

TAX ANALYSTS EXCLUSIVE

Conversations: Leonard E. Burman

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Leonard E. Burman is a fellow at the Urban Institute and director of the Urban-Brookings Tax Policy Center. He previously served as deputy assistant secretary for tax analysis at the Treasury Department from 1998 to 2000 and as senior analyst at the Congressional Budget Office. This fall,

he will become the first Daniel Patrick Moynihan Chair in Public Policy at the Maxwell School of Syracuse University.

Burman recently sat down with Tax Analysts' Sam Young to discuss his future plans, the outlook for healthcare reform in Congress, and his proposal to create a VAT to pay for healthcare.

Tax Analysts: This is a very busy time in Washington, and you've had an impact on many issues now being debated in Congress. It seems to be an interesting time to be moving out of Washington instead of accelerating your efforts here.

Leonard E. Burman: I came here on a two-year leave of absence in 1985. I love teaching, and this job came up. It's the first Moynihan chair at the Maxwell School of Syracuse, and it just seemed like it was designed for me.

For a while I've thought I'd like to get back into teaching. I don't believe there's ever going to be a time that will be quiet, when I'll be able to walk away and say, "My work here is done." That's just not going to happen.

The other thing is I'm not actually walking away from Washington. I'm changing my vantage point. I expect to be involved in policy debates. I expect to be writing about policy issues. If tax reform ever does come on the agenda again, I certainly hope to be involved with that.

But I expect that having a perspective outside the Beltway could be helpful at this point. I also think that the Tax Policy Center [TPC] has gotten to the point where it's a mature organization that can do just fine without me. The other people in the Tax Policy Center are exceptionally good economists and policy analysts and incredibly dedicated, and

I'm absolutely confident that the TPC will do great work without me running it.

TA: Was there something in particular that drew you to Syracuse?

Burman: They had this great job. I was always an admirer of Pat Moynihan, and it's a huge honor to have a chair in his name. They want me to be involved in public policy, and there's support for coming to Washington to testify and things like that.

And I'm a bicyclist, as you might know. I like biking in that part of the country. Now, admittedly, during the eight months when it's winter that's a challenge, but during the two weeks of summer it's really nice.

TA: So you don't think your impact would be attenuated at all by being in academia?

Burman: I think it might be greater, with time to think about big issues and less time with administrative issues and responding to short-term efforts.

TA: Do you have specific goals for your time in academia?

Burman: Yes. First, to become a good teacher. I think I will be.

Second, I plan to write a book on catastrophic budget failure, which is working out the economic consequences of continuing our current fiscal policies. We all know our current policies are unsustainable. It's become almost a cliché. The Congressional Budget Office produces a report every two years that says how bad our budget policies are over the long term. But nobody has played out in detail exactly how bad the disaster will be if we actually keep on going until we go over the cliff. And that's what I want to figure out.

I'm going to work on a research project in collaboration with some of my colleagues from the Tax Policy Center to model the effects of catastrophic budget failure, and then I plan on writing a book on what got us here, what will happen if we continue our policies and go over the cliff, how we can avoid doing that, and — the hardest chapter of all — how, if we got on a sustainable path, we could make it stick.

If I can figure all of that out, I think I will have an impact.

TA: Have you accomplished what you wanted to at Urban?

Burman: Yes, actually. I have.

I came to the Urban Institute thinking that I'd like to do for the public what I'd been doing in government for 20 years: provide careful, unbiased analysis of tax policy issues.

We wanted to explain the results in ways that were accessible to the public. In particular, we wanted to provide information for reporters, like the people at *Tax Notes* and other publications, so

we could explain the effects of policies in terms they could translate for the public. We wanted to provide an independent source of advice for policy analysts — people working on the Hill and in the administration. We wanted to keep an eye on what the government is doing and fact-check them. They couldn't just say things about their policies that have no basis in fact or in the economic literature, and I think we've done a good job of that.

