caricature of the U.S. system is that it basically just taxes a narrow base of income. It relies much less on consumption taxes than pretty much any other industrialized country, much less on environmental taxes. Why aren't we -- if revenue raising is so high on the agenda, shouldn't the tax reform debate be a much more ambitious debate than the one that is actually going on in Washington now? Marty.

MR. FELDSTEIN: Well, I think by consumption, you mean a value added tax or something like it. And the reason that I don't like the idea of a value added tax is, I think that if you had a value added tax, it would simply make it so much easier for Congress not to deal with controls on spending.

I think there is a consensus now that we have to, in addition to raising revenue, have to slow the growth of various entitlements, look for other savings in the discretionary part of the budget. If you could pick up 4 or 5 or 6 percent of GDP with a value added tax, everybody could relax, and I think that would be a mistake.

MS. MINTON-BEDDOES: Larry, what's your view on value added taxes?

MR. SUMMERS: I've had kind of the same view for about 25 years, which is that we haven’t had it because conservatives like Marty think it’s a money machine for government, and progressives think it’s not that progressive, and we’ll only get it the day that progressives decide that it’s a money machine for government and they want more government, and conservatives like Marty decide that it’s the least distortionary tax. And I don’t think that day has quite yet come, and so I don’t expect it to figure prominently in the next couple of -- in the next debate.

Look, I think whether we get a value added tax in the United States or not over the next 10 or 15 years is going to hinge on a question which I don’t think anyone really should believe that they completely know the answer to, which is this: What is the structural increase in health care costs going to be and how successful are we going to be in controlling?

The truth is, it’s not going to be possible to control public health care costs vastly more severely than private health care costs, because if you do, then the public programs won't work, and it won't work when half the doctors opt out of Medicare.

So the success in controlling public health care cost is ultimately going to be hostage to the success in controlling overall health care costs. And given the interplay of technology, given that an increasingly affluent society probably is right to want to devote more resources to health care, given the kinds of relative price changes that take place between health care and other things, I don't know how rapidly health care costs will grow over the next 10 to 15 years. If they continue to grow at the kind of rates that we've had, and we continue to treat health care as a -- to an important extent, a public obligation, I suspect the pressures for more revenue are going to be such that there's not going to be a viable alternative to consumption and value added taxation.

If efforts to contain health care costs are successful in keeping health care costs at rates only

-- growing at rates only slightly greater than GDP, even with an aging society, then I suspect the debate will play out in these terms because there won't be a taste for consumption taxes to pay for broad new government initiatives. And I am uncertain as to what our success will be in containing health care costs.

MR. FELDSTEIN: Larry is right, there is no way to be certain about it, but I think the issue comes down to how much will middle and upper middle income people and continually rising affluent middle class pay for their own health care and how much of it will be financed by the government.

So even if health care costs grow more rapidly than GDP, which seems likely, that doesn't mean that government financed health care costs have to rise that much more rapidly. And the Bowles-Simpson proposal struck me as a good one of limiting the growth of government financed health care costs to grow a GDP plus one percent. That means that I will have to pay more out of pocket either for my insurance or for my health care or both. But those are separate issues from what our focus I think is supposed to be.

MS. MINTON-BEDDOES: Absolutely. We can have a long discussion about health care reform, but let's not. But I take your point, Larry, that if health care costs carry on growing, then maybe the political environment for a value added tax changes.

But let's go back to the here and now, where the debate is to simplify about two issues. One is tax expenditures and the other is the taxation of capital, both the corporate tax and what should happen to capital gains taxes and dividend taxation at the personal level. There's also the question of reduction in marginal rates, but let's --

MR. SUMMERS: Can I just say one more thing under value added taxes --

MS. MINTON-BEDDOES: Very briefly.

MR. SUMMERS: -- that I don't think is contentious. It doesn't make any sense to have a value added tax that raises less than 2 or 3 percent of GDP. Once you're going to set up all the apparatus of it, it just doesn't make any sense unless you're going to have 3 percent of GDP, 2 or 3 percent of GDP. And so we won't do it until and unless there's a political consensus for needing that much revenue. And there isn't any political consensus for raising that much revenue now. And that's why I'm saying the value added tax isn't an important part of the current --

MS. MINTON-BEDDOES: There's not even any concerns about raising any revenue right now.

MR. SUMMERS: Right. (Laughter)

MS. MINTON-BEDDOES: Let's go to the current debate, and particularly the taxation of capital. And, Marty, I want to start with you because there's a sort of -- and I'm going to over simplify, but a traditional view amongst many economists is that, you know, low, preferably zero taxation of capital is more efficient, more pro growth, and yet we have a corporate tax here which is, if you saw the article in the, what was it, Sunday's *New York Times*, clearly full of loopholes. And then there's the question of taxation of capital gains at the personal level.

Start with the corporate tax. How much of a problem is the U.S. corporate tax and what needs to be done with it?

MR. FELDSTEIN: Well, the common opposition, correctly, about the U.S. corporate tax is that if the margin -- the corporate tax rate is higher than any other country, any other industrial country, at 35 percent. There are a lot of special features that make the effective corporate tax rate lower than that.

The thing that strikes me about the corporate tax rate is that we economists don’t have a clue about who ultimately pays the corporate tax, how much of that is born by shareholders, how much of it is born by capital more generally. What we understand is that in a world where capital can easily leave the corporate sector to go into other things -- housing, unincorporated businesses, the rest of the world -- then the corporate tax is not born by shareholders, or it may not even be born by capital at all, and ultimately then is born by the workers rather than by capital owners.

So we don’t really understand that, but the perception of the corporate tax that it’s born by corporation or by their owners makes it a very hard tax to give up. And so every country in the world has a corporate tax.

What distinguishes our corporate tax from others is that we tax in a very inefficient way. We tax worldwide income of American corporations, but allow those corporations to pay their U.S. tax only if and when they bring those funds back to the U.S., which they don’t.

So the net of it all is that we now see that more and more multinational U.S. corporations earn profits, do their producing in the rest of the world, but don’t bring the profits back to the United States because of this extra tax that they would have to pay. And that’s why one of the key reforms that I think would be a good one would be for the U.S. to join in what every other OECD country does, and that is to have what’s called a territorial tax system, which says that you can bring the funds back to the U.S., paying a relatively small tax, 3 or 4 percent, as long as you paid your tax wherever you earned it in the rest of the world. And that's what all other countries are doing, and it would eliminate a lot of the game playing that that story in the *New York Times* and that goes on more generally.

MS. MINTON-BEDDOES: What about you, Larry, would that be your priority for corporate tax?

MR. SUMMERS: I'm a little more enthusiastic about corporate taxation than Marty is. I guess I'd make three points.

First, yes, the incidents of the corporate tax is complicated, but corporate executives seem in very little doubt about it. Nobody ever comes and argues for a major cut in the payroll tax, but there are literally thousands of people employed in this city by corporations with the objective of reducing the tax rate on corporations, which suggests at least some fairly strong view on their part that that burdens corporations and their shareholders. And I think over the reasonable run, that it's a good --

that there are substantial effects of that sort.

Second, I think it’s important to understand that on marginal investments, it’s not clear that the corporate tax system is very burdensome at all. If I consider advertising, which will build my brand, which will pay off over time, if I spend a dollar advertising, I deduct a dollar, and so it only costs me 65 cents, 35 percent of the cost is shared with the government, 35 percent of the profits that I earn is a consequence of the advertising are shared with the government, whatever maximizes my profits if there is no tax will also maximize 65 percent of my profits. The same argument works with respect to research and development.

What about with respect to putting in place a new factory or a new building? Well, for the last couple of years with respect to the new factory, we’ve let you write that investment off in the first year. We don’t do that going forward, we require you to depreciate it, and so there is a sense in which the government is sharing more of your profits than it’s sharing of your cost. And that was a really big deal in the old days when the interest rate is high.

But in the current world where the interest rate is two percent, the fact that you have to defer your tax -- your depreciation tax for five years really doesn’t reduce very much, it’s value at all. So it’s far from clear that the corporate tax is operating as a major deterrent to investments right now.

