

THE URBAN INSTITUTE
TAX POLICY CENTER

SECOND ANNUAL STATE OF THE TAX SYSTEM FORUM

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[Joined in progress.]

DR. ROBERT REISCHAUER, President of the Urban Institute: — (Cordes) has done time as a visiting fellow here at the Urban Institute, and still is an important contributor to the work we do here in many areas, including the nonprofit sector analysis that we do.

Ron Pearlman is a professor of law at Georgetown University Law Center where he teaches courses on federal income tax. He was, of course, the assistant secretary at Treasury for tax policy and chief of staff of the Joint Committee on Taxation in the Congress where we worked together. He is the president of the American Tax Policy Institute's Board of Trustees and has been a visiting professor at Harvard Law School.

Gene Steuerle, is a senior fellow here at the Urban Institute, and one of the codirectors of the Urban-Brookings Tax Policy Center, a frequent contributor to various journals and other publications, most notably Tax Notes, where he writes a regular column, and he is the author or editor of 11 books and more than 150 reports.

The panel is going to be moderated by Peter Gosselin, who is the national economics correspondent in the Washington Bureau for the *Los Angeles Times* and served as the national economics and chief domestic policy writer for the *Boston Globe* for a number of years. Peter is the winner of a number of awards for journalism and is an economics graduate of Columbia Business School.

With that, let me turn this over to you, Peter, and let's get underway.

MR. GOSSELIN: Okay. I'm going to make just a few remarks and then turn it over to the panel, and when we get to the other end and questions, I've been asked by the organizers of this to be sure you wait until you're recognized and have a mike and state your name and organization.

A gathering such as this can quickly degenerate into an occasion for commiseration, perhaps especially during a presidential year. Those of us who cover, ponder, or participate in the development of tax policy in this country often come to feel that we're a saving remnant. We're the only people left who understand how truly lunatic it is to—and here take your pick—cut taxes and raise spending; cut taxes and conduct a war; cut taxes in one breath and threaten to take as much back in the next with an alternative minimum tax, carom from the double taxation of capital income to, in some cases, no taxation whatsoever; try to fix anything from healthcare to commuter costs, both do everything from family values to entrepreneurship by tinkering with taxes. But if you force yourself to stand far enough back, you can begin to see some surprising continuities in America's tax systems, continuities that suggest things may not be as bad as we first think, that suggest that tax policymaking, more often than not, is more or less like the nation's founders intended it, with the extremes canceling themselves out and a durable consensus remaining for what's left.

Let me take one example. For all the talk of political revolution, President Reagan's 1981 tax cuts barely managed to offset the inflation-driven bracket creep of that era. They never managed to cut individual income tax receipts as a percent of GNP below what they were at the start of his predecessor's term, and roughly what they are today. The lesson is that legislative sausage-making may be ugly to behold, but the results, at least in the case of taxes, are not always as unpalatable as they first seem.

As we proceed today, I hope our speakers can help us distinguish between what are truly new threats to the way this country raises money for public purposes and what are simply variations on old and either harmless or at least survivable themes. I hope the speakers can also help us to see the current crop of tax disputes in a broader context, one that is suggested by Gene Steuerle's nice elliptical remark, which he variously delivers as—and here again take your pick—“government does not exist to cut taxes, to reduce deficits, or to spend surpluses.”

And with that I will turn to Gene.

MR. STEUERLE: Thanks, Peter. You already took my best line.

(AUDIENCE LAUGHS)

In recent years, as I'm sure all of you are aware, the political debate has really been dominated by taxes, and it now turns out that 2004 doesn't look to be an exception at all. And yet the debate is often ill-informed, lacking historical context, discussed as if taxes are really separable from the expenditures they finance, and based on a lot of myths, myths that both left and right, Republican and Democratic stalwarts fall prey in their various attempts to castigate each other.

So, first, let's remove some myths and set forward some facts. Tax policy is no longer used mainly or even primarily to raise revenues. Tax breaks, rather than direct expenditures, account for a quarter to a third of the benefits and subsidies granted to the public. They're the primary instrument that our policymakers argue they are going to use to try to promote growth or deal with recession. They're used to implement macroeconomic policy and change the distribution of income and affect the behavior of farmers, research firms, energy suppliers, the poor, and hundreds of other groups—all of whom Nina gets to support her in service to the taxpayers. There are tax breaks for home ownership that are bigger than the entire budget of the Department of Housing and Urban Development. The Earned Income Credit is larger than any welfare program such as Food Stamps or TANF, which is Temporary Assistance to Needy Families. The tax break for employer-provided health insurance is the largest subsidy we provide in either the tax or the expenditure budget for the healthcare of the nonelderly.

Both parties in this world are actually united on a lot of fronts. They're united in trying to hide taxes and tax rates, in spending for the tax system, and using taxes to fight every economic and social woe. Social conservatives are no less vigorous than are social

liberals at pursuing these objectives. Third way Democrats and compassionate conservatives, they all feel your pain on everything, and no tax provision is too small to provide some salve. Recent presidents have turned to the tax code when they couldn't get what they want any other way, whether it be financing school construction in state and local areas, or trying to pay more to the troops.

Now, compared to most of the nation's history, it's only in the contemporary period that deficit reduction or surplus spending, not tackling some larger problem at hand, has largely defined policy. During this modern period, Congress has paid limited attention to the underlying purposes of most tax and expenditure programs. So when I use the line, which Peter gave you, that we don't really have a government to reduce deficits, we don't really have a government to reduce taxes, we don't really have a government to spend surpluses, what I'm getting at is that we're not often debating the primary purpose of government programs in the first place. That's what we should be debating, and then we get our tax and other systems in order to try to meet those objectives.

Now, on the budget side, the game in Washington and most state capitals, as well, is to spend or use up money before the other person does. On the expenditure side, entitlement programs like those for retirement and healthcare are precommitted to absorb ever-larger shares of revenue in an automatic fashion, even in the absence of any legislation. Not to be outdone, those who favor lower taxes legislate tax cuts into the future. A major supply-side advocate called this the two Santa Claus policy. The Democrats could be Santa Claus on one side, then the Republicans could be Santa Claus on the other. However, I think even he didn't think about what would happen when both Santa Clauses showed up at the same time.

Given this background, I've come to the conclusion that the tax reform agenda for the near future is not the adoption of some idealized tax system, whether it be an income tax, or a consumption tax, or the removal of tax from capital income, or a more progressive wage subsidy, or any of a host of other reforms. That's not to say that I, and we, do not have to make choices, that I do not have an opinion, and that we do not have to make choices on these matters. But, in the end, I think the real reform we need today is in our processes themselves.

Now, process reform is necessary to deal with the two major fiscal problems that I identify by the end of my book; that is, the two problems that I think are most pressing in the current period: the lack of any principled approach to tax policy development, and the long-range budgetary quagmire. In the first case, we can't control the lobbyists, or the special interests nearly so well, in my opinion, as we can strengthen the parts of the system that are meant to provide us with the nonpartisan analysis we need. This means we have to require a much-strengthened IRS, offices like Nina's. We have to strengthen Treasury, OMB, CBO, the Joint Committee, and the GAO. Right now, the information they develop is often hidden or, when made public, is simply not allowed to rise to the top of the debate.

And as for the budget, the Congressional Budget Committee should be empowered to enforce rules that only through future legislation can any program increase in cost beyond some initial period, say, like four years. The grand budget compromise that I think inevitably must come, and it must take place in the near future, is between those who would allow retirement and health programs to grow without bound and those who would continually prescribe tax cuts into the future. I think neither is viable as a matter of budget policy.

