Transcript of the Plenary Panel Discussion on “The State of Tax Reform” At the 110th Annual Conference on Taxation of the National Tax Association

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Session Chair

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Panelists

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The National Tax Association thanks the Penn Wharton Budget Model for providing a transcript and recording of the Plenary Session on "The State of Tax Reform" at the 110th Annual Conference on Taxation in Philadelphia, Pennsylvania on Friday, November 10, 2017. Note: Panelists were invited to edit the transcript for clarity.

John Friedman: [00:03] -- Thank you so much to all of you for attending the 110th Annual Meeting of the National Tax Association, and we are joined this morning for a discussion of the tax reform efforts that are ongoing. So we have a group of economists here to give their views and discuss what's going on.

Now when we were planning this session back in the Spring actually there was a little bit of worry about whether this would be a topic that would be timely at the actual time that we would have the panel. There's some chance that nothing would have happened and we really wouldn't know any more than we knew in the Spring. There's some chance that a bill would have been passed and that would have been it. So we're very thankful to those in Congress who really appreciated our plight [01:00] and timed the bill. And I just want to point out that it's not only that they chose to release the House bill last week. There was some concern with two panels on the program -- one organized by Mark Mazur yesterday and one this morning -- that there would not be enough new information to talk about this morning. And so we're very grateful that the Senate chose to time its release in between these two panels.

So given everything that has been released recently, obviously, we're all trying to figure out exactly what's going on. But I thought it would be worthwhile to give a very brief overview of what is in these two bills simply to give everyone some shared basis for discussion.

So the House bill, which passed out of committee yesterday, has changes on the individual side including reduction from seven brackets to four, with the top rate staying at 39.6% although [02:00] only over a million. It most prominently increased the standard deduction, while eliminating personal exemptions with a new, although temporary, family credit. It eliminated most both above- and below-the-line deductions with prominent exceptions including the charitable contributions deduction, reductions in the mortgage interest deduction going forward, and the elimination of the state and local income tax, but not entirely the property tax deduction. It repealed the AMT, it increased the child tax credit, and it moved to using chained CPI [02:38] for the brackets and thresholds, most of them which over time will increasingly expire.

On the business side, the headline is reduction in the corporate tax rate to 20%. It eliminates many credits and deductions, including partial limits on the deductibility of interest. It includes full expensing of investment for the first five years, although not after that. And then it goes to the territorial system for [03:00] foreign income with various different base erosion provisions, which we can get into in more detail with a transition tax. It also includes a 25% rate on pass-through businesses with various different guard rails, which again we can get into. Then the estate tax exemption is doubled initially and then repealed in six years.

So overall, the projections that we've gotten from many different sources, JCT, from the Tax Policy Center, from others, from the Penn Wharton Budget Model from Kent Smetters, we can talk about that in more detail later. There's a revenue reduction of about 1.5 trillion dollars in the first ten years. Most households receive a tax cut initially, although changes over time due to the various sunsets, phase-ins, and chained CPI mean that there's both a reduction in the fraction of households that receive tax cuts, as well as some shift in the location of tax cuts from poorer or middle-class households to the rich. **[**04:00**]** The second decade revenue losses appear roughly similar in size to that in the first decade so it's going to be slightly smaller as a fraction of GDP.

Now the Senate bill, which we are even more real-time on here, looks broadly similar from 30,000 feet, although there are some important differences in the details. For instance, they have entirely repealed state and local income and property tax deduction. They dealt with pass-through businesses in a slightly different way using a deduction as opposed to a rate cap. And the international provisions again are similar, but they are implemented in a slightly different way. One of the more important overall differences is that the Senate bill appears to have much less upfront tax cuts than the House bill so that the bill provides both larger overall tax cuts and larger tax cuts on the individual side in the tenth year. So it seems like going forward it might be significantly more expensive in the second decade. **[**05:00**]**

So to give you a sense of how we are going to go about this this morning. I'm going to give all of our panelists a chance to just say something upfront and general about the tax provisions in the various bills. We're then going to discuss a number of different elements of the different tax proposals and talk about the economics of those options. Then we are going to have questions from the audience at the end. You all will notice an index card that should have been on your seat. If you would like to ask a question please write your question on the card and then pass it into the middle. We are going to collect them at various points during the session and then we can work them into the discussion as we go.

So with that let me introduce our panel and give them the opportunity to open. So working from your left to right, but not by political affiliation -- first, we have Alan Auerbach who is the Robert D. Burch Professor of Economics and Law **[**06:00**]** at UC Berkeley. He's affiliated with NBER as well, and I think importantly for this panel, you see, I think all of our panelists have significant and important government experience, which they can combine with their academic expertise for this panel. So, Alan was the Deputy Chief of Staff of the Joint Committee [on Taxation] in 1992.