The most vexing issues do involve, as Marty said, the questions of international allocation, offshore income, all of that, and there you have to decide on what your philosophical approach is. We probably are caught in a bad middle right now. And there basically are two approaches that the world can take. One is, you can basically give up. And right now you say that with a lot of trouble and effort, the Irish-Dutch sandwich and stuff, you can do investments abroad and not pay much taxes on them, and it’s really not worth it to have people go to all that effort, so we ought to just make it official that you don’t have to pay any taxes on your foreign income, and that's what the territorial system does, and that's a reasonable argument.

The alternative view is that we ought to attempt to crack down in serious ways on the allocation of income. We ought to raise questions about deferral. We ought to cooperate with other countries, and so we don't head towards a world where multinational income is taxed at a very low rate because of their ability to pit one jurisdiction against another given the distribution of that income.

And so it seems to me that right now the U.S. tax system, it's like a library, we're running a library. The single dumbest thing you can do is announce that you're going to have everybody think that there's going to be an amnesty on overdue books, but then not actually ever have the amnesty, because then you assure that no books are every going to come back, and they're always not bringing back the book waiting for the amnesty which never comes, and so you never get the money. And that's what the U.S. debate is right now. Nobody in their right mind would bring in money right now with people thinking that who knows what's going to happen after the election and who knows what's going to happen next, there will be some kind or repatriation. Even if you thought you ultimately had to bring the money home, you surely would be waiting right now.

So this is a debate which my hope would be that the clarity comes more in the direction of internationally collaborative efforts to tax this income rather than the avoidance of this income. But clarity in a different direction would be better than the current place which assures that the money will not be brought back, and doesn't tax it, and generates all the extra complexity.

MR. FELDSTEIN: We would have to persuade every other industrial country to give up the territorial system and to crack down on their companies. That seems very unlikely to happen. Can I say one other thing about -- Larry was very careful to say something about short run versus long run in terms of the corporate executive. Yes, the profits of a corporation in 2012 are not going to depend on the corporate tax rate, the pre-tax profits, and that’s probably true in 2013, and, therefore, it’s not surprising that if I’m the CEO of a corporation, I would like to see those profits taxed at a lower rate.

The real issue is what happens over the longer run. And I think that’s where, as economists, we don’t really know where that tax burden is going to fall. And, therefore, relying on the corporate tax is, to me, a very strange way of raising revenue since we don’t know who’s ultimately paying.

MR. SUMMERS: There’s an issue --

MS. MINTON-BEDDOES: I need to move on from the corporate for a second, so please --

MR. SUMMERS: There is an issue you have to think about, which is, I don’t know what the percentage is, my guess is it’s on the order of 40 percent of U.S. corporate shares are owned by pension funds or endowments or foreigners in ways where there’s no U.S. individual income tax paid.

And so it’s one thing to say you should eliminate the corporate tax, but the income is going to be taxed anyway by dividends and capital gains. It’s another thing to say that when the income is going to be held by the Nebraska Pension Fund or the Harvard Endowment and there’s going to be no taxation ever on that income, now, you can say, well, there’s going to be so much more capital accumulation that actually, while it feels like the corporation isn’t paying taxes, ultimately, because there’s so much more capital accumulation, profitability is going to be less in the economy, and wages are going to be higher in the economy, and so ultimately cutting that tax is going to benefit workers, but that’s an argument with a lot of steps.

MS. MINTON-BEDDOES: Well, let’s move to -- because there’s clearly a division here, you know, to move to a territorial system crackdown, if I just summarize it, move to the personal taxation of capital, so capital gains and dividends, where, you know, one argument might be that, as in 1986, they were equalized and there's now a pretty big gap. Is that -- what direction, Marty, I'll start with you, should the taxation of capital gains and dividends at the personal level go?

MR. FELDSTEIN: So I think the fundamental question is, do you want to tax not just capital gains and dividends, but interest, as well? Do you want to tax the returns to savings? And we have a kind of mixed system. We say if you put your money into an IRA, you'll get a deduction, so we give you a deduction for savings. If you put your money in a Roth IRA, you don't get a deduction, but we don't tax the income on those savings.

So for a lot of people, we have a system that, in my judgment, correctly doesn't tax the return, the savings, or it doesn't tax savings itself. And I think there are two advantages to that. One is a kind of pure fairness advantage. I might like vanilla ice cream and Larry might like chocolate ice cream, but we would think it very unfair if we had a higher tax rate on vanilla ice cream than on chocolate ice cream, at least I think it was very unfair since I'm the guy who likes the vanilla ice cream. But that's similar to whether when I get my income, I want to consume it today or set it aside and consume it in the future. And so the tax law currently, unless you're in an IRA situation, or a 401(k), taxes people who want to consume their income later, who want to save now and consume it later, taxes them at a higher rate than the fellow who wants to consume his income now. So I think from a pure neutrality, a pure fairness point of view.

MS. MINTON-BEDDOES: Couldn't you put it another way then and say the fellow who gets all of his income in dividends, naming nobody, pays a rather lower tax rate than the fellow who gets his income in wage income?

MR. FELDSTEIN: But I want to start with the wage income to begin with and say, well, if I divide that income, save some of it, consume of it now, the interest, the dividends, the capital gains that I get by postponing it is just a question of the timing of the spending of that income, just like the division of my income between vanilla and chocolate, but that's out of the neutral with respect to that.

MS. MINTON-BEDDOES: Larry.

MR. SUMMERS: It depends on what examples you choose. And Marty's point about the double taxation of savings is a fair one, but it's not the only kind of an example you can imagine. Imagine, Zanny, that you start the next Facebook. In your garage, you've got some idea, you get your friends to loan you some money, make some investment, and you own a third of this thing that's in your garage. At the moment you get the third, there's no income because the thing is not really worth anything, and your thing ends up being worth $100 billion, and you end up being worth $33 billion. Many of us would feel that you should pay some taxes. But under the law, you pay no taxes.

Now, you might think that at some point you will want to diversify, you will want to sell your Facebook, your Zannybook stock. But actually, if you’re half-competently advised, you will find ways to borrow money, you will be able to spend 31 of your $33 billion without ever incurring any tax liability.

Now, you might ask, what will happen if 60 years from now you die and give the money to your children? Will -- and then your children, you know, they don’t care about Zannybook, they sell the stock, will they pay capital gains tax? Answer, no, they will not pay capital gains tax.

So I think you have an issue around great fortunes. And in a moment when the top 1 or 2 percent of the people own half of the wealth in the country, large fortunes is kind of a significant issue, and you have to factor that into the discussion of capital income taxation. So I do not favor the idea that we should not have capital income taxation for reasons that I think go crucially to fairness. We can’t as a country figure out that a guy who runs a private equity company is earning income by working. We let him call his income capital gains. And so in a country where we can’t figure out how to do that, if we escape -- if we cut the capital income tax rates to zero, there will just be massive erosion of fairness and progressivity. So I have not bought into that agenda at all.

I'll sit in on your side for a second, I think you'll agree with. Conversely, I think that you do have to be realistic about these things with capital gains. In our current world, where we tax them only when they're realized, and where we don't try to -- where we allow them to entirely escape taxation if they're passed on through estate, the estimates of the Joint Tax Committee and the estimates of the Treasury are that the revenue maximizing tax rate is about 30 percent.

Raising the rate from 30 to 40 percent, you actually lose revenue. If the revenue maximizing rate is 30 percent, it sort of follows that raising the rate from 25 to 30 percent, you're going to impose a very large burden on people per dollar of revenue that you're going to generate for the government.

So I think a thoughtful approach to capital gains taxation does involve recognizing these elasticities of realization behavior and does lead you to lower capital gains rates than certainly the rates we now impose, certainly the top rates that we now impose unless seized with the case for reductions in dividends, taxes, because you don’t have an issue like that realization issue, and because we do need to raise -- we do need to find ways of raising revenue.

I do think that this whole area of escape, erosion, avoidance, all of that does require more attention. And I am told by those who advise people much wealthier than I that with good advice, the capacity to very substantially avoid a state taxation is quite substantial, and reforms that address that issue would, it seems to me, to be constructive without requiring higher marginal rates.

MR. FELDSTEIN: I want to come back to the savings point.

MS. MINTON-BEDDOES: Very briefly.