But let me return to the lessons from history. Tax policy is not monolithic. Rather, it's a labyrinth of programs exerting influence in almost every sphere of life and it remains inseparable from the broader budget process. Without question too much is attempted. Still, our history of failures is also a history of hope. When the U.S. tax system does get out of whack, the political system has responded. The tax reforms of 1982 to 1986 provide a prime example. True, many of these problems could have been anticipated and avoided in the first place, and some of the fixes were not well-designed—witness the alternative minimum tax today—and we always seem to wait for a crisis or a near crisis to happen. Perhaps the story of the U.S. tax policy process is simply part of democracy's broader story. Bureaucracy, waste, cronyism, and borderline corruption when no wolf is at the door, but, in fact, we have a system that seems to be pretty good at handling emergencies and responding to powerful forces.

Not all of you will agree with this bittersweet conclusion, but one point is clear: tax legislation's day has arrived.

Thank you.

MR. GOSSELIN: Okay. Nina?

MS. OLSON: Well, I'm not sure why I'm on this panel, because the National Taxpayer Advocate and her office doesn't do tax policy. So that's my first disclaimer. Whatever I say here is my opinion, and my opinion alone. We do deal with the results of tax policy, and in looking at some of the cases and the issues that my office deals with, I'm struck continually by what's not normally an element in developing any kind of legislative proposal, which is really taking a commonsense approach to what taxpayers themselves can stand in the way of complying with whatever laws or policies you set forth. And also, a commonsense approach to what the bulk, if I can speak about the bulk of taxpayers, may be able to say to themselves. "Well, I may not like it, but this makes sense; I see why you're doing it." And as the tax law, as we have it today, has evolved, I think we've gotten very far away from those commonsense type of issues.

I have tried to say to the IRS for several years now that we need to realize that we take our taxpayers as we find them. They will not be perfect, and they will not fit into equations. I have tried to say to Congress in my annual reports to it that exact message, too, that when you legislate, you need to be very careful about what you are asking taxpayers to do, because your policies will fail if you do not acknowledge that.

I have been a strong advocate for literally a kind of anthropological analysis of the taxpaying public, what types of personalities or behaviors do they fall into, and what kind of reactions will this legislative proposal trigger in those different groups. And once you've identified that, you can decide whether you care about it, and you should change, maybe make some modifications to that proposal, or whether you don't care about it; the policy demands are stronger than those issues.

The AMT is a perfect example, obviously, of the lack of common sense, and I think what you see in the rather astounding press response, and public response to our annual report identifying it as the most serious problem of taxpayers is really a sign that, in fact, there is a constituency in the public for simplification—you just need to know how to pitch it. And pitching it seriously means talking to the taxpayers about the things that matter to them, which is that the tax code is confounding to them, and then that resonates.

I think, again, that in some instances, one of my experiences about the lack of common sense in the code goes to something that happened in our broadest tax reform in '86 about the employee business expenses, and removing it from above the line to a miscellaneous itemized deduction. I was preparing income taxes in that year, and maybe unlike many people in this room, I have in my life prepared literally thousands of tax returns as recent as 2001, you know, hundreds each year. And my clients in the years after that provision was changed, for employee business expenses and medical expenses, they would continue to come to me with these little things, you know, dental assistance, saying, I took this course, I paid for these shoes, well, they never made it as a deduction, but they persisted in bringing it, even up to the last year that I was doing returns for pay, which was 2001.

And what that told me was, taxpayers themselves have this sense of being taxed on their ability to pay. And they are earning income, and they are spending money in order to earn their income on really legitimate things, and for that not to be recognized in the calculation of their income above the line distances themselves from the tax system, and makes the tax system feel that it's not organic and like them, based on their experience, but something that is imposed on them from on high. So all the policy arguments about how we should remove it below the line and relieve them of their bookkeeping—in fact, they insisted on keeping those books because it reflected their reality. And to the extent that the tax system is distanced from them, we lose taxpayers.

The last thing I guess I want to say, or maybe the next-to-last thing, was something that Gene and Peter both talk about, the truly new threats to the tax system. And I think that that distancing is, to me, one of the greatest threats, that taxpayers no longer feel like they have a role in the system, and so they are not participants. It is done to them. And when you get into that kind of dialogue with the tax policymakers and the tax administrators, it does not spell a good future for the tax system.

Which brings me to my very last point, which is the pureed spinach theory of tax policy. When my son was very young, he went through a whole series of eating different

things. And I was very concerned, because he went through a period of eating lots of liver, pureed liver—I don't know, pureed spinach. And I went to the pediatrician. I said, you know, what do I do about my son? He's a year-and-a-half, and he's eating all this weird stuff in spurts. And he said, children eat what they need at any given time, and if you look at them over the period of time, they will get what they need.

Now, how does that relate to taxes? Well, I thought that if you took the world of United States taxpayers and you asked them what they were comfortable with paying and what they wanted recognized in their code about their lives, you would actually come up with a very interesting tax system. In other words, you may have one person saying, don't tax this, absolutely not, and another person saying, don't tax this, absolutely not. If you put it together, the pureed spinach theory, you would maybe get an organic system that was something that not only made sense in terms of policy, because it related to benefits, taxation, ability to pay, et cetera, but also related to what taxpayers were able to sustain.

MR. GOSSELIN: Joe.

MR. CORDES: Well, let me begin by first congratulating Gene on the book and maybe give a little insight, I think, as to what the genesis of the book might have been. I remember Gene and I were talking about this when he was in the very early stages, and I seem to remember he thought of this a little bit as a sequel to *The Tax Decade*, which is another very fine piece of work that he did earlier, that essentially looked at the evolution, if you will, of tax reform well into the 1980s.

This turned out, I think, to be a somewhat different book, however, and in a number of interesting ways, it really does take a very broad view of the different themes that have informed or deformed, in some cases, the evolution of tax policy over a long period of time, and really provides a very fine sort of political economy account of things, and it's well worth reading for that reason.

I guess I want to focus on a couple of broad points that maybe concept a basis for some further discussion. The first is to simply offer an observation at least about my own perception of how the policy environment is different today than it was through much of the '80s and even into the early '90s, when I was quite active as much outside the university as in the tax policy realm. And, I guess, you know, people have sometimes talked about the Washington consensus as affecting international policy. Okay, I've worn my international hat, Bob. You could almost talk about a sort of pre-mid-1990s, late 1990s sort of tax policy consensus that might go as follows: There was broad agreement among a number of the people involved in the formulation and evaluation of tax policy both inside and outside of the government, at least certainly through much of the '90s, that the income tax ought to be seen as the principal source of federal revenue. There was, I think, some general agreement that sort of policy analysis of this particular federal tax policy generally ought to be conducted, guided by the classic principles put forth by Haig, Simons, and Schanz, which, again, sort of tacitly accept as a normative principle that income is what ought to be taxed, and given that you've made that decision, you then strive for a base that is as broad as possible, and rates that are as low as possible.

There was an emphasis on the role of taxes as a source of revenue, not as an instrument of social policy, although, even at that point, everybody realized the reality was that people would want to do that. But what I'm trying to say there is that there was, I think, less of an acceptance of what I would argue is sort of the inevitability of the use of the tax code for social purposes, which seems now to be a bit more on the front burner. And, finally, this was a bipartisan view, by and large.