I think the best example of the kind of impact we can have was during the last presidential campaign. Everyone who wrote a story on the candidates' tax plans referred to our estimates and our analysis, and almost everyone referred to us as "the nonpartisan Tax Policy Center." We'd reached a level of credibility and respect that has been incredibly gratifying.

We certainly had an impact: Both presidential candidates were using our numbers. The talking heads on the Sunday morning talk shows cited our estimates and analysis. There was even a *Doonesbury* cartoon that referred to one of our numbers.

TA: How would you like to be remembered from your time at Urban? Is there something you look back on and hope people will remember?

Burman: Starting the Tax Policy Center with Gene Steuerle and Bill Gale is my greatest professional accomplishment. I'm proud of it, and know my colleagues are proud of what we've accomplished. I hope and I expect that they'll build on what we started and make it even better, and I'll be able to say I was involved at the conception.

TA: Do you have a sense of why it's been difficult to fill top positions at Treasury?

Burman: There are a couple of things. One is that they put a lot of restrictions on who was eligible for the political positions. You can't hire anyone who was a lobbyist, so that rules out my former boss, Jon Talisman, who would be fabulous but is a registered lobbyist and thus disqualified.

I think the tax problems that some other administration appointees had raised the bar for tax compliance for any candidate. It's just a routine part of the process that their tax returns are gone over in minute detail, and any kind of substantial error would disqualify you for the job.

And that's unfortunate. I think one of the reasons our system needs reform is that it's really hard to get your taxes right. I'm not sure I could survive the vetting process myself.

I was in government before, but I wasn't aware of it being a big deal. It seems to have been elevated to a higher level. After Zoë Baird 20 years ago, everyone was checked to see if they had a nanny problem, and now the big thing is you have to have done well on your taxes.

I think it's important that we have tax officials who comply with the tax system, but it may be, given how complicated our system is, that it's a standard few people can meet.

The other thing is that I don't think tax policy is a high priority for the administration right now. Their plate is full with health reform, environmental issues, and international issues. If you were thinking about this as a time for tax policy, you might think that all the air would get sucked out by all these other issues. You'd probably be right.

TA: Does that mean you don't think the staffing difficulties have had much impact on the Obama administration's agenda?

Burman: I think there is an impact. The one thing that's been true, through the Bush administration and all the way back to when I was working under Clinton, is that policymakers think of the tax system as a way of providing goodies that would win support from particular constituencies. Obama is certainly not immune from that.

There are likely to be many, many proposals helping people who are suffering one way or another, and most of those proposals are bad tax policy. I used to joke when I worked for President Clinton that every time he felt somebody's pain we got a proposal for a tax credit.

Bad things happen to good people, and for the most part it's not the role of the tax system to rectify them. A lot of the time it's hard to come up with any cure that makes any sense to run through the tax system.

That's why it's important to have somebody there to say, "I feel your pain, but this is not a role for tax policy."

TA: So not having people in those positions may make it easier for the Obama administration to advance policies of which tax experts would be skeptical.

Burman: It's certainly a concern.

The other thing is that when they want to advance something that actually makes sense as tax policy, it's good to have the intermediary between the people in the White House and the people in the Office of Tax Policy to serve as a filter.

The role of the assistant secretary and the deputy assistant secretaries is to sometimes push the staff to produce things they might not be entirely comfortable with, and other times to push back against the White House and say these things are out of bounds and that it doesn't make any sense for Treasury to be working on these issues.

The political appointees protect the staff, but they also serve the administration, and there needs to be that filter. It doesn't work well to have people at the White House calling career staff people at the

Treasury Department and asking them to work on initiatives that are politically motivated.

TA: Two areas in which tax policy has been discussed recently are a surtax to support expanded federal healthcare spending and reform of the earned income tax credit. Do you have any thoughts on those?

Burman: I don't have any problem with asking rich people to pay more in taxes. The surtax is a club. It's a very blunt instrument for accomplishing that.