MR. FELDSTEIN: Very briefly. I talked about the fairness, but there is also the inefficiency of distorting people's decisions about whether to consume now or consume in the future, and that effects not just capital gains, but dividends and interest. So I think it's worth distinguishing between the person who in the back garage starts a new business and then has a capital gain and people whose capital gains, dividends, and interest come from savings out of income. And we do that with IRAs and 401(k)'s and Roth IRAs, and the question is, should they be opened up, should they have the kind of ceiling that they have now, or should individuals who want to postpone the taxation of income be able to put it into an IRA or pay the tax and then not be taxed on the dividends, capital gains, and interest by putting it in a Roth IRA? And I think there's a very strong case, both a fairness case and an efficiency case, for allowing that.

Then there's the separate issue of whether you should be incented to take time off from your current work to work on the Zannybook technology by giving you the chance to get very rich from that innovation, and that’s certainly what the current law is designed to do.

MS. MINTON-BEDDOES: I’m going to open to questions in just a second. But before I do that, briefly one last topic which we haven’t covered which is the question of tax expenditures. And from your initial remarks, Larry, it seemed that you didn’t assign an enormous priority to limiting tax expenditures, and the whole debate about should you have kept them, should you get rid of them, should you convert them to credits. Very briefly, how high a priority should that be, and what tax expenditures ought to be kept or got rid of?

MR. SUMMERS: No, if you heard me that way, I misspoke. I suggested that I did not believe that substantial base broadening done in likely ways would produce a substantially simpler tax code. I do believe it would produce a substantially better tax code because it would be fairer and would avoid a variety of kinds of distortions that we have. And this is a place where Marty and I would be in agreement. Marty has put forward a variety of proposals. The Obama administration has put forward ones that are somewhat less ambitious than Marty's that are directed at limiting the full use of all the existing deductions. And I think the premise of both efforts is a political strategy that you're better off attacking deductions and exclusions as a group than you are trying to choose which ones to go after, and I think that's a good thing to do.

I think with respect to most of them, but not all of them, there's an oddity that if an affluent individual gives a dollar to charity, they get a 35 cent deduction, and if a middle income individual gives money to charity, they get a 15 cent deduction.

So I would, for the most part, favor the conversion of the deductions into credits and then some limitation on the deductions. How best to do that, you can debate the technical means, but I would be very much in support of base broadening.

MS. MINTON-BEDDOES: Marty.

MR. FELDSTEIN: So when I talked about

raising revenue, I said there are good ways and bad ways. I think raising tax rates, raising marginal tax rates is a bad way, because whatever distortions there are in the tax law, it exacerbates, and whatever disincentives there are, it makes worse, as well. So what I would think should be done is to cut back on these tax expenditures, what Bowles-Simpson correctly calls spending through the tax code. And since it is spending, since it is the government saying, well, we would like to encourage you to have a bigger house, a bigger mortgage, a bigger health insurance policy, we don't write you a check for that, we let you exclude it or deduct it.

Somehow, it seems to me, Republicans and Democrats ought to be able to come together around that, Democrats saying we want to raise revenue, Republicans saying we want to cut spending, and Marty saying to his Republican friends, that is spending, it just happens to go through the tax code rather than the outlay side of the budget. And, therefore, what we ought to do is get the extra revenue that we need by cutting back on that spending.

So there shouldn't be a division between those who want to cut spending and those who want to raise revenue, it's the way we get that revenue, by cutting tax expenditures. And the specific way that I think we should do it is to say you can keep all of the current tax expenditures that you have, all of the deductions, the exclusion of health insurance, but you just can't be too greedy about it. You can't take too much of a tax saving from it. So you add up what the tax savings would be from all of the schedule deductions, it's one line on the tax return, and your health insurance exclusion, and if that exceeds some percentage of your adjusted gross income, that excess is not allowed. So everybody gets to keep all of the current tax expenditure benefits, but only up to a certain amount.

And I've done the calculations on that, putting a cap of two percent, and that produces roughly the same percentage extra tax at every broad adjusted gross income class. So it doesn't change the progressivity of the system, but it produces an enormous amount of revenue.

You could start with a less binding cap, you could phase it up over time. I wouldn’t put it in next year for the reasons that Larry said, because of the concerns about the cyclical situation in the United States.

MS. MINTON-BEDDOES: But it also then avoids the fight between which kinds of benefits.

MR. FELDSTEIN: That’s right.

MS. MINTON-BEDDOES: Let’s go to questions. I know we have very little time left, for which apologies. But are there any questions? Yes, the gentleman there in the fourth row on this side. Just wait for the microphone and be reasonably brief.

SPEAKER: Well, as a retired individual, I’m very concerned about inflation as far as what it does to my net worth. And in my corner of what I think is unfair about the tax code is the fact that long-term capital gains, whether it’s houses or stocks or firms, as well as the alternate minimum tax, are not indexed to inflation, and I'd be curious to hear some comments about that.

MR. FELDSTEIN: Well, I did say that in my opening remarks, that I thought that's one aspect of the unfairness of this, we don't take into account inflation. In the definition of capital gains, that wouldn't be hard to do if we continue to have the capital gains tax.

MR. SUMMERS: I think you're right in principle on capital gains. I've noticed over time that there's rather more enthusiasm for recognizing the inflation component of capital gains than there tends to be for recognizing the inflation component of interest deductions.

And, of course, on the same principle that one does it for capital gains, one should do it for interest deductions, and I think there's a reasonable case for doing it. It would be surprising to me if the country having thought about doing this and deciding not to do it at a moment when we had 5, 6, 8 percent inflation in the '70s and '80s will now gravitate to this issue at a moment when inflation is very, very low, but in principal, you're right.

MR. FELDSTEIN: It's cheaper now.

MS. MINTON-BEDDOES: It's cheaper to do it. Next question, the gentleman there, five rows back.

SPEAKER: We've heard a lot of talk about base broadening. I just want to know if you both favor taxing Harvard and Harvard Endowment as part of our base broadening efforts. A nice tax expenditure there.

MR. FELDSTEIN: I wouldn't call that a tax expenditure because we've decided it is not a taxable entity. So it's not a question of the measurement of their taxable income, but whether or not their income should be taxed. So there is a broader question which is how we should treat nonprofits in this country. Should we allow contributions to Harvard, to museums, to symphonies and all that? And there are two choices.

We can do it the way we do it in this country or we can do what the Europeans do and make those government-financed organizations, the universities, the museums, the symphonies and so on. And I think the diversity and the way we do it in this country is preferable.

MS. MINTON-BEDDOES: The gentleman here.

SPEAKER: Thanks. A question for Professor Feldstein. A great many Republican legislators have signed up to pledges not to increase taxes, and as I understand it, those who promote the pledge include filling in loopholes in anything other than a revenue neutral way. Given what you said today, A, does that worry you? B, do you see a way of finessing it?

MR. FELDSTEIN: Some Republicans that I've talked to think that even though they signed up for that kind of an agreement, if there's a tax reform which is pro growth, which is tax rate lowering, then even though it raises revenue, they could go along with it.

So I hope that once we get past the election and people move from their hardened positions, both with respect to entitlements on the Democratic side and with respect to tax revenue on the Republican side, we will see an operational way of dealing with this problem.

MS. MINTON-BEDDOES: I'm afraid we're out of time, and I think that that's actually an appropriate place to end. It seems to me that we've had an extraordinarily interesting discussion, but one that showed that from two different perspectives there is actually quite a lot of agreement. There's a lot of difference in emphasis, but a lot of agreement. And hopefully, the next panel will put some more concrete flesh on that in terms of what we actually get to in the next few months in terms of a concrete tax reform. So thank you both very much indeed. (Applause)

MR. GREENSTONE: Thank you very much for everyone joining us for the second panel. It's a tough act to follow, but, fortunately, we have a star-studded cast here.

I will begin by introducing Alice Rivlin to my left. Alice may well have the best budget resume in Washington, D.C. She's been the director of the

OMB. She's a founding director of the CBO. She's served on the President's Commission on Fiscal Responsibility. She was the co-chair of the Domenici-Rivlin Task Force on Debt Reduction. And in addition to all that, she was vice chair of the Fed for several years, so.

Also to my left, we have John Engler, who served three terms as governor of Michigan. After that, he was the president of the National Association of Manufacturers, and is currently the president of the Business Roundtable. And when I was looking at his background last night on the web, I was struck by the following statistic: the companies that belong to the Business Roundtable have annual sales of not 6 million, not 6 billion, but $6 trillion. So John, I think, can speak authoritatively for the business community.