Bob mentioned that I was at the Treasury as a Brookings fellow between 1980 and 1981—well, the first half was Carter, the second half was early Reagan—there was a blip when the supply-side group came into the Treasury, but they didn't last very long. I think Ron may have—I don't know if you were there at that point or not, but with that very brief interlude, to an outsider, what really struck me was the fact that this was an environment in which regardless of which political party was in power, people had sort of a general sense of what the tax code ought to do, how it ought to be evaluated that really transcended party lines.

Now, how does that contrast a bit with the current environment, and much of that, I think, is discussed very nicely in the book. Well, the first is a point that I've already mentioned, that Gene has mentioned, that I suspect we will be talking about this morning, which is the extensive and growing use of the tax code for social purposes, and I would argue almost the embrace of that as an operative principle of tax policy. And I guess from where I sit, I would have to sort of date the revival of that as a notion really into the Clinton administration, which really did make very broad use of the tax code to provide credits for higher education, for childcare, and so forth, and this was a bit different from the earlier environment.

There already in the academic community had been a breakdown of the consensus that the income tax is the normatively best tax base. I guess the rule of thumb back then—we'd have to update this now by about 10 years—is that any public finance economist under the age of 40 favored consumption taxes, and the older of us favored income taxes. So in the academic community, there clearly was, as I say, an erosion, shall we say, of that consensus. That has begun to spread into the tax policy debate, and so now in addition to sort of dealing with the implications of really wanting to make affirmative use of the tax code for social purposes, you have this issue that we're not even sure which kind of tax base we ought to have.

That's further complicated by the fact that now within the consumption tax advocate group there's another group which really doesn't advocate consumption tax, because they basically just want to reduce taxes on capital income, but they're not prepared to do the other things that go with consumption tax, which is limiting deductibility of interest income, who essentially, as near as I can tell, just want low taxes on capital income without seeding it in the broader framework of a consumption tax.

And then, finally, there is, I think some erosion of this, what I would have called this bipartisan compact of how you think about tax policy, and even thinking of the role

of institutions like the Office of Tax Policy, the Joint Committee, as somewhat technically neutral bodies that, while obviously are going to be involved in the political debate, are certainly meant to step outside that a little bit, and I think that's been an important part of the character of some of the institutions that Gene has talked about, but I think that is under some threat. And Gene, in fact, has commented on this, I think, in a recent Wall Street Journal interview, was it, on the latest go around where OTA estimates became part of the political debate. So I think, in some ways it was ever thus, but I do think it's a bit different at this point.

Third point that I want to sort of put out for discussion is the implications of what it means to conduct tax policy in what still is kind of an anti-tax environment, because there are lots of things that happen when you, in effect, are compelled, if you will, to have the debate within that environment that might not otherwise happen. In some cases, you get all kinds of complexity in the system simply because you don't want to, or can't do the obvious things such as raising tax rates. A very simple example known to many of you are the personal exemption phase-out and the limitation on the ability to take itemized deductions. I think those were put in place while I was still at CBO, and Bob was at CBO. Everybody kind of realized there needed to be some increased income tax revenues, but at that point Bush Senior had told everybody to read his lips, and so you couldn't raise rates, so you raised rates through the back door, but at clearly some price of complexity in that kind of an environment. And that, I think, puts some constraints on what's available and what's not available.

The final point really relates to, I think, the point that Gene closed on, but I think it's really a very interesting, broad policy question to talk about, and that is, in his concluding chapter where he asks who won, because the book is, in fact, a story of competing interests in the debate of what the tax system should look like, he basically concludes, well, sort of nobody won, different parties—I don't mean political parties here, but different parties, stakeholders in the debate, have had ascendancy at different points, and to some degree a lot of these different perspectives are now in play. And he comes close to kind of hinting that we may need to be thinking about tax policy in a different basis.

I guess I'd like to challenge Gene, if we get a chance, to say a bit more about that, because while process reform is part of that, what I think he's—at least the takeaway that I get from that is, what he's really suggesting, and I have some sympathy for this, is that the current environment, where we don't have a policy consensus really on what the tax system should look like, and where we now have these kind of competing forces of individuals who wish to use the tax system very affirmatively and explicitly as an instrument of social policy, where other individuals want to change the nature of the tax system itself, we seem to be in an environment now where the evolution of what the tax code is, is going to be determined as much by a lot of local, pragmatic kinds of compromises. Again, it was ever thus at some level, but I think there may be a difference of degree here that's worth worrying about.

And the question is, where exactly does that take us? I mean, some of the principles—horizontal equity, equal treatment of equals, vertical equity, appropriate treatment of unequals, however you want to define this—I think are still out there as guiding principles. Clearly the three mantras in the Treasury I tax reform for fairness, simplicity, and economic growth—I may not have gotten the order right—are still out there. We still want a tax system that's fair, that promotes economic growth, and that is also simple. The problem is that having all three of those have never been compatible goals to begin with. There have always been tradeoffs involved in that. And now the terms under which we are evaluating those tradeoffs seem to have shifted somewhat, and I'm not sure that we have kind of a broad framework in which to have that debate, but rather one which is going to be guided much more by the political winds, which I think is an unfortunate element, because the tax code, first and foremost, whatever anybody may want to think about it, is there to raise revenue, and we can't lose sight of that, and how you raise revenue has all kinds of consequences that you need to worry about aside from these other aspects.

MR. PEARLMAN: Thank you. Let me add my congratulations, Gene, to the rest of us, for the book. We look forward to seeing it, and I know it's bound to push the Richard Clarke book off the bestseller list.

When I received this invitation, one of the wonderful things about teaching for me is I can sort of distance myself from this stuff. When I received this invitation I thought, why do I want to waste a beautiful spring day talking about the state of the tax system, and I'm so happy it's raining today.

I think the tax system has some serious problems, perhaps not peculiarly serious to the times, but serious problems. I think complexity is clearly a problem in the tax system, but I'm inclined to think that it's not the computational complexity that often is described. My mother is 91 years old. She visited us. She lives in Florida. She visited us at Thanksgiving, and she announced to me how incredibly complex the tax system is. Her income is comprised of some Social Security and a fairly modest amount of dividend and interest income, and I prepare her tax returns, so I have been baffled by that. On the other hand, I do think that what tax lawyers tend to refer to as transactional complexity, or the transparency of the tax system—what Nina, I think, was averting to when she commented on the limitation on itemized deductions—is a serious problem in the tax system, and does erode, I think, individual confidence in the system. So I think complexity is an issue, and an issue that needs to be addressed.

I worry about the revenue-raising, not necessarily revenue-increasing, but revenue-raising capacity of the system. We are clearly marching boldly, and I think I would add for most marching blindly, towards a consumption tax. For most individuals the combination of the various tax-sheltered "retirement savings" vehicles and a reduction in tax burden on investment income comes pretty close to a pure consumption tax. And at the business level, in 1984, when expensing was suggested as a component of the Treasury's tax reform proposals, I thought a fairly compelling argument could be made against expensing in an income tax structure. And it took a while to persuade the

Secretary of the Treasury that that made policy sense, but ultimately that view prevailed. It didn't take much to enact a bonus depreciation provision. I don't remember hearing any serious policy debate, and my guess is it will be with us for some period of time.

And yet in a world in which the income tax system can be characterized as, at most, a hybrid system, with all these consumption tax incentives, we still have placed no meaningful restrictions on the deductibility of interest on indebtedness, so it's commonplace to borrow and invest in these tax favored forms, and exempt, or nearly exempt the income and take the interest deduction. Not a very pretty picture from a conceptual standpoint.