Jason Furman is Professor of Practice at Harvard Kennedy School also the Nonresident Fellow of the Peterson Institute. He was the CEA Chair most recently, from 2013 to 2017. Jason, were you an 8-year reunion fellow in the Obama administration? Alright. So, NEC before then.

Glenn Hubbard is the Russell L. Carson Professor of Economics and Finance at Columbia Business School, as well as being the Dean of Columbia Business School. He too was Chairman of the Council of Economic Advisers from 2001 to 2003 -- the beginning of the George W. Bush administration. And he was DAS for Tax Administration at Treasury at the end of the first **[**07:00**]** Bush administration. He's also affiliated with NBER.

Then at the end, Kent Smetters is the Boettner Chair at Wharton, who is also the Director of the Penn Wharton Budget Model. He too was the Deputy Assistant Secretary of Treasury of Economic Policy at the beginning of the George W. Bush administration and is affiliated with NBER.

So with that, let me just ask you all to go down the line and offer a few brief overview thoughts before we dig into the details.

Alan...

Alan Auerbach: **[**07:28**]** Thanks very much John. Nice to be here for the NTA's annual panel on tax reform. [laughter] Although this time we really mean it.

I'm certainly critical of a lot of things that are in the House and Senate tax bills. But let me just say, stepping back from that criticism, there are a lot of good things **[**08:00**]** in these bills, at least in the approaches being taken.

If I were asked to design a tax reform, there are a lot of things that I would put in that I see here. I've always thought the Alternative Minimum Tax is not a good provision, and there are many other things that make sense, conditional on doing other things.

I think cutting back on some tax expenditures makes a lot of sense. We've gone too far in using them. I think encouraging investment by moving to investment expensing and helping to pay for it by cutting back interest deductibility is a step in the right direction, because it reduces the financial distortions at the business level, while maintaining an incentive to invest.

And I think, at least if you're going to go the way that they go in terms of trying to **[**09:00**]** protect the existing system of corporate taxation based on residence and location, which, of course, is not the way I would go -- as you know from last year's panel -- [laughter] then they do have some -- some, not all -- sensible foreign base erosion provisions. That is, they are approaches that have been proposed by experts in the past, some that other countries have adopted. And they show some thinking of what needs to be done to protect a tax system, conditional on using an out-moded system.

More generally, relying less on business taxation, more on individual taxation in a world where multinationals are more important as a source of business income, is certainly defensible if you think about the relative mobility of **[**10:00**]** businesses and individuals. So I think overall that that approach makes some sense.

Now, of course, this is happening in bills that by design lose huge amounts of revenue in a 10-year budget window, probably lots more outside the budget window if one ignores phase-outs and other kinds of tricks that we don't really think would be part of a long-run tax system. Moreover, the bills try to limit the revenue loss within the budget window using provisions that don't make a lot of sense.

For example, eliminating net operating loss carrybacks to increase the asymmetry in the treatment of risky business income is moving in the wrong direction and indeed moving in the direction opposite to what **[**11:00**]** the House blueprint from a year and a half ago would have done, which would have been to pay interest on net operating loss carryforwards.

And more generally, phasing in elimination of tax expenditures, such as eliminating the deduction of state and local taxes, would have made a lot more sense than adopting such provisions in year one.

As an illustration of what we might do, in 1986 the Tax Reform Act, in eliminating the deduction for non-mortgage consumer interest, did it over a period of five years. You can certainly do that. You can do it over a longer period. It would make more sense, particularly where you're affecting the real estate market, where you can have significant effects on asset values, to phase the provision in rather than doing it immediately.

Of course, there's a revenue loss within the 10-year budget window associated with such responsible approaches **[**12:00**]** to eliminating tax expenditures. And so that sort of responsibility goes away if you're desperate for revenue and aren't taking a coherent approach to trying to maintain revenue. Again, contrary to what was done in 1986.

John: **[**12:17**]** Thank you, Alan.

Jason...

Jason Furman: **[**12:19**]** Great. Thanks so much for having me here. I agree with Alan about a lot that is thoughtful in both the House and the Senate bill. I actually was impressed with how many of the tough choices the House was actually able to hold onto over the course of their mark-up. But I would also emphasize what the bill as a whole, both of the bills, do.

I wanted to make three broad points. One is, if we want to reform our tax code, an absolutely essential part of that has to be having more stability and predictability in the tax code. And this fails that in three **[**13:00**]** important respects.

One, as drafted, key provisions would sunset after five years. And then, to get through the Senate, more of it will have to sunset after ten years. So that guarantees that we will have a set of fiscal cliffs every five or ten years. So this tax reform discussion about the Trump tax reform, the Ryan tax reform, whatever you want to call it, isn't just going to be on this panel today; we are going to be discussing the exact same tax reform every year for the next decade.