To my right, we have John Podesta, who's had an almost impossible number of influential positions in Washington, D.C. In the Clinton White House he had several key positions and was ultimately the chief of staff. After his time there, he founded the Center for American Progress, and is now the chair and counselor for the Center of American Progress.

And I should add, John has been an incredible friend to The Hamilton Project. We've collaborated on events, he's spoken at previous events, and part of the reason we're so excited to have John here today is when there's a mass of facts and confusion about policy and economics and their intersection, John has a unique ability to somehow shed light and clarity on an otherwise very complicated situation.

And then we also have to my right, Jim Poterba, who's my colleague at MIT and is, in addition, the president of the National Bureau of Economic Research and a fellow of the American Academy of Arts and Sciences among many other honors. One of the most influential public financial economists in the world and one could go on and on about Jim's accomplishments. But I'll just add, I'm fortunate to have him as a friend who is willing to dispense advice, professional and friendship and even advice on how to manage our three young children, which I appreciate.

So I thought I would begin with Alice. So Alice, could you give us a sense of the economic stakes at this moment in time and how big a reform should we be looking for and can you place that in the context of the tough, current economic conditions?

MS. RIVLIN: Yes. We should be looking for a very big reform and for some of the reasons that were talked about in the earlier panel. Every once in a while, we get an opportunity to solve a problem like reforming our tax system that should have been solved a long time ago, because something else has to be solved. And the something else that has to be solved is the fact that our debt is growing faster than our GDP because we have this enormous number of retiring baby boomers who need health care and our expenditures of the federal government will go up rapidly over time to meet that obligation and our revenues won't. So here's the opportunity to do a really big tax reform that will give us a better tax system. I think it can be fairer.

Fairness, as Larry stressed, is really important. Right now our tax code is riddled with things that not only make it more complicated, but, much more important, make it less progressive, things like the home mortgage deduction which benefits people up the income scale more than people in the middle or at the bottom. And we just built an enormously large number of very large houses for very high-income people. We really don’t need to encourage that. So we could convert back to a credit.

But what we need to do is look at our whole tax system and see what of these deductions and exclusions that have accumulated over the years for worthy purposes could either be eliminated or reduced to a more progressive form in a way that will allow us to have a fairer tax system and one that raises more revenue because we’re going to need more revenue. We can’t get to a stable debt unless we have more revenue. We also have to reduce the rate of growth of entitlements. But it’s not realistic to think that we can accommodate this many older people who need medical care, and we have a high standard of medical care, without some more revenue.

MR. GREENSTONE: Thank you. I thought I would turn next to Governor Engler. So Governor Engler, there’s something approaching a consensus, I think, about corporate tax, that the rate is too high and there are too many exclusions. This appears to have -- you know, provide the broad outlines of a deal. What is the business community looking for in this kind of tax reform? And then I think more broadly, what could this offer to the American economy, say to the typical American household that --

MR. ENGLER: Well, I think the --

MR. GREENSTONE: -- $70,000?

MR. ENGLER: Sure, it’s a great question. And I think the business community to start, generally speaking, is looking for certainty and predictability to de-risk what are so many areas of uncertainty. And I do want to spend a little time on that because the tax debate and the fiscal debate are very much part of the risk and the uncertainty that confronts somebody deciding about an investment today.

Not to suggest there aren't a lot of risks and uncertainty in other parts of the world, but we've moved from a country that could make big decisions and move on to set a direction, chart a path, to a country that doesn't seem to be capable of making very many decisions. And it's not just taxes and spending, it's energy policy. Where are we headed with health care? What's the housing policy? What's the regulatory policy? And you sort of get the point.

And I think there is on the sort of -- the discrete quest of corporate tax reform, a recognition that today the U.S. has the highest corporate tax rate in the world. That is a competitive factor among nations. And I think one thing that as a former governor, I was very much in the '90s involved with the conversations about competition among states and I think people get it, that states will knock themselves out.

You see this from time to time when somebody announces I'm looking to put a plant somewhere in America. And every governor is on the phone, the economic development officials and the governors themselves are on the plane flying to the headquarters. Choose us. Choose us. And here are the reasons why, and this is what we'll do for your workforces so that we can build you a road, what we can do on the tax side.

Well, what's not understood I think in Washington among top policymakers today is just how vigorous that competition is among nations. And virtually everybody -- I was at the Milken Institute for two days in Los Angeles this week and happened to walk by the Canadian booth. Invest in Canada, and it's the Canadian argument as to why Canada makes sense. And, of course, one of the things they mentioned is their very low corporate tax rate among other things.

Now as a Michigan governor, I paid a lot of attention to Canada in the '90s. In fact, one of the little secrets of some of the success we enjoyed when we had five years with the unemployment rate in Michigan below the national average was that Canada was in their lost decade. Unemployment in Canada was 9.7 percent average for a decade, budgets out of control. Well, they changed a number of things, and some of those are on our agenda.

One of those was corporate tax reform. I believe it is possible to do and we work hard with the Committee of 12 to have a proposal in front of them that would have given us a corporate tax reform that would have been -- it wouldn't have led the world, but it would get us back toward average with the -- and today, we do lead the world. Although I did find that Guyana has actually, a higher corporate tax rate than the U.S., but none of the other industrial nations.

MR. GREENSTONE: And I wonder if you could elaborate on that a little bit. If we had a more competitive corporate tax structure, --

MR. ENGLER: Yeah.

MR. GREENSTONE: -- what would that mean for the average American family?

MR. ENGLER: Well, the obsession has to be on how do we get the American growth rate back up? If we're going to languish around 2 percent, that's not adequate. And you really need to see the kind of robust job creation that'll get that unemployment rate below 8 percent, get the workforce participation back above what is almost a historic low, at least in recent years, decades even. You need that GDP to get back above 3, 3-1/2 percent. I think, Alice, a 1 percent increase in GDP will also add about a trillion-dollar contribution to revenues, so.

MS. RIVLIN: We're all for more growth.

MR. ENGLER: Yeah. And so it's prior to the growth agenda. And so I would say by itself, it is an important contribution. A competitive tax system also fixes your territorial problem. A lot said about more than $2 trillion on corporate balance sheets. Much of that's trapped offshore. Let's bring those trapped dollars home. Let's not have a tax code where you can go anywhere else in the world without paying additional tax and spend them, and the only place you will pay an additional tax if you'd be unwise and bring them back home. That can't be the right tax policy for America.

MR. GREENSTONE: Thank you. So Jim, in addition to your many academic accomplishments, you also served on President Bush's advisory panel on federal tax reform in 2005. I wondered if you could talk to -- we've heard a little bit from Alice about the challenges we face with the budget and the debt and from Governor Engler about the corporate tax reform, I wonder if you could, based on your experiences in 2005, that you could give us a sense of how we can pull everything together to produce a coherent tax system that includes income taxes, corporate taxes. I guess in the previous panel there was a discussion about consumption taxes and environmental taxes. So you have two minutes.

MR. POTERBA: Yeah.

SPEAKER: Second time with bad hair.

MR. POTERBA: I should start by saying and acknowledging the folks from Treasury and others who were so helpful in doing the work of the 2005 panel. You know, the recommendations of that panel didn't exactly create a lot of waves in Washington. So I think there's a big proviso around any answer I give, which is I'm not sure we succeeded in the task. But I do think there were two lessons that I would point to in this.

One is it's really important to think about tax reform as a holistic activity, something which is going to affect many components of the tax system, and to avoid the risk of getting cherry-picked and people saying, you know, you put together a plan which is great, except for this provision which I think has to be pulled out. Because the essence of tax reform is that there are likely to be winners and losers, particularly if we're doing tax reform in a revenue raising environment.

There are likely to be many losers in that situation. But we may be able to get to a system which is more efficient, which is better for growth, and which makes the ultimate burden of the tax system on the taxpaying public smaller. But it does put a great deal of pressure on keeping everything together so that you can say, you know, we've done a whole collection of reforms here which on net don't leave you too much worse off or leave you a bit better off. But as soon as you start to say, well, we can take some components out of that, the thing starts to unravel. So that's a very important lesson.