And, of course, then we throw some tax credits on top. So in addition to substantially reducing the effective tax rate through the regular tax system, through the measurement of income, we then add tax credits without regard to whether the underlying income is exempt or nearly exempt from tax.

A third thing I think that hasn't been talked about much this morning, but from my perspective as a tax lawyer is as serious a problem, and that is that we've imposed a monstrous enforcement tax on the Internal Revenue Service, and, indeed, government still does depend to some extent on tax receipts, although over the last couple of years apparently not very much. But we've imposed this compliance burden on the Service, but at the same time have demonized the agency and its employees, and significantly restricted its effectiveness through years of budget cuts. So I think the system has some problems. Having said that, is an attempt at comprehensive tax reform an answer? I think not. I think I share Gene and Joe's views that tax reform is in the eyes of the beholder. Some see it as a vehicle for simplification, some see it as a way to maybe return to what we thought was a fairly good effort in 1986—imperfect, certainly, but a fairly constructive income tax reform effort. Others certainly see it as an opportunity to jettison what remains of the characteristics of an income tax, in favor of a purer consumption tax. And sadly, in my opinion, for others it simply means reducing revenues by whatever means, in order to reduce the role of government.

There are a number of lessons one can take from having been exposed to the tax legislative process, and I suspect none of these will come as great shocks to you. But, first, there's no monolithic view of an ideal tax system, even among academics, and certainly not in the political process. And frankly, I don't think there's any reason to think there ever will be. So that any comprehensive reform effort is likely to be sort of a mishmash of competing theories.

Good tax policy, as a second point (whatever that means), and bad tax policy, I would add, is not the purview of any political party. I've always thought it quite amazing that anyone would have guessed in 1981 when Ronald Reagan was elected, that a serious, base-broadening reform of the income tax would take place during his presidency, and particularly at a time when one of the Houses of Congress was under Democratic control. On the other hand, I would not have imagined that the Internal Revenue code would have

been junked up as much as it was during the Clinton years. So, as I said, I don't think tax policy, good or bad, is the purview of either political party.

Third, the result of any tax reform effort will result from different tax policies, tax policy theories, and different political objectives, and that means that if we were ever to embark on a process of trying to get to one conceptually theoretically ideal system, just wait a few years and we could be reasonably assured that it won't last.

So I tend to share Gene's view that it's much more important to focus on the process, the tax policy process, to try to derive what might be done to restore the political and public appreciation of the importance of a revenue system to our government, and to sort of do what Bill Gradison used to say when he was a member of the Ways and Means Committee, and that is to think incrementally.

I spent the first 19 years of my life as a professional as a tax lawyer, sort of removed from the tax policy process. I must say I think during those years, while I was trying to serve my clients, and be a creative tax planner, I don't remember an attitude on the part of individuals and businesses that is quite as hostile toward government generally, and toward the tax system as I think is the case today. That is, I think, quite disturbing. Yet, I don't think it's a tax policy issue. I mean, I think it goes well beyond that. It goes to the respect that government officials and the public has for government, and for the institutions of government.

I must say, I don't know whether it's possible to be particularly optimistic over the short term that any of this is going to change. Over the longer term, I do think that extremes tend to get muted, fortunately, in this country, and my hope is that will be the case, at least during the number of years that I continue to read books like Gene's and others.

Thank you.

MR. GOSSELIN: Great. Now, again, the organizers asked that you wait until you're recognized, and that constitutes getting a microphone, and when you do get that microphone could you tell us who you are, and what your affiliation is. And who has microphones? There's one, and there's the other.

Questions?

QUESTION: Yes, Bob Lerman, the Urban Institute, American U.

I'm a bit struck by the degree of pessimism about making change in a place that we like to think of as trying to be optimistic that we can make changes. And I was thinking about the analogy with welfare, which admittedly touches a smaller share of the population. But, you know, over time at least there were many efforts to create what I would call sort of at least incrementalism towards some vision through working groups on welfare that occurred between different think tanks and groups, through even just the

nature of the way the research developed, and I'm wondering why people are quite so pessimistic about at least trying efforts that may have borne some fruit in the past, with regard to consensus building. Sure, it might take a number of years. Sure, it wouldn't mean that that the result would be a single, magic bullet, but I think if one were able to attract fairly broad segments from different sides of the political spectrum, one would perhaps do a little better.

My other just quick question is, why it is that almost every department seems to support research, external research, why doesn't the Treasury Department do so?

MS. OLSON: Can I just say, I am not pessimistic. I don't think I spoke about that. I, myself, am optimistic. But, I do believe, to some extent, what Ron referred to about the distaste for government. I think before you can get people, or policymakers to come together, you have to change the attitude toward government, and I think that's the first debate, because I am a populist, and in my job I'm the voice for, or an advocate for taxpayers.

What I at least personally have tried to do is take complicated and difficult issues, and put them in some kind of popular framework, so that there can be pressure from outside, whether it's articulate or not I don't know, but pressure from the people about the state of things. And to some extent, I have challenged taxpayers to stop whining, that taxes are us, and government is us, and you can argue about the size of government, if you want, but you can't argue about the fact that we need a government, and it is not them, it is us. And to the extent that I'm able to bring that debate out, and talk about taxes and choices in that context, then I think you open the discussion for the public officials, and the policymakers to feel like they have to be responsive to that.

Right now everyone seems to be in some kind of collusion about government being bad, and that gives a bye to Congress and other policymakers to not face really difficult issues, and take stands that may not be popular, but could be explained and accepted. And I'm trying to actually—quite literally, part of my strategy—is to change that dynamic in the tax-paying public. I'm optimistic, maybe I'm foolish, but I'm optimistic.

MR. GOSSELIN: Anybody else want to take a bite of that?

MR. CORDES: Yes, just to follow up a bit on that point, and relate it to one comment that Ron made about the anti-government sentiment, and how that's not fundamentally an issue of tax policy. I agree with that at one level, but at another one, it still becomes quite important, because, for example, it does provide the underpinning for that one set of voices that Ron did mention in his remarks, which are a set of voices in this debate that essentially just wants to reduce taxes, and it wants to reduce taxes because government is bad; taxes provide revenue for government; therefore, we starve the bad kind of thing. That, while it's not a cause for permanent pessimism, I think it's a constraint right now that, to come back to Bob's comment, means that it's going to take a

lot of conversation and maybe the first thing that needs to happen is for that sentiment to thaw a bit.

Now, maybe it is, we see this interesting spectacle in my home state of Virginia, where the senior Republicans in the Senate have actually proposed tax increases greater than those of the Democratic governor. There's now a debate that cuts across the party lines, according to the Post that's simply because they're all really proud of their AAA bond rating. Whatever the reason, I gather there are other signs that this may be happening at the state and local level in other places, and while I agree at some point that's not tax policy, to the extent that we may have seen the beginnings of a change there, I think that might also then allow some of these other discussions to begin to happen, because to the extent that part of it is just—we want to have taxes be as low as they can—that thinking is not helpful to the overall debate about which direction the tax system ought to take, other than that it ought to collect less revenue.