The surtax would not be based on taxable income but on adjusted gross income, if I understand it correctly. It doesn't allow deductions for anything, including things that are clearly legitimate expenses of earning income.

I had actually put forward the idea of using a surtax as a replacement for the alternative minimum tax. The idea was that the alternative minimum tax is an incredibly stupid tax with really undesirable policy consequences, and it's incredibly complicated. We can replace it with a slightly less stupid tax, which is a tax on AGI, which at very low rates might not do too much damage and would be simpler than the AMT.

But now they're talking about the surtax as something to pay for healthcare. The AMT would still be in place. They'd essentially be taking this stupid surtax and placing it on top of the incredibly stupid alternative minimum tax, and making the income tax system even less coherent than it is now. It would create a lot of inequities in that people wouldn't be able to get deductions for things that would really make sense, and arguably make the tax system less efficient as well.

A better way to finance healthcare would be something that's more broad based, particularly if you could broaden the base by bringing questionable deductions back into income, so you can raise revenue without raising tax rates.

One example is limiting the exclusion for employer-sponsored health insurance. It would broaden the base and at the same time it would cut back on the level of subsidies provided to health insurance. A lot of people, including me, are concerned that adding another \$100 billion a year or more to our already huge spending on healthcare at the federal level is an appropriate use of resources. If we can somehow take the existing subsidies for healthcare and redesign them so that they're more targeted at people who need help — lower-income people — and do less to encourage people to spend more on healthcare, that would be a much more sensible approach.

TA: You had an op-ed in *The Washington Post* on limiting the income tax exclusion for employer-provided health insurance. What was the response to that?

Burman: The response was almost universally positive. The exception was the Machinists Union, which didn't like that I used machinists as an example of recipients of an overly generous health insurance policy.

I was arguing that the exclusion for health insurance could be working against union members' interests by encouraging them to take way too much of their compensation in the form of healthcare and not in the form of wages. First of all, I think if people actually understood how much of their compensation is actually going to health insurance, they would say, "Raise my wages and put me in an HMO." Second, it makes companies a lot less flexible in dealing with workers. If you can get rid of a full-time worker with their huge bill for health insurance, you're a lot better off than if you just cut back hours for a few workers, because health insurance is a big fixed cost.

TA: Does it make sense to tax health measures to pay for healthcare reform?

Burman: I think it makes sense to try and cut back on other health tax expenditures and direct expenditures as well. There is a big concern with our government spending [on healthcare]. It's got to be close to \$1 trillion in tax subsidies and everything else, and another \$100 billion or more in potential additional spending raises real concerns.

In terms of limiting the exclusion for employer-sponsored health insurance, that could help to slow the rate of growth of healthcare costs. It would dovetail nicely with health reform. If on the spending side you can find measures that would reduce healthcare spending both by the private and the public sector, that would be a big plus in the long term, especially if you can do it in a way that doesn't harm an individual's health.

The big concern is that when you cut back on spending for health, you end up cutting back on things that are lifesaving or make a huge difference in people's quality of life, and that's why it's such a challenge.

TA: What about reforms to the EITC?

Burman: I'm a huge fan of the earned income tax credit. It provides needed assistance to low-income families and it encourages them to work, which is a good thing. But it is way too complicated.

Low-income people have complicated family situations. Sometimes grandparents might be taking care of grandchildren, but they're not eligible to take credits because their child is around. It's this complex, Rube Goldberg system of supports for low-income people, and the rules for eligibility are

different among all the different subsidies. The EITC has different rules from the child tax credit or the Making Work Pay tax credit or personal exemptions.

It would make a lot of sense to simplify the code so you get a subsidy for working that didn't depend on whether you have children or not and a subsidy for children that didn't depend on whether you were working or not. That could make it easy enough that ordinary people could figure out how to fill out their own tax returns — right now the vast majority pay people to do their returns — and it would improve the chances they would understand how the tax code is affecting them.