I think the second thing that I would point to is the importance of putting the corporate and the individual tax on the table together and thinking about this. And there really are two reasons for that. One, as the earlier panel certainly suggested, thinking about how you tax corporate capital income or capital income more generally, is likely to be very important in the coming discussions around tax reform. You can't really talk about capital income taxation without having the corporate tax as part of the discussion because you really need to think about projects which begin in the corporate sector in many cases and collect all of the taxes that are levied on them before they ultimately get to their investors. And you heard earlier the many different, you know, combinations of corporate and investor tax treatments which can go into that.

You can have a tax-exempt investor investing in a taxable corporation, you can have an S corporation doing a project that is only taxed at the household level, you can have a taxable individual investor investing in a corporation and collect taxes at two levels. So you really need to think about what you're doing to the playing field on all of those different ways of taxing investment projects.

Not only does the corporate revenue feature in this, it also is important for the distributional analysis, because when you get to the very top-end -- the top 1 percent, the top 1/2 of a percent -- when Congressional Budget Office, for example, looks at distribution tables, a significant component of the tax liability, all of those very top-end households, comes from the imputation of corporate tax liability to those households. So if you want to get an accurate measure of total burdens, you need to feature the corporate tax, as well.

The other piece of this, you know, we did thing things in ’86 that changed the relative tax burden on C versus S corporations and a lot of the data that we all look at on the rising inequality is the number that, you know, relies on numbers that are reported on tax returns. And if you change where income is in the corporate sector versus in the household sector, and it shows up in different places in the system, that can have a substantial impact on the measures of inequality. And anyone who’s looked at the numbers knows that there was a -- at least a discreet blip in the concentration of income amongst taxpayers -- individual taxpayers, right after the ’86 act, which at least could be attributed to some shifting of where those numbers were.

MR. GREENSTONE: Thanks. Okay, so we got a lot of work to do to solve all this. And that’s why we have John Podesta batting cleanup here. And I thought I would try and make the task as difficult as possible for him and just review what's coming down the pipe. So I guess we're going to hit the debt ceiling before the year ends.

MR. PODESTA: Right.

MR. GREENSTONE: The Bush tax cuts are set to expire at year end. There's the expiration of the payroll tax cuts from the stimulus, there's an increase in AMT, there's a sequester-induced cuts in defense and domestic spending. I would say that's on the policy side.

On the political side, I hear there's an election in November. I went and looked up on Intrade to find out who's going to win. According to Intrade, the President will be re-elected with a 60 percent chance. The House will go Republican with a 66 percent chance -- I'm sorry, with a 78 percent chance and --

MR. PODESTA: Stay Republican.

MR. GREENSTONE: Yes, sorry. And the Senate will go Republican with a 66 percent chance. Plus, we’ve got a lame duck session.

MR. PODESTA: Right.

MR. GREENSTONE: Okay. What’s going to happen? (Laughter)

MR. PODESTA: What’s the answer to that? I think it takes someone who has been burned so many times through their career to think of this as an opportunity, but I view this as perhaps the circumstance under which you can actually find your way to tax reform. So I actually view this as, you know, as something of a time where this debate could come together, not just because of the economic argument that Alice talked about, which I agree with, but because of the political construction that could likely result in a deadlock in the lame duck session, but with people with a strong degree of interest in reforming the code.

Because one of the things you mentioned in particular, which is what we’re looking at on January 1st, is a snap-back to a code that actually, you know, we lived under in the Clinton Administration. It goes back to more or less the circumstance under which President Clinton governed the country, and the economy did exceedingly well. And so that becomes a new baseline, I think, for this discussion and a new context for -- in which we look at the ideas that have been already discussed this morning in the panel with Marty and Larry, and then that have come forward here.

I would say the -- you know, most importantly, what that produces is a revenue level that is substantially higher than current policy. So current law that is what happens if nothing happens, if gridlock prevails, which is probably in Washington a pretty good bet, is a level of revenue that goes back to about 20, 20-1/2 percent of GDP once the economy has fully recovered. The earlier panel already described the problems with that in the very short term, what happens in 2013 if the economy is still (inaudible) -- I think I just lost my -- no, there it is -- if the economy is still operating with high levels of unemployment? But eventually it gets back to about 20-1/2 percent of GDP, substantially higher than what we've been operating under. Under Obama's first 3 years we've been at 15.8 percent of GDP, which is where we were under the Truman administration.

So I think that you begin to have the circumstances in which revenue is at a higher level and the choices that you need to make, therefore, the tradeoffs between base broadening and lowering rates, operate in a context that's quite different than the one we've operated in under the last couple of years, or really even under the last decade under the Bush tax cut. So that would be, you know, my first thought about this.

I would say just a couple of other things. One is there's, I think, general agreement about broadening the base and lowering the rates and I think, again, that context gives the possibility to take a look at that. But if you think about the rates as they currently exist, we have the lowest top rate since World War II in existence now. And we have the lowest capital gains rate since Hoover was president.

So I think there's only a certain amount of lowering that one can do even as you're broadening the base.

The base broadening exercise has to deal with the big, huge revenue shortfall that's facing the U.S. And maybe just -- not to -- you know, I could go on, but I just want to make one last point on that topic, which is that Governor Engler raised the issue of Canada, and held up a brochure and talked about the Canadian economy which is doing reasonable well these days. But if the United States actually had revenue equivalent to the revenue of Canada at state, local, and federal level, which is below the average in the OECD, we'd balance the federal budget. So if it's good enough for the Canadians, I would say probably maybe it's good enough for the Americans to try to get to a revenue level that we had in 1999, 2000, where we balanced the budget, created a surplus, had very strong economic growth, very strong job growth, people were doing well across the income spectrum, and, most importantly, people in the middle were doing better. And the question, particularly of wage and equality, was just not a topic on the table because wages were going up and medium household income was going up.

MR. GREENSTONE: Thanks. I thought I would pose this next question to the whole panel. So there’s a lot of different ways to judge tax reforms. One theory of the case that we put out in our 12 Facts document is that three important factors are: their impact on growth, their impact on progressivity, and then their impact on revenues. I want to just pose to everyone here, suppose we actually do something about taxes, something changes maybe on January 1st, what is the probability that we’re going to end up with a tax system that’s worse than the one we currently have?

MS. RIVLIN: Well, it’s not zero. We’ve done that before.

MR. GREENSTONE: But we’ve described we have this wonderful set of problems. Everyone kind of agrees on them.

MS. RIVLIN: Well, but --

MR. GREENSTONE: How could we end up with a worse situation?

MS. RIVLIN: Well, I think two ways. One is that we could do a really good tax reform, which would be positive on all the things you mentioned. It would be pro growth because it would lower the rates slightly. Though I agree with John, we can't get them down terribly far. It would be more progressive or at least as progressive, but I would hope for more progressive. And it would be -- what was your other criteria?

MR. GREENSTONE: Revenues.

MS. RIVLIN: Ah, yes, of course. And it would raise substantially more revenues. We could do that. We have that opportunity and the models exist. And they came out of Simpson-Bowles, they came out of Domenici-Rivlin. We know how to do that in principle, and we might even do it. But then, unless we put some kind of safeguards in place that prevents the Congress from doing what they usually do and did quite quickly after the 1986 reform, we risk having things added back in. Oh, of course, we want to have this worthy program and we don't want to spend money for it.

We want to put it in the tax code, and then the tax code erodes again. So I think that's a serious danger and that we should do what I'm sure would please Governor Engler and his friends, put some impediment to continual change. We need a tax code that we have really fixed and then we leave it in place for a while.

MR. GREENSTONE: Okay, so you're view is, we could end up with a much better tax code, but then it will slowly become worse over time?

MS. RIVLIN: If we aren't careful, yes. That's my view.

MR. PODESTA: Well --

MR. ENGLER: Go ahead, John.

MR. PODESTA: No, go ahead.

MR. ENGLER: Well, I would just say that Alice is right, the risk is not zero. In fact, it's probably far from zero because you can make all these changes and make them temporary for two years. I mean, that's the worst thing -- 60 provisions of the tax code expired December 31 of last year; 41 more expire at the end of this year. We actually don’t have a tax code. That’s the real secret. We’ve got this amalgamation of all these expiring provisions at various times. Nobody can plan on anything. So permanency is a fundamental of reform. And then you would, as Alice said, leave it alone.