MR. STEUERLE: I'm not a pessimist either, what I've really tried to deal with, after going through these 25 years of history of tax policy, is to recognize how these cycles were playing out, and to realize—

[tape change]

MR. STEUERLE: —a particular policy to a definitive point conclusion, not that that's not important, but it's often trying to channel the energy and the forces, so that we get rid of a lot of the outliers, the really bad policies that have come along the way. It's partly trying to deal with that. But in terms of actually where I think history might go... One example, which I think Nina has already brought up, is I think, for instance, reform of the alternative minimum tax will come along. It could be the vehicle upon which a lot of other reform follows. I'm not saying all that other reform really is directly related to the alternative minimum tax, but I have a suspicion that once you reform it you have to reform other things. So there is this sense I have that one has to take advantage of opportunities, and I do talk about that.

The welfare reform analogy is not a bad one. One can certainly think of a lot of ways it could have been done better. One can think of a lot of ways both the government and the foundation community could have done research which could have better informed that type of reform, were it to come along, which it didn't do. So there were a lot of decisions just made totally off of the top of people's heads, and there were a lot of things that weren't done there. So it's not a bad analogy.

MR. GOSSELIN: Okay. Real quick.

MR. PEARLMAN: I don't want to talk about pessimism or optimism, but I do want to comment on the other point Bob made, and that is the importance of third party research, or at least that's what I derived. There is some history of that, both at the

Treasury and the Joint Committee. Over the years there have been modest efforts to involve academics in policy analysis, but not nearly enough. When I was at Joint Tax, I tried to interest the tax writing committee chairman in a proposal that would vest in the National Science Foundation some ability to undertake a much bolder continuing agenda of tax policy research, which would presumably be private sector, but publicly funded. It wasn't of any interest then, and I would think much less now. But I do think that when one talks about the process, as Gene suggested in his comments, and I gather in the book, that part of the discussion of process should focus not just on what happens at the government level, i.e., the Treasury or the tax writing committees, but what happens under the umbrella of government in the private sector. And I think that point is a very important point.

QUESTION: I'm Eric Toder, I'm with IRS, and my comments don't reflect the views of my organization. I'd like to dissent from the position that Ron and Gene took that we should emphasize process, although I do think that process is important, and obviously we should improve everything. But, I think that—it reminds me of Keynes's quote that practical men are all the slaves of some defunct economist, and that for a long time in my experience we were all perhaps slaves of Joe Pechman and Stanley Surrey, and the people who believed in a broad-based income tax, and that eventually led to reforms. And while that was not perfect, the one advantage was, without some kind of vision, the only thing we have is fights about distribution, or efforts to get special interest provisions in the code. And no process, no matter how clever, can stop that, unless we have some overarching vision of where we want the tax system to go, and what we think is a good tax system in order to counteract that. And I agree with Nina's comment that the vision has to be rooted in some practical reality that can resonate with taxpayers, but I think it's really the job of all of us in this room to really focus on developing the vision, because the one thing that's been missing in the last 15 years is any really serious debate about what our tax system should look like, what an ideal system should look like. We're fighting over distribution tables, and whether there should be a tax credit for health and so forth.

MR. GOSSELIN: Okay. So does someone want to rise to defending process reform, or offer a grand vision?

MS. OLSON: I don't know whether Gene was actually saying that, because Gene made a strong emphasis on principles, basing it on some kind of principles. And I think—and I've thought for some time about the AMT—that that was the opportunity for us, because the revenue hit is so great, and it is that opportunity for us to start talking about what a system should look like. And because maybe you have one or two, three, maybe, years before I think you have riots in the street, but that's just my point of view about it, is that we should be talking about that now, what we want the world to look like. And if you give people a year to vent, and try to change the debate about how people feel about the tax system, and how people feel about government, maybe then you have two years to start to really begin to talk about fundamental tax reform, or not fundamental tax reform, what you want the system at the end of the day to look like. At the end of the day being, what happens after AMT.

MR. GOSSELIN: Gene, this might be an opportunity, if one were to listen to Joe and Ron, you sort of become the Rorschach test of this. One interprets you as defending incremental reform, and the other suggests behind what you've most recently written you're hinting at a grand compromise. So which is it?

MR. STEUERLE: I guess I'm trying to be true to the lessons of history. I don't know if there is a vision out there that people are going to adhere to, and stick to. I mean, more and more I've come to the view that tax policy is like expenditure policy. So yes, I think we need to have visions about tax policy, just like we need to have visions about expenditure policy. But to think that there is a vision of expenditure policy that's going to define it permanently is probably almost the same mistake in tax policy. Having said that, it doesn't mean that I don't believe that visions aren't what drive us. And yes, I'm an admirer of Joe, and Richard Goode, and many of these people who give us visions. In fact, I would be glad to put forward one of my own. But, I think at this point in time perhaps I have a more narrow vision, which is, we've got to figure out a way just to get some of the real, if you don't mind the term, crap out of the tax code. It might be my short-term vision, before we try to worry about whether we're going to adopt a consumption tax, or replace an income tax with a consumption tax, to me those bigger scale issues often deter us from doing the things we know how to do.

So I suppose you might accuse me a little bit of being like the politician—someone came in the room one time and argued for a policy, and he said, right, you're right, and somebody else came in the room and argued for the exact opposite policy, and he said, you're right, and a staffer came up to him and said, which is it, you said you were for the policy, you said you were against the policy, you're right, you're right.

MR. GOSSELIN: Right here.

QUESTION: Hi, David Weiner from the Congressional Budget Office. My views don't reflect CBO, nor Eric's.

There seems to be some lamenting of the loss of the link between the purpose of the taxes and the spending. And Joe mentioned Virginia, what's going on there with the compromise. It almost sounds like you're advocates for a balanced budget amendment. I'm not putting those words in your mouth, but that seems to be the linkage that is behind what's happening in Virginia now.

MR. GOSSELIN: Anybody?

MR. STEUERLE: In my book I argue about the two big fiscal crises, one is just the lack of principle development of tax policy, but the second one is what's happening in the budget, and I've largely come to the conclusion that the mistake in the budget we're making, the biggest mistake we're making, is trying to enact provisions that build in growth into the future. So in some senses it's very related to what Nina was talking about, it takes away from current voters—I think Ron, too—it takes away from current voters

the ability to vote today for what they want their system to be, because somebody 5, 10, and 15 years ago largely determined where the tax system is going to go, and where the expenditure system is going to go. And the only way I know to constrain that is to essentially make more of policy discretionary.

Now, that's harder to define in tax policy than it is on the expenditure side, but I think in both cases the main thing is not that you can't have permanent features, or more permanent features, but I think features that have too much built in growth, that pre-determine policy in the future, somehow are going to have to be constrained, and that will involve process reform, and it will involve some of these arbitrary budget rules that we go through, whether it's Gramm-Rudman-Hollings, or a Budget Enforcement Act. We know they're not perfect but we've got to get rules in place that say, that's not allowed—not only is it not allowed but the growth we have going into the future, whether it's tax cuts 5 years and 10 years from now, or health expenditure growth 5 or 10 years from now, those have to be constrained, and have to be voted on once in a while. That's really tough, but that's not a balanced budget amendment.

QUESTION: Len Burman, the Urban Institute.

This discussion reminds me at some point I told my daughter, my daughter asked me what the amen corner meant, I explained to her what it was. This is sort of the tax policy amen corner here, and there is another point of view—and I was immersed in this when I was in the Clinton administration—which is that tax credits are good. Basically people's sense of fairness is what they're personally getting out of the tax system, and the reason the politicians go for all these things that just drive us crazy is that people like getting child credits, they like getting the dependent care tax credit, the adoption credit, and all these other things. Sometimes I wonder if maybe we don't have the right perspective. It's certainly true that budget rules aren't going to solve the problem. Part of the reason we got all these tax credits was because under the budget rules that were in place until a couple of years ago you could pay for tax cuts with tax increases, whereas you couldn't pay for spending increases with tax increases. So a lot of things just got moved into the tax system that way. But, I don't know if there's a magic bullet that sort of solves things on the individual side.