TA: Some commentators have expressed concern that increased assistance for low-income earners has meant that too few taxpayers actually pay any taxes. How do you think that affects the debate?

Burman: I think there is a legitimate concern that a lot of people see the government as being free. There is a cost to providing government services. Even if we're not paying it with current tax revenues, our children are going to be paying for it — with interest. People ought to see that. It raises real concerns when you think that a majority of taxpayers might think that they can vote for any new program and it won't affect their taxes.

But there is also a problem that we confound subsidy programs with taxes. High-income people get stuff back as a result of what they pay in taxes: They get the value of having a national defense, having a court system, and having roads. We don't provide those in the form of refundable tax credits. We don't tally up whether what they get back is worth more or less than what they paid in taxes.

I think it's an unintended consequence of providing more and more of a social safety net through the tax system. It makes it look like a lot of people — close to half of taxpayers — don't pay any taxes. They do owe some tax, but they're getting back more than the amount they owe in taxes in the form of refundable credits.

My view is that we need to provide support to low-income people — and everyone else, actually — with direct spending programs. The front side of the tax form ought to be devoted to tallying up tax liability, and the back side ought to be devoted to tallying up whatever subsidies you're getting through the tax code. That should be true not only for low-income people, but for middle- and upper-income people, too.

It does get into a broader issue: We now provide an enormous amount of spending through the tax code. Everyone who reads *Tax Notes* understands this, although real people have a harder time with it. Eric Toder and I estimated that in 2007 there was over \$750 billion in tax expenditures going to

individuals. It's a lot of money. It's more than 60 percent of total income tax revenue.

A lot of those tax expenditures probably make sense, but a lot of them don't, and they don't get much scrutiny. They don't get the same kind of scrutiny that direct spending programs do, for example.

TA: The Joint Committee on Taxation's scoring system has come under fire. Edward Kleinbard has been vocal in defending it, but do you have any thoughts on it? Is it something you would like to see reformed?

Burman: I think the Joint Committee on Taxation does an amazingly good job under very difficult circumstances. There will always be critics, because people who want new programs will always want the JCT to say that they cost less than what the official score is, and people who want to avoid taxes will say that a new tax will take in less than the JCT says.

The perennial debate is whether they should use dynamic scoring, which would take into effect the economic growth effects of tax changes. I think the JCT is absolutely right in refusing to build that into the regular estimating process.

The reason is that there's no way to tell the growth effects of most tax changes, because they're often made in the context of deficits. For example, the 2001 and 2003 tax changes were all paid for with borrowed money. You might say that cutting tax rates, particularly on high-income people, may make the economy grow more, and it probably does, in a revenue-neutral context.

But if you're borrowing the money, and down the road you're going to have to bring in what you borrowed plus interest in additional taxes, the consequence could be that the economy will be smaller than it would have been without the tax cuts in the first place. The growth effects always depend on things that aren't specified in the proposals. As a first approximation, ignoring those is the best policy.

That doesn't mean they should be ignored in the debate. Policymakers ought to consider whether policies will contribute to growth or harm it. But I don't think we should be counting on money that's going to come in under assumptions that are almost sure to be violated in future years.

TA: Another way to fund healthcare reform is a VAT. Would you describe the obstacles for its adoption in this country and what framework you'd like to see used here?

Burman: I've been a big advocate of enacting a VAT dedicated to paying for healthcare. The reason I like that is that a VAT would be relatively efficient — it doesn't tax saving, it's relatively easy to administer, and it could even serve as a stimulus. If

you said that a VAT was going to take effect next year, you'd give consumers a powerful incentive to buy things now. If you phase it in over a couple of years, you can repeat that trick over and over again for a while.

Over time it would encourage saving, which is something we desperately need over the long term.