I mean, where we were, you know, a quarter century ago, after ’86 was pretty good, but there was a lot of work then to start undermining it and changing it and tweaking it. And I think a broader, a flatter, a fairer tax gets us where we want to -- in the direction that we want to go. I agree -- Jim made a point that’s really important. I mean, we thought with the committee of 12 while they were trying to get on about $1.4 trillion worth of budget reductions, there was actually an opportunity to do corporate tax reform, maybe standing alone. But now that we’re caught up in the ’01, ’03 expirations and everything, you know, you’re really talking at a minimum all of business which gets us -- that’s why --

SPEAKER: Right.

MR. ENGLER: -- when you talk about individual rates, they come right into that because of the past heredities. He made the other point, which it’s hard to tease out, but a lot of the income inequality is -- there is so much business income in that higher -- you know, that top-end of the tax code today because of past heredity partnerships and all that. But there’s got to be some kind of sort of equilibrium across the way.

And we’ve got this rather confused, and form is absolutely trumping the substance here. So there’s a lot of things you can do that would be problematic and could be more problematic. The other thing you could do is, there was a piece of what the administration talked about. There was sort of good and the bad in the framework which talked about a lower corporate rate at 28 percent. A good direction, a good conversation.

But some of the treatment on international income, I don’t think we want to be the only nation in the world that sort of is requiring immediate recognition of foreign earnings and subjecting them to our tax rate. That strikes me as a big disincentive and two consequences could happen. And one of them -- neither of them are bad, but neither of them are good. I mean, you could end up with -- you've seen some companies, hard to do, but suddenly the headquarters are not here.

You've seen others -- I mean, we love Budweiser and nobody ever thought they'd be owned by Brazilians, but if you look at just the tax consequences of that transaction, it made perfect sense. When Alcatel-Lucent worked great, but when they put that together everyone thought, well, that's going to be U.S. headquartered. No, the tax laws and losses and everything worked much better to be a French company. And I like headquartered companies in the U.S. I don't want to have a policy that says over the decade it makes more sense to be headquartered somewhere else in the world.

MR. PODESTA: You know, Michael, I think the biggest risk is you lock in a very low level of revenue, that all of the discussion about broadening the base and lowering the rates ends up lowering the rates without broadening the base. And then I think we're really in the soup because you build a huge structural deficit and that, after 2013, will be even more difficult to get rid of I think. And the -- you know, the other possibility, I think, is that you begin with the sort of theory that we'll just figure it out as we go along.

MR. ENGLER: Yeah.

MR. PODESTA: We'll set the rate at the front end, and then figure out how to get there. And that, I think, could have very negative consequences on the middle class because if you begin by dropping the top rates as the first part of the equation, and then build that out by essentially building income back in, targeted at working people in the middle class, I think you could end up with a situation that's even worse than what we have today.

MS. RIVLIN: And that's a very real danger coming out of this campaign, because the candidates are all saying -- at least the Republican candidates are all saying -- we're going to lower the rates. And they aren't telling you how they're going to --

MR. PODESTA: Well, that's the --

MS. RIVLIN: -- make up the revenue.

MR. PODESTA: -- 25 percent.

MS. RIVLIN: Yeah.

MR. PODESTA: To 25 percent top rate without any way to pay for all the revenue.

MS. RIVLIN: There will be an extrication --

MR. POTERBA: I'm actually a little more pessimistic than the other panelists. I mean, I think if your scenario of "tax reform" by December 31st were to appear, there's actually a very good chance we would get something which would make things worse off. Because I think true tax reform is really -- it requires a process. It requires going through some consensus building around the key issues that are going to be embraced and the key principles that are going to guide your new tax system.

If you think back to the way we got the '86 reform, right, there was Treasury One which came out in ’84. That didn’t get the full consensus. There was Treasury Two, which then did somewhat better. We nearly didn’t get that to work. And then finally, there was the Senate Finance Committee and we had bipartisan support ultimately in ’86 which led to that agreement. But there were tradeoffs, there were compromises. The Treasury One and Treasury Two, for example, both preserved some favorable treatment of capital gains on the grounds that there was the inflation issue and the entrepreneurship issue. We ended up with a single top rate, 28, that applied to capital gains as well as ordinary income. But that took a lot of horse trading to basically get there.

So I think that almost anything that came out quickly with -- I mean, there are things that could happen quickly that might be improvements, and some of the kind of limitations on tax expenditures that Marty mentioned earlier were, one might put a cap and that would sort of have the effect of broadening the base in a very simple way and generate additional revenue along the way. You know, that would be an example of something which would probably move us in a good direction.

But I think there are many things that could be simple tweaks at the end of this calendar year that could move us in the wrong direction. And also that would give up the very important option value of having a serious debate about where we want to go that could then lead to a more fundamental reform.

MR. ENGLER: Another piece just related to that very briefly is transition rules. If you're going to go to a lower corporate rate, let's say a business rate, and you're going to use tax expenditures and deductions and credits, there is a phase-out and transition required. You screw that up, you can do a lot of short-term damage.

MR. GREENSTONE: Yeah. So let me just add as a small promotional plug for The Hamilton Project's "Dozen Facts," part of the reason we wrote it was so that we could evangelize everyone in this room and so that when you hear in the future 28 percent tax rate or whatever the thing is, you can turn right to the 12 Facts and see, well, what is that going to mean for progressivity and what is that going to mean for revenues? There's a topic that I think is highly related to all of this and I think, as with many issues, there's not really a consensus in Washington about it. But there are very different viewpoints about it and it's another thing that we tried to cover in the 12 Facts.

And I wondered, Jim, if I could start you off with it, which is in economics research there's kind of a growing body of research which I'm not sure everyone agrees with, but that -- really at the high end of the income distribution, you would not reduce work effort by much if you had top marginal tax rates as high as 50 to 70 percent. And I know not everyone agrees with that, but I wondered if you wanted to take --

SPEAKER: Francois Hollande agrees with it. (Laughter)

MR. GREENSTONE: But just more generally, I think the question is to what degree do tax rates effect both work effort and/or GDP? Because it's a central part of the narrative that we need to reduce marginal tax rates.

MR. POTERBA: You know, let me take a stab, Michael. It's a very hard question. I think the first thing to just recognize is that there's only so much that economic research can deliver in answering a question like that; that the essence of studying the history of tax rates is that we have relatively few changes and that we, unlike natural scientists, can't hold constant all the other things that are going on in the world when we tweak tax rates.

Moreover, that, you know, it's like the experimenter in the lab who actually fiddles with what's in the different Petri dishes. The tax rates themselves are often a response to perceived circumstances in the economy. So, you know, the classic example is you wouldn't want to just look at whether when the investment tax credit was available. There was more investment or less investment because many times the investment tax credit is turned on precisely because we're worried that investment is low. So you discover that the correlation doesn't quite do what you might otherwise think. That's the first problem. So we really don't have that much evidence to look at. And doing comparisons of decadal growth rates and top tax rates and things like that, I think, is a remarkably low power way of trying to study these questions.

Second, you know, at the very top end of the distribution, measuring something like hours of work is probably not what we're after. Right? If you thought about the top executives or entrepreneurs or others who are in those parts of the distribution, aside from, you know, lawyers where we have very careful billing records on how many hours they work, it's really hard to pin down something like, what is labor supply for those groups?

What's much harder to think about is what leads, you know, an engineer at a company like HP to decide that they're going to leave the security of the big firm and do something with three other friends from college in a garage and see if that pays off. So, you know, we can describe what the ingredients of that entrepreneurial process are, we can talk about how tax rates on different parts of that may create incentives to do one thing versus another.

But if you then say, you know, can you point to the very simple data series you can look up in some book and relate to the tax rates, we don't have anything that's as easy as that to do. So, you know, I think that there are two things that I would take away from it. One, I am absolutely sure that incentives do matter and that they do matter even at the top end of the distribution; that the folks who are trying to decide whether to lead an easier, calmer life or to take more risk or to be more competitive, are sensitive to what their after-tax returns are. But I'm not exactly sure what that elasticity is.