MR. GOSSELIN: If I can just make a couple of responses to that, because I think Len hits on an interesting point here, which is that I think part of what we might consider to be a somewhat alternative vision that may help guide some elements of tax policy I think is to sort of recognize this development, and perhaps begin to think about it in a slightly different way. I was going to be the one, but Len has already done this, to dissent a little bit from the standard Treasury mantra that those of us who were all in the Office of Tax Policy learned, repeated, was that if you were going to use the tax code for social purposes you could always do it better with a direct spending program. First of all, I'm not sure that's empirically true in a number of cases. When you start to think about in reality the way you would craft a direct spending program that did all the things that the tax expenditure would do, very often it's not clear how you could feasibly get there.

So part of what I'm beginning to think might be a useful thing to think through, and Eric Toder has actually made some contributions to this in some work he's done, is to sort of look at this and say, yes, there are realms of public policy where, in fact, the tax code is a valuable tool as a means of providing incentives, or as a means of, in effect, delivering income-conditioned things to people, and then we ought to think about how to do that properly, using the tax code for doing it. That doesn't mean doing everything, and doing it any old which way. I still think there are some guidelines, and let me give you one example of a credit enacted during the Clinton administration that I could quibble with at some level, and that is you have a number of these higher education grants, which obviously I have a higher education institution, I can't at some level complain about the lifelong learning credit, which I tell my graduate students about, but partly because of budget reasons and partly because of a number of other features, the credit is capped.

Conventional economic analysis suggests that for many of these individuals what you've basically done is decided effectively to cut taxes for people, without really giving them an incentive to change their behavior at the margin, because it doesn't affect the last dollar cost of attending graduate school, for example—but the group that gets favored with the tax cut happens to be those who in some broader sense have decided to spend their income on certain kinds of things. That's an area where I think even if you decide you're going to use the tax system as an incentive mechanism, you can look at the subsidy and say, does this make any sense, and it does begin, I think, to conflict with some of the basic principles of horizontal equity.

For example, you might say, why should these taxpayers, in effect, get a tax cut because they choose to spend their income in this way, whereas these others don't, even though it's not changing their behavior? You're sort of making a value judgment at some broad macro level that you want people to spend income on certain things versus others, and that may be okay, but it's not a very well designed incentive. And I gather the Treasury has now probably had to think about these things a lot more. But it may be something to look at a bit more formally in that regard, and I think that would deal with, sort of, Gene's point, that that would also lead you to begin to identify those features of the system that are "crap," that are put in there under the guise of providing an incentive or meeting a particular social purpose, but which, in fact, don't do that at all.

MR. PEARLMAN: Let me just suggest, I don't think that suggestion is new. I think the policy process has been doing that for years. But you need a baseline, and I think one of the benefits of what Joe described as the Treasury mantra is that it articulates a baseline—that by saying that, more or less, a Haig-Simons model on income tax made sense, or that in the Treasury maybe it's better to credit Joe Pechman for this, it forced the policy process, at least in an ideal sense, to examine incentives that were enacted through the tax system, and I think that's essential.

If we were in a consumption tax world, a pure consumption tax world, I think, again, having sort of the pure baseline then enables analysts to make the kind of inquiry that Joe and Len suggest.

Let me say one other thing, briefly, and that is, at least when I made a reference to process, and my impression is when Gene made a reference, we weren't just talking about sort of mechanical process, nor should the attention be placed on revenue estimating, or distributional analysis, which obviously are very important, but process in the sense that you want to make sure that there are institutions within government—and from my perspective that means tax institutions, the Treasury Department, the Office of Tax Policy, the Joint Committee, Congressional Research Service, CBO, the list goes on—that have within them the capacity to do the kind of both mechanical and visionary analysis that should be done on a nonpartisan basis. And I think it is quite possible, I think those of us who have been in government can attest that it's quite possible to have quality nonpartisan analysis done in a very partisan environment.

And at least during the years I was at the Treasury, I took pride in the fact that I think the Office of Tax Policy at the analyst level was pretty nonpartisan, and was pretty well insulated from the political process—so much so that when I visited the White House, they weren't too positive about the Office of Tax Policy on occasion. So, I think it's important to think of process as much broader than just sort of the mechanical aspects.

MR. CORDES: And let me just support one important implication of what Ron has just said, which is that precisely to the extent that you want to do careful analysis of using the tax code to achieve a variety of social purposes, that needs to be embedded in exactly the kind of broad process that he's talked about, which not only involves the traditional groups that we've talked about here, but also begins to develop some capability in some of the agencies to work with the Treasury, which they always have—it's not that it's not there, but again it's more a matter of deepening that because, for example, when you get into other areas we haven't talked about that Gene briefly mentions (energy, environment, and so forth) which are clearly a set of candidates out there for a variety of things, there are just a lot of technical issues. And as capable as people in the Office of Tax Policy are—and they're a remarkably capable and diverse group of people, you know—these get to be fairly complicated issues. And the ability to involve in the process experts from other areas becomes very important precisely because you are, in fact, delivering a subsidy that happens to use the tax system as the mechanism for doing it.

MS. OLSON: This semester I'm teaching a course at Georgetown, a seminar on social policy through the code, and my students have an assignment to identify social problems, analyze whether it should be a direct spending program or a tax expenditure, and then create a tax expenditure that's designed to solve this problem. So, by the end of the semester we will have solved the world's problems, and that's fine. And, at the same time, I've been using this also for me to review some of the literature about the earned income credit, since I'm living the earned income credit daily as a tax administrator. And I think that during the whole course of the semester, I literally flip-flopped back and forth depending on what I was reading and teaching, whether it was a good thing to run this through the code or a bad thing to run this through the code. And I think I have come down on the side of saying that it is an appropriate thing to run through the code.

And it has made me think that the one thing about the EITC, which is maybe different from other business-based credits or programs, tax expenditures run through the code, is that the EITC sort of grew and morphed over time. And, I think that business-based, you have lobbyists, representatives, folks who are very vocal during the policymaking process, where you are able to hear, as you are thinking of something, what might work, what might not work, what people like, what people don't like. Whereas, with a program like the EITC, that evolved over the years, it really did get batted around, and I'm not sure that all the groups that should have been at the table at various times were at the table—particularly the IRS being asked what can you do and what can't you do? And now, we have this program, and we're trying to deal with what we've got.

I think over the last two years I've been working on a piece for my annual report, and threatening to publish it, and I guess this will be the year that I do it, which is, if you're going to do a social program through the code, such as the EITC, what does it need to look like from the point of view of the tax administrator. And I've been trying to come up with, to use Gene's words, principles, so there are principles about process. And one of the things, I think, is that if you are going to do something that is broad-based as opposed to business-based, is you really have to think about the role of preparers. Who are the facilitators of a credit? And the EITC is the case in point that Brookings and Urban spend lots of time talking about refund anticipation loans, fees that are applied in order to get the credit, and we did not think well about who we are going to help deliver this credit to the population, and we did not do our research on what are the characteristics of this population, can they file their own returns, and how badly will they need this large chunk of change that we're giving them? And maybe if we had gone back on day one and said, this is actually what this thing is going to look like, and who are going to be the players in here, we would have thought about that a little differently, or designed it a little differently. So that's clearly something in the process of developing a credit that, if you're thinking about the process of it, that you need to put in.