The resistance to creating a new tax is that our country started as a tax revolt, and we still have that spirit. People are very wary of new taxes, and policymakers are terrified of imposing a new tax. They remember that former Ways and Means Chair Al Ullman 30 years ago proposed a VAT and then was voted out of office the next time he came up for election.

I think they forget that Ullman was actually not very good at doing things that get congressmen reelected. He was only narrowly defeated, and people criticized him for being aloof and out of touch with his constituency. He never came home on weekends and didn't do a lot of constituent work, so it's not clear that the VAT was what brought him down. Certainly if he'd done other things congressmen are supposed to do, he would have been reelected.

I would like to add a VAT in the context of overall income tax reform. My proposal would cut income tax rates pretty dramatically. I think if you said that a VAT would come with a voucher that would pay for decent health insurance for everybody, that most people would see that's a pretty good deal, that they'd be getting way more in health insurance than they'd be paying for in a VAT.

The combination of the VAT plus health insurance would be pretty progressive, because high-income people would be paying a lot of money in the VAT, but their health insurance wouldn't cost any more than it would for a middle-income person. But it would require some real political courage to propose a new tax. It turns out it's not a winning argument in the United States to say, "We should be doing it because the French do it."

The fact is that the reason the VAT is so popular around the world is that it allows those countries to have a pretty robust social safety net, and it makes their tax systems more efficient than they would be if they relied entirely on income taxes.

I believe that we will get a VAT eventually. My fear is that it won't happen until we're at a point of great crisis where people aren't willing to lend us money anymore and we're going to have to raise a whole lot of additional revenue. I think it would be better to do it now and in the context of making the overall tax and expenditure system more efficient.

Another advantage of tying the VAT to health-care is that everyone would pay the VAT, and everyone would see that if health-care costs continue

to grow faster than the rest of the economy, VAT rates would go up. Taxpayers wouldn't like that, and that would put pressure on policymakers to lower the rate of growth of health spending.

Over the long term, our fiscal challenge is almost entirely in health-care, due to promises the government has already made to pay for Medicare and nursing home care for seniors through Medicaid. If we had a dedicated revenue source to pay for that, the long-term fiscal imbalance would disappear.

TA: How would you prefer to address the inherent regressivity of a VAT?

Burman: A VAT is thought to be regressive because low-income people consume all of their income or even more, and high-income people spend only a fraction of it. But the combination of a voucher and a VAT is actually pretty progressive. For a family health insurance policy, a middle-income family might get a voucher worth \$12,000 and only pay \$5,000 or \$6,000 in VAT.

It is true that low-income families with children wouldn't be getting anything new. They already get health coverage through Medicaid, and older people get coverage through Medicare.

Older people would basically be taken care of because their Social Security benefits are indexed for inflation, so if a VAT increased prices, they'd get more in the way of Social Security. For people who are getting Medicaid coverage now, you could offset that with a refundable income tax credit that would equal the amount of VAT that someone at the poverty level would be paying.

The combination of careful reform of the income tax system and the voucher to pay for health-care would be very progressive overall.

TA: Who would get the voucher?

Burman: The voucher would go to everyone. The credit would essentially be like a demogrant. Fair-Tax supporters call it a "prebate" — that's basically a credit that offsets the amount you pay at the poverty level. I propose the same thing as part of this VAT — that everyone would get this credit, and higher-income people would pay it back through the VAT.

TA: Is there a particular form of VAT you'd prefer to see?

Burman: The credit-invoice VAT is the most administrable. It's said to be self-enforcing, which is something of an overstatement. Under a credit-invoice VAT, each seller in the chain of production is responsible for paying the VAT on the sale price they get, but they get a credit for the tax paid by their suppliers, so they have an incentive to buy things from producers who've already paid the tax. If their suppliers haven't paid tax, it means they have to pay more themselves.

As compared to the national retail sales tax I mentioned before, where if you don't pay the tax at retail, the government loses out on the whole thing, under a VAT if a retailer doesn't pay the tax, the government would still have collected tax at all the earlier stages of production.