Second, we do have evidence that the taxable income responds to what marginal tax rates are; that when you lower rates we -- and capital gains as the earlier panel eluded to, is the best example of this, where when you lower the rate you seem to, in some cases, generate more realizations. Not necessarily more revenue all the time, but more realizations. But, you know, that -- even if for other parts of taxable income that seems to be true.

Deductions seem to be very sensitive to rates. Even income generated seems to be somewhat sensitive. But what’s really hard is -- to get to the bottom of your question which is, how does that map into the underlying economic activity which ultimately feeds back to the growth that we care about?

So I think it’s very dangerous to dismiss the notion of behavior response to taxes completely. At the same time, I think that the, you know, the existing body of evidence doesn’t leave us in a place where we can point systematically to it’s enormous or we can dismiss it.

MR. PODESTA: Yeah, well, look, it won’t be shocking to hear me say this, but I think we had a 16-year experiment with this, with higher marginal rates, higher capital gains rates from 1992 to 2000 and then from 2000 to 2007, before the recession. What did we get? Ten times the job growth, twice the GDP growth, twice the business investment growth, medium wages and medium income and average wages going up versus down. You know, I do think the burden now is on the people who keep arguing for cutting particularly capital rates and for cutting taxes overall to show why that won’t result in what it resulted in in the first decade of this century.

MS. RIVLIN: I agree with all of that and with what Jim said. But I think it should make us wary of political claims that, for example, if you were to raise the top rate back to where it was in the ’90s, that this would kill a lot of jobs. And the public ought to say, how do you know that? What’s the evidence that that’s true? Because these assertions are being made all the time and people who make them sound as though they really do that, but they don’t.

MR. ENGLER: Well, let me approach this a little bit differently because I’m not sure that’s the question I worry very much about. I look at today's economy, there's 3 million jobs that aren't filled because people don't have the skills to fill them. That worries me.

If a child is born in the District of Columbia where we are today, I think under current spending -- let's say it's 25-something, but say it's closer to $30,000 per year of spending -- we're prepared as taxpayers then to set $325,000 aside to help that child be a productive person by the time they're a high school graduate. What's happening with the $325,000? We're getting a dropout rate that's unacceptably high. We're getting a success rate of those who do graduate that's unacceptably low.

So we've got a lot of other factors I think, that come in. And whether or not somebody works one year longer or not, or works a little bit harder or wants to do overtime, you know, those are -- I'd like to have those problems versus the ones I'm talking about. And I think that the fact that we've got our labor participation rate so low today because there aren’t jobs and we’ve got a +8 percent unemployment rate, we really need to say, what’s it take to get growth going? That’s where the focus ought to be. I think there are a lot of these fiscal and tax questions that are important.

But I also think the whole question of uncertainty in a lot of other areas and so there’s a bigger, broader, political set of questions about, let’s send citizens through entitlement reform a clear message of what the rules are going to be on when you’re going to be able to retire and draw Social Security, which you’re going to be obligated to do in terms of your health care after we do Medicare reform, or what are we going to do for people who can’t pay for care and they’re going to rely on Medicaid.

And how do we -- because all of those are economic signals that are going to impact people’s decisions about how much I work, how hard I work, how prepared I’m going to be or understand I need to be, when you’ve got military leadership saying that more of the majority of young people aren’t eligible to be inducted into the military service. We have a national challenge and all of that comes -- factors back in.

I don't want to make this so overwhelming, but the tax rules are merely the rules of how we play the game, but we've got a bunch of other rules that impact how we play the game. They're also just as unclear and just as uncertain, and so I don't get too worried about the question you posed about where those incentives lie, because I think if we get to the point where that's all we have to worry about, then we'd have a bigger debate about it.

MR. GREENSTONE: So let me pick up on a thread of what you mentioned there. So there's no questions the recession -- the great recession moved into everyone's living room several years ago. And I think collectively, it is still in the nation's living room one way or another. We also, as I unfairly burdened John Podesta with, are having all these tax events happening at the end of the year, what should -- how should we be trying to balance the continued weakness in the economy with this kind of looming tax threat and the fact that it, in several scenarios, it could be quite contractionary?

MR. PODESTA: Well, my view is that -- you know, again this was discussed in the previous panel, that you have to think about this in terms of how you phase in whatever changes you're trying to make. In the -- and I think that there's fear that you have that snap-back, plus I think you mentioned, Michael, but you have the looming threat of the sequester that was built into the statutory provisions that were passed last summer when the debt limit was last raised.

So that's another $1.2 trillion out of federal spending that would come over the decade, significant amounts out of defense, which whether the political system would tolerate that or not, you know, I'm uncertain about. But they're definitely -- there's contraction built into current law --

SPEAKER: Yeah.

MR. PODESTA: -- and I think that that,

again, is an argument why the spring of 2013 is actually an important moment, an optimistic moment that you can find -- I think because neither party really wants that outcome -- that you could find maybe some common ground, and that would, I think, necessarily have to include a transition and a phase-in to what are our higher revenue levels.

MR. POTERBA: I think, Michael, you know, we're in the somewhat fortunate position for the U.S. that the troubles in the rest of the global economy give us a little bit of breathing room in addressing some of these longer term fiscal challenges, right. The capital markets do take a long view and we could, in fact, make substantial progress at restoring a sustainable fiscal trajectory without doing things that have to immediately burden the level of fiscal support for the economy.

So I think that, you know, if in 2013 we could put on the table a plan which did bring us a genuine approach towards stabilization but that phased things in -- you know, Governor Engler's point about transition rules can be very important. So figuring out what you're going to do and then explaining how you're going to, especially on some of the capital tax side phase from where you are today to where you're headed, that's a project that can take a couple of years to do well. But there's enormous value to giving the market participants a heads up on where you're going.

And because the U.S. is still able to borrow at relatively low interest rates because of concerns elsewhere in the world, we have that opportunity, a window when we can try to take some of those things on. That window may at some point close and, you know, we may not always have the discretion of taking our time to think about these for a while before we have to respond. And we've seen some of our European counterparts have to do things very quickly when the capital markets don't give them that breathing room.

MS. RIVLIN: I think we need to do two things at once. I'd go a little bit beyond the slow phase-in. Clearly, we don't want a big increase in taxes right now. Any increase in tax rates right now in a weak economy. And we don't want a cut in expenditures, especially a mindless one as the sequester would be.

Indeed, I would argue that we need to invest more in the short run, fix some of the problems that Governor Engler was worrying about which are not only our skills gap, but our infrastructure isn't very modern. But we need to do that at the same time that we phase in, in a predictable way, the stabilization of our debt on both sides: on the spending side and on the tax side. And here's our opportunity to do that right.

MR. ENGLER: Alice is making a really important point, and, Jim -- really all three of the previous speakers just did in response to this question. But if you set a certain policy direction and you are phasing it in over time, you've still set the direction. And that's really important. That's a big signal as long as it's a certain signal.

And what we've done is we've created such uncertainty and -- I mean, a two-month extension on payroll taxes? Are we serious? You know, we've got a payroll tax to support Medicare funding that's coming online, I think that's in January, as well --

SPEAKER: 2013.

MR. ENGLER: -- depending on what happens with the Supreme Court decision and the law itself, but we need to, as a country, have our political leadership be willing to lay down a position and say, this is the direction we're going to go in.

And one of the things that I observe around the country is you have today governors in both political parties, in some cases -- say Governor Nixon in Missouri's got a Democrat legislature, Governor Christie in New Jersey's got a -- or excuse me, they've got it flipped, he's got a Republican group in Missouri with a Democratic governor; Republican Christie has Democrats in New Jersey -- and other mixes and permutations that exist all over the country. Well, they're working through things because under a lot of the state constitutions, they have no choice. They've got to balance a budget, they actually have to present a budget. Here we have a sort of perpetual non-budget, and we need to be able to start making some longer term decisions. And doing that, in reforming some of our problems, if we do a little bit now but say this is what we're going to do over long period of time, it's amazing how these numbers respond.

The Social Security Agreement, which was bipartisan when it was done way back when, has actually been quite durable. It's lasted a long time and we could probably -- Social Security really, in terms of ease, is almost one of the easiest ones to deal with. But because it's easy, we don't fix it, just like we don't fix the immigration system. I mean, all of this comes together and I think what the country is riled up about is can't anybody here play this game anymore? Can't you do something?