MR. GOSSELIN: In the audience, at the way back.

QUESTION: John Gist with AARP.

I wanted to disagree with something that Gene said a little while ago, and this has to do with your comment about discretionary tax policy, or perhaps discretionary policy in general, as the answer to what I think you regard as excessive spending in the retirement and health area, however you characterized it. I'm not making a case for more or less spending in the retirement or health area, I'm just saying that it seems to me that discretionary—that nondiscretionary policy is very functional in the sense that I don't think Congress wants to negotiate these things year after year. I don't think the public would be happy if there were a lot of discretion over tax policy regarding Social Security, Medicare, or a lot of other programs that have automatic appropriations. They were put there for the very reason that you can't—you don't want to fight these battles, and you have to have some certainty in the resource allocation.

If everything were subject to discretionary policy, I think, there would just be chaos in terms of people's ability to count on the benefits the government has promised. So, I just wanted you to comment on that.

MR. STEUERLE: Well, I don't want to go too far down this road. I'm not saying that we don't need automatic features in both the tax and expenditure system. In fact, in a footnote I said on the tax system it's especially hard to think about exactly what a limit might mean, because you do want permanent tax systems in place—you don't want to debate every year whether you want to enact a new income tax. And you're sort of making the same case, where you don't want to have to debate ever year whether you're going to have your Social Security check coming or not.

What I'm pointing to is the principle problem of when you build too much growth into these programs. If you look on the expenditure side of the budget, and you literally take what's now in the law, and you predetermine how every dollar of revenue will be spent 100 years from now, that's mainly because retirement and health eat it all up. And so things like letting the age of retirement, letting people have more and more years of retirement, automatically, without ever voting on it, to me is not just bad from the needs-based policy—that is, I don't think that's the primary need of society to give us an 18th or 19th year of retirement, I think it's really bad budget policy to have that happen automatically. And so, you need to put constraints on those systems so they don't have a lot of the automatic growth.

But would you still have automatic systems, yes. I would still try to build in some more review process that would require time to say, okay, every five years, or ten years, we have to review some features of the system, the whole systems, so that the thing came back on the table, and then more policy was discretionary over time. But, you're right, you do need some stable features, and this is like a debate, what should be constitutional, what shouldn't be. This isn't really constitutional. It's sort of quasi-constitutional. And I think just like you don't want to put too much in the constitution, you don't want to put too much in this quasi-constitutional group of things that are permanent. You particularly don't want to have too much built-in growth.

MR. GOSSELIN: Could I ask a quick question of all the panel members—we've heard about the need to get crap out of the current system, and about the possibility of riots in the streets, and that changes are coming. But we seem to have looked right past the fact there's a presidential election coming up. A question to each of you, would you hazard a guess about the shape of the tax debate in this campaign, and will it address any of these issues that you see as important, or are we going to fudge on them?

Wow, that was a stopper.

MR. PEARLMAN: Well, in terms of big ideas, no. And then, I'm sure, they're going to have positions on things like what to do about the AMT, but that doesn't strike me as a—maybe not even that. I don't know. But even if they did, it wouldn't be a front-burner issue, I don't think. To the extent—

MR. GOSSELIN: How do you explain to yourself that we've just spent three years talking about taxes, and elections are the mechanism by which we make big changes, and we're going to have one in which we have no big ideas?

MS. OLSON: Well, I think that you can't talk about taxes in detail in this election, because if you don't talk about the AMT, you know, it undermines everything that you're promising. You're going to have to deal with either that there's a huge revenue impact if you try to fix the AMT, and then that deals with what you can and can't do because it leaves nothing in the budget, nothing that you're able to do, any of your new programs that you're trying to sell to the public, or you talk about the fact that the AMT is there and it will essentially be a flat tax on large numbers of people in the years to come.

So, I think that the other thing is, and this is just my personal point of view if you read the papers, candidates are talking about what they think people want to hear rather than showing leadership, going back to principles, about maybe what people need to hear. And that doesn't get people elected.

MR. PEARLMAN: I find that incredibly shocking. I just hope the discussion of tax policy doesn't get specific, because frankly, I don't think anything good will come out of that.

QUESTION: [Inaudible.]

MR. PEARLMAN: I think it's better in a presidential campaign environment to let the candidates talk about the desirability of reform of the system, and they can complain about aspects of the system they don't like. I'm going to keep my fingers crossed that they don't get too specific, because if they get too specific it ain't going to be good, would be my guess.

QUESTION: Bob Reischauer, the Urban Institute.

Peter's question related to a question that I wanted to ask. Bob Lerman was struck by your pessimism, and I was struck by your optimism, and I was glad to see that all of you came and said, no, we're optimists. And I am a pessimist for exactly the reason that Peter raised in his question. There's sort of the feeling that, well, tax policy goes through these big swings, and we sort of get back to normal, and things work out, and sure, as analysts don't like this or that, and we pick at it, but that's what we're paid to do. And I'm not at all sure about that. If you think about the election that's coming up, I think tax policy is going to be an issue, and do we stay the course, or don't we—and imagine for a minute that the president is reelected, and the Congress remains in Republican hands, maybe with slightly larger majorities, it will be very hard, I think, for that power block not to in January or February pass an extension of the tax cuts that we have now, and go forward with the various provisions that have been in the president's budget for the last two or three years, to add a few more credits here and there on, and then what do we do.

We have this proliferation of credits, which are very difficult to undo, and the only other avenue to raising resources is to raise rates, which is not likely to be in those cards.

Some people might take some sort of solace out of what happened in 1987, but I don't think there's much to be had there, simply because at that time, with respect to the individual income tax, when we broadened the base and lowered the rates, that aspect of the bill was a revenue loser, and we poured some more money in, and it's not apparent where the money would come from now for any kind of fix. Add to this the fact that the newspaper is filled with stories about how IRS isn't enforcing the law; there's a very low probability of getting audited. If you get audited you say, "Turbo Tax made me do it, a mistake, I'll pay up" and all is forgiven. And at some point we do get Italian-like problems with compliance. And we're in a situation where the revenue take is so divorced from the spending, what we want is 1950 tax burdens with 2004 spending commitments. The debate that Gene hopes we have, which is, hey, these things have to be related in some sense, disappears completely. So I think there's a good reason to be logically pessimistic about where we're going.

MR. GOSSELIN: Okay, optimists, let's hear it.

MR. CORDES: Well, someone once accused me of being a short-run pessimist, and a long-run optimist, and that's going to be my reconciliation. My optimism is that our democratic system, somehow or another, seems like it's just not going to get through the next crisis, but somehow or another it does. Our tax system, whatever else you can say about it, does raise revenue. So there are certain things out there—there are certain strong institutions that I see as making it through this. But, all the issues you raised, in terms of a short-run crisis, most of what you talked about were budget crises, rather than, I won't call them the more narrow, but the tax policy issues of horizontal equity and efficiency and stuff like that. You're saying, we're just not raising the revenues we need out of this system, or we're spending too much. Whatever it is, we're creating a huge budget problem. That is a short-run crisis. We do need to pay a lot of attention to it. I have no problems with saying that's a major cause of concern.

I also agree with you that today is very different than the '80s. What's required for the budget today is much, much bigger, requires much more creative thinking and much more leadership than we even had in the '80s. And we're not seeing it yet, in either political party. So sure, that can be rather pessimistic. A call to arms doesn't necessarily mean that one doesn't have the long-run view that eventually our system will get through this.