That's a reason why a VAT can exempt most small retailers. Most VAT systems exempt small retailers. One of the criticisms of a VAT is that you're going to have to pay tax on the kid who mows your lawn. The answer is no. That person would be exempted under the law — and that person would be subject to the income tax now — so it's kind of a red herring.

The other alternative is the subtraction-method VAT, where you pay tax on the difference between your supplies and what you get when you sell. The problem with a subtraction-method VAT is that if someone has cheated earlier along the chain, there's no way the government can collect the revenue.

TA: Do you have a specific trade-off between income tax and VAT in mind?

Burman: My idea was that if we paid for all of healthcare that's currently being paid for out of general revenues with a VAT, we could cut income taxes a lot. The way I got at that point was by thinking about what made the 1986 Tax Reform Act work.

What made it work was a source of revenue that made income tax cuts for most individuals possible, and that was the corporate tax. In 1986 there was a \$100 billion increase in the corporate tax, and that paid for big tax cuts for individuals. There was a moment in which all these corporate CEOs came to Washington to say they supported tax reform. Even though their companies were going to pay a lot more tax, they personally were going to pay a lot less.

If you had a VAT paying for healthcare, most people could pay less under the income tax. They would be paying the VAT for the first time, and some people would end up paying more overall, but that might be a more palatable tax than the income tax. Certainly at the state level, people like the sales tax more than the income tax.

What I proposed was that you could simplify the income tax enough that most people wouldn't have to file income tax returns anymore. I think that would be a huge advantage. Right now most people use paid preparers to help them with their tax returns. Most people have no idea how they're affected by the income tax, and I think that's a really serious problem.

Under my proposal, most people would pay a flat 15 percent income tax rate, and high-income people would pay a 25 percent rate, and most people in the 15 percent bracket wouldn't have to

file returns. Everything would be worked out through withholding from employers and financial service providers.

TA: How do you see a VAT coordinating with local sales taxes?

Burman: I think that's an issue. Charlie McLure, who is an economist at the Hoover Institution and a former deputy assistant secretary at Treasury, held a conference that looked at the issues of coordinating a VAT with state and local sales taxes. The problems aren't trivial, but they are solvable. Canada has a decentralized system like ours, and they've got a VAT that's coordinated with taxes at the state level.

Some states might choose to piggyback their own state taxes on the VAT, and that would be relatively easy. A few might keep their own sales tax, which would still be feasible. One advantage of implementing a VAT, for states, is that if a lot of states decided to coordinate their state taxes with the federal VAT — basically just adding 5 or 6 percent onto the federal VAT rate — it might be possible for the first time to get the federal government to pass legislation allowing them to collect taxes on Internet sales and mail-order sales.

When the Supreme Court last ruled on this issue, they said that if states would coordinate their tax bases, then it would be constitutional for the federal government to allow states to require retailers to pay the tax across state lines. The reason that the Supreme Court said it wasn't constitutional 25 years ago was that they thought it was an undue burden on retailers. There are 47 or so states with sales taxes and a lot of localities with their own sales taxes, and they all have different bases and different rates. If they all piggybacked on the VAT, it would be very easy to coordinate.

The other thing is that if the federal government was running a VAT, its compliance activities would help the states. If they identified people who weren't paying the federal VAT, the states could go after them, too.

The drawback from the states' point of view is that if you had a substantial federal VAT, there would be more of an incentive for people to try to avoid the taxes at the state and local level.

TA: If the VAT depresses consumption, wouldn't that hurt states that rely heavily on sales tax revenue?

Burman: But on the other hand, if the federal government is taking over obligations for paying for healthcare, the states would be way better off. The same healthcare pressures that will bankrupt the federal government over time will also bankrupt the states. So if the federal government could find a way to pay for healthcare, and took it off the backs of the states, it would vastly improve their long-term fiscal positions. ■