And what we're saying today is that you've got a range. And in some areas, as I think we saw with the previous panel, Dr. Feldstein, they're not all that far apart. You know, there's differences, but pick a direction and go that way. If we've got it wrong, we can change it. But what we can't cope with is no direction, no decisions, uncertainty.

MR. POTERBA: I mean, if I can just say one thing about the '83 Social Security reform, which may be illustrative for where tax reform might go, all right. One of the ways in which that reform was achieved was that the Democrats coming into that wanted to make sure that at least 50 percent of the closing came in the form of tax increases and the Republicans wanted to make sure at least 50 percent was in form of benefit cuts.

And one of the features of the '83 reform was to include Social Security payments in the federal income tax to a greater degree than had heretofore been the case. And the Democrats were allowed to count that as a tax increase and the Republicans were allowed to count that as a benefit cut. And, therefore, when you put the two sides together, both were able to declare victory and go home, and we managed to get the reform.

So I think when you heard the earlier panel talk about particularly how we might think about tax expenditures in the context of tax reform, that certainly sounds to me like it has the same secret sauce associated with it that we’ve used once before in this restaurant. And maybe there’s something to be done there.

MS. RIVLIN: But it requires Democrats and Republicans actually negotiating with each other, and that’s what’s not happening right now.

MR. POTERBA: That’s right. All right --

MR. ENGLER: People are actually elected, you know, that -- I mean, we can reach agreement in a lot of unelected panels. Alice and Pete Domenici did that once.

MS. RIVLIN: Oh, yes, very easy, but we weren’t running for public office.

MR. ENGLER: Yeah, and you weren’t czars, you couldn’t just put in effect.

MR. GREENSTONE: Okay, so there’s a lot of demand for questions from the floor. But I'm just going to impose a 90-second rule for the whole panel here --

SPEAKER: Okay.

MR. GREENSTONE: -- for one more question. There's a lot of people who say if we're in a moment where we need more revenue, we could raise income taxes one way or another or, alternatively, we could broaden the scope of things that could be taxed. Larry Summers and Marty Feldstein talked about consumption taxes. What I want to raise is a slightly different tax, which would be an environmental tax, in principal a carbon tax that has the benefit of reducing something that we don't like very much in the process. Why is that not part of the discussion?

MS. RIVLIN: It should be. I'm for a carbon tax. I think it's a twofer: it gives you revenue and it raises the price of fossil fuels over time, which we need to do. But it is such a polarizing issue, worse than the things we're talking about on this panel, that I don't think we should put that up front.

I think there’s a bigger chance of getting the kind of income tax reform that we’ve been talking about and we better go for it.

MR. ENGLER: I think it runs a competitive risk. I think the carbon trading system in Europe has largely failed, and I think a new tax on productions or a carbon tax at a time when we seem to be developing because of the proliferation of shale gas now, announcements by Dow Chemical, big construction down in the Gulf, chemical plants coming back, chemical exports now rising. There used to be a great balance of trade contributor positively.

We ought to be taking advantage of -- the energy advantage as a nation to really help move the manufacturing back onshore. There’s some of that. We’re highly productive as a result of this tough recession and why would we put a carbon tax up there as a way of reducing competitiveness? You can tax anything. You do have to -- I don’t think business takes the view they aren’t going to pay taxes or -- actually, we don’t pay it, we collect them. And the individuals aren't going to pay taxes, but -- because we have to run the government. That's a pretty ironclad rule.

MR. GREENSTONE: Okay, you've got about 20 seconds left.

I think John Podesta can speak and maybe --

MR. PODESTA: Well, look, I'm not optimistic. Even though I would support it, I'm not optimistic we'll get one. But I think given what Governor Engler just said, there are other ways of dealing with energy taxes that could have a positive effect, for example, getting rid of the fossil fuel tax preference provisions in the tax code.

And the other way to think about this, I think, is shifting from foreign resources to domestic resources by taxing oil, which would have the effect, I think, of moving more gas into the transportation sector. And, you know, that would have -- definitely have an impact on our balance of payments. About half of our trade deficit still comes from importing oil. So I think there are different mechanisms by which you could impose energy taxes that would have a positive effect on U.S. domestic growth.

MR. POTERBA: Two quick things, Michael. One, that discussion really needs to be part of a broader energy policy design debate that goes beyond just the tax system. And I think that one needs to tee that up. But there's a bandwidth issue, and that's the second point, in terms of how much we can take on at one time. I think we have to take on the basic structure of the corporate and individual income taxes as part of the fiscal reform challenge, and that we might as well just devote our attention to that in the very near term while we've got this, you know, this moment of Taxmageddon coming up at the end of this year and it provides the focus for doing that. And then come back at some later date, maybe not too far down the road, to think about the broader energy policy issues.

MR. GREENSTONE: As someone who knows and thought a lot about energy policy, obviously you have an optimistic view of irrational policies.

I'm going to go to the floor for a couple questions. I think there's someone coming over with a microphone.

SPEAKER: As some of you pointed out, having both sides come to the middle is crucial. We can't get results without that. But what we see is asymmetry here. A very high proportion of the Republican side of the aisle has signed an agreement with Grover Norquist not to raise any taxes. When you take two-thirds or even three-quarters I think the latest count is of one side out of the bargaining range, how do you get to the center point?

MR. ENGLER: Well, you know, I have some -- years ago, I have some credentials in that party. Being agnostic now at the Roundtable and very objective let me just say this, there's also some asymmetry in the work that's being done by the two houses. And it seems to me, if you're going to have in the traditional legislative debate format, you'd do what they're doing on transportation.

The Senate would pass its version, the House would pass its version, and they have this whole mechanism called the Conference Committee where you actually sit down and work out the differences. But if only one house is passing the legislation and the other house is not, hard to go to conference. And the answer I get from some is, well, it's really hard. (Laughter)

MS. RIVLIN: I think Marty Feldstein said it well. When Republicans, and he is one, recognize that we're spending through the tax code, then we have hope of coming together here.

MR. PODESTA: I would say that no one has a lower expectation of what the congressional Republicans will do in this room than me. But I come back to the fact that on January 1, 2013, we're going to have a seismic event in the tax code that's going to restore the Clinton era tax code. That is a circumstance, if Obama is re-elected, in which I think he's got negotiating leverage to come -- to force the Republicans to the table and to the center.

MR. GREENSTONE: Yes?

SPEAKER: Should we institute the 1986 tax code that was passed under President Reagan? And what would be the implications and would the Republicans support it?

SPEAKER: That's a good question.

MR. POTERBA: You know, I think if you -- you know, if you gave me the choice of that code versus where we are today, I might well go for that code because we actually had a number of things there that were holistic in the way they thought about the tax structure. But I think as Governor Engler has said, you know, you have to -- the tax system has to be responsive to the economic environment that we're in. And particularly on some aspects, the international mobility of capital, the global corporate environment, we're no longer in the '86 environment and I think we have to think very hard about that.

The other thing, of course, is the near-term macro environment, and I don't know that you'd want to go just to there without thinking about some sort of a phase-in. But I don’t think that’s a very likely outcome in terms of where we go.

MR. GREENSTONE: I think we have time for one last question.

SPEAKER: Hi, for Mr. Engler. Do you agree with Marty Feldstein that more revenue needs to be part of a tax code reform?

MR. ENGLER: That what?

SPEAKER: More revenue needs to be part of the tax code.

MR. ENGLER: Oh, absolutely. And I’d start with getting -- doubling GDP and really getting that growth rolling, which a lot of those decisions, by the way, are not tax code decisions. They may be regulatory policy, other kinds of decisions. But no, I don’t have a problem with revenue. And you know, you’re talking to somebody who’s a governor who raised the gas tax, never signed one of these tax pledges that was talked about, but yet never felt I had to apologize for a record which included -- I mean, we raised sales taxes, we cut income taxes.

I think your tax structure and how the incentives line up matter most. I mean, I -- and we had -- so both as a record as a governor and sort of -- and I think the Roundtable, speaking for our own organization today, you know, we looked at the corporate tax rate. I mean, our whole discussion with the Congress was on what we call the revenue neutral, which we felt was actually -- if you scored it the way I would score it, was significant revenue growth because it was a much better tax code.

MR. GREENSTONE: Okay. I wonder if you could all join me in thanking the panelists for such a stimulating roundtable. (Applause)

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