That's my reconciliation.

MS. OLSON: It's sort of the pureed spinach theory, over a period of time you get what you need, you'll be able to correct yourself. I think from my point of view one of the biggest challenges—and to me what's the one that remains to be seen, whether we triumph over this—is the attitudinal issue, how taxpayers feel about their system. And while much has been said about the IRS finally getting back on the beat, I feel that debate

has not been sufficiently nuanced enough. I want to see—taxpayers don't need the IRS to go from one end saying, “we're not there,” to the other end, “yes, we're back, and we're jackbooted thugs,”—there's got to be something in-between. And we at the IRS need to do a much better job of creating those nuances. And that will make taxpayers feel better about their system, rather than one extreme or the other. And government is not particularly good about being subtle and nuanced. And I don't know how we're going to do this one. I don't want us to go from one extreme to the other, because you do too much of that, and you have a snap, which goes to taxpayers participation in the system, or lack thereof.

MR. PEARLMAN: I don't know whether this makes me short-run pessimist, long-run optimist, or whatever but an element that Bob has pointed out is that you've got this fairly large budget deficit, and I guess one question, but I don't have an answer to it, is at what point is that entity seen as a serious enough budget problem that one then has to confront the implications of it, the way the states have to, because they don't have a choice, they have balanced budget amendments. When that becomes an issue that the Congress is willing to take seriously, then I think one has to begin to look at revenue raising as well as budget cuts as a mix of things. At that point I think some of these bigger issues come back in play. But when that happens—I confess I'm not sure when that will happen or what would cause it to happen.

I mean, if you go back to the 1980s you had, by some respects, a smaller deficit, but it led to a whole series of things on the budget side that actually did have an affect in the end. What is it that gave Congress the political will and the interest to do that, and make it treat that as a very serious problem? I mean, we can all remember all of the concern and the nervousness about the deficit that just doesn't seem to be out there right now. I think when it is out there, you're going to have to look at revenues and how to raise them, because you don't have any choice, you're not going to be able to do it all on the budget side. You're correct that to the extent that certain things get put in place you have that much less flexibility of what you do, but at some point it may become a serious enough budgetary issue that you then have to begin to look at serious revenue raising, and then that does tend to create a window for thinking of reform while you're raising the revenues.

MR. GOSSELIN: Any other questions?

QUESTION: Dan Ezro, House Budget Committee. Just a question on strengthening tax institutions, the IRS.

With Commissioner Rossotti's vision, which was focused around IT, strategic planning, and customer alignment, has that gone any length in kind of finding the third way between not being there and being over aggressive? Is that on course for a positive prognosis for getting the IRS to a respected organization?

MS. OLSON: I'm assuming that question was to me. It cannot be said enough that the IRS's systems modernization is essential to us in being able to administer the tax

system. And I think that what Charles Rossotti did was make us understand, us being the IRS and Treasury, and Congress, everyone, understand how essential that is. Commissioner Everson, I think, has come in and done some corrective action in terms of the systems, giving the prime, clear notice that we need to be on track. So that's one component of that.

The customer service side, I think, and again I am speaking for myself in this, how we roll out in the next two years these new compliance initiatives, putting revenue agents and revenue officers on the street, dealing with taxpayers, how we do the corporate tax shelter approaches—leaving aside the enforcement, sort of criminal investigation side of the IRS—how we deal with the run-of-the-mill taxpayer who has tax problems is going to tell me whether the customer service changes that Charles Rossotti tried to bring about have actually taken place within the organization.

I think the senior leadership of the organization has said over and over again, it's not a pendulum. You can do both at the same time, you can bring taxpayers into compliance, and have compliance initiatives at the same time as delivering customer service. Whether that message and the resources are there to do both remains to be seen. Some of that is in Congress's lap, to fund the enforcement-compliance side, as well as customer service. I do not see us being able to do compliance well, much less enforcement well, if we do not maintain a vigorous contract with the taxpayers—that when they call, when they want to resolve their problems that they get a human being, that it is easy for them to resolve their problems, that we want them in the system, and we welcome them in the system. That's just my personal point of view. I will say that that is actually my professional point of view.

QUESTION: Don Alexander, that's why we have a taxpayer advocate's office. But, I was going to comment on your prior statement about the earned income credit—somebody should have been there at the beginning, somebody was. I seem to recall that, debating Milton Friedman about the negative income tax. That's when it came about. It should not have been given to IRS at that time. IRS must manage it now because it can't be changed. But what that meant was, I think, and I'm a pessimist, almost the downfall of an income tax that is a sensible income tax. We try to do too much with our income tax and we can't deliver. We try to give all those who we want to favor in some special, economic way their little break. And all those we want to favor in a social way their little break. We wind up with a code that's full of breaks, and it's extraordinarily difficult for IRS to administer.

Now, on this balance between enforcement and—I can't call it customer service. A customer can decide not to do business with an establishment. I could not let people get off my mailing list, nor can Mr. Everson. But, you can call them taxpayers, and you can deliver a service that's needed better than IRS is being able to deliver it. But you can call on clinics like the one you used to run, Ms. Taxpayer Advocate, to try to deliver in a wholesale way, so that you can spend some of your budget, which Commissioner Rossotti did not spend very much of, on trying to maintain compliance with our tax laws. We have enormous problems now, brought about largely by what happened in 1998, and

the Internal Revenue Service reaction to that. I hope we can somehow restore compliance, because if we don't you bright people up there are going to have to develop a tax system that can be satisfactorily administered. And I'm not sure our present system, much less our future system, meets that test.

MS. OLSON: I want to be very clear on this, that I very much support the idea of the IRS being back on the street. I'm bearing some scars right now about a current proposal about withholding on independent contractors to bring some more money in the system, but I'm very much in support of that.

MR. STEUERLE: Could I just add, you and I have had this discussion before on the earned income credit saying that merely going to take something out of the tax system, throw it in the spending system, doesn't necessarily resolve the issue for society as a whole. If all you've done is clean up a tax system and messed up a spending system, there may be those of us who say, gee, that's a nice thing, because we work on taxes, but there's a broader issue. And one reason the earned income credit is in the tax system is actually administratively, they're the one, the agency gets the wage records, the W2s. That's the administrative basis for having the IRS involved. Whether it should have been a spending program versus a tax—in fact, it's actually counted in the budget as a spending program for the most part—whether it should be run more by a spending agency or by a tax agency, I'm not sure. And there is one compromise that I would make, and I've long argued is, IRS has a lot of programs under its nose. It does not run itself as an agency that has programs. It organizes everything, what Nina was talking about, everything is organized around the tax return. You get the tax return in, you process it, you do these things with it, you run some data on it. It's all organized around the tax return.

They still do not have internally a capability that says, okay—actually they're doing it more now around earned income credit, but they don't do it for the charitable deduction, they don't do it for medical expenses. They don't say, here's a program, we need to put a couple of people aside to worry about what that program is doing, to put out at least the administrative data, to be in charge of analyzing for the public the limitations. So IRS creates some of its own problems by hiding internally the problems that it has with a lot of these programs that it runs. It doesn't actually put forth the data or the analysis to show us what's going wrong half the time. We have to almost beg it out of them.

MR. GOSSELIN: I think we're running out of time. Are there any other really pressing questions? All right.

Listen, I want to thank the panelists, the Urban Institute, and this audience.

Thanks.

(Applause and end of event.)