The second respect, in terms of stability, is the debt under this bill is projected to be nearly 100% of GDP by the end of the decade. That makes it likely that there will be further fiscal action, and I suspect that fiscal action would be on both the spending side and the tax side, and more of it will be needed as a result of passing this today.

Third, there's the **[**14:00**]** process, and I want to go out on a limb and make three predictions. One is, if this passes, it will be known to history as the Trump tax cuts. Number two, at some point in the future, Democrats will be in charge of something. [laughter] And number three, when that happens, Democrats won't feel any more warmly about Donald Trump than they do today.

The combination of all of those says that a rushed, highly partisan process is unlikely to create the type of consensus and buy-in that would make this last. So, even if this passed tomorrow, this would not be the last word on tax reform over the next decade, we'll be revisiting this issue constantly.

The second set of points I wanted to make is about how to assess a tax reform, this one or any. And the way I think about it is you can look at the direct effects of the tax cut, and then also look at the indirect effects.

The direct is what was sort of **[**15:00**]** naive class warfare-ish type of Democrats do when they say -- "Look at this person getting a tax increase; look at that person getting a tax increase; look at the static distribution table; millionaires are getting this; the middle-class are getting that; people without children get nothing."

And I have a lot of sympathy, just to be clear, with the naive Democratic class warfare approach thinking about these tax bills. There's then and by that score, the tax bill in the House pretty amazing with a 1.5 trillion dollar tax cut that you managed to raise individual income taxes on over 60 million households by the year ten with a net tax increase in year ten leaving out everyone at the bottom.

Then there's the more sophisticated, indirect -- "I have a really complicated computer model that has 80 different countries and a million different equations and does all this different stuff, and at the end of that you get a $4,000 to $9,000 wage increase." **[**16:00**]** And that sort of sounds like you care about growth and care about the economy, and I care about growth and care about the economy. That's why I've done some economic advising.

But when you're doing indirect, you need to do two things. You need to do -- what's the incidence of the corporate tax which might lead to additional capital, additional wages. You also need to do the incidence of the deficit, and look what that does to capital formation, what that does to wages, what that does to what people are doing. And to say -- "I have this wonderful model of lump-sum taxation that shows all of this extra growth", and then ignore that lump-sum taxation when you're talking about the impact that the plan actually has on people -- is internally inconsistent.

My reading of a range of models when you look at both the incidence of and the effect on capital formation of the corporate tax cut and the effect of the increase in the deficit, the net effect of those is relatively small, macro-economically, so it's not crazy to ignore it. If you look at it, it's just as likely to be negative as **[**17:00**]** positive. And then if you do the financing part of it, not the overall macro part, it's almost very likely to be overwhelmingly negative when you have to have the eventual tax increases to pay for it.

The last thing that I wanted to just say is -- this comes through evaluating all these plans -- is the reason we have the tax system is to raise revenue. And a lot of the discussions we have seem to forget that. So they look at a plan and say -- 20% rate is pro-growth -- and then you put it in the model, turns out a 0% rate is even more pro-growth than a 20% rate. Or -- such-and-such tax credit is good for the middle class -- well it turns out if you did an even bigger tax credit, it would be even better for the middle class.

And if your modeling has the feature that a 0% corporate tax rate is better for growth than a 20% rate, or cutting everyone's tax rates to zero is better **[**18:00**]** for them than having the tax rates in the bill, your model is probably missing something that's of first-order importance of thinking about the tax system. And an awful lot of the models and an awful lot of the discussions out there have that feature. Talking about one part of it without talking about the other, which is the need to raise revenue and the impact that not raising revenue has on, for example, dramatically higher taxes in the future, lower spending, and the cost of the deficit in the interim.

John: **[**18:34**]** Thank you.

Glenn...

Glenn Hubbard: **[**18:37**]** Well it's always a pleasure to be in a room full of people who want to gather and talk about tax reform, which is an annual event. I know lately economists talking about tax reform have sounded with real-time commentary like it's the fast-moving basketball of the NBA. I think we're actually more effective when we are like the slow-moving Golf Channel, if we do it right. I love these Golf Channel meetings and I think they're important.

The way I think about tax reform as the perennial subject when an actual proposal comes on the table, **[**19:00**]** is to think like the game show Jeopardy -- if that tax reform is the answer, what was the question, and try to guess it. [laughter]

There are three choices here and I think the grade depends on the choice you make. So obviously, business tax reform, if "what is a reform of business taxation?" were the question, there are a lot of good things here. I agree with a lot of what's been said before: I'll just add a few things.

The second question, one that politicians talked a lot about, in the tax reform, on both sides, is a middle-income tax cut. There I think it's kind of a middling answer; it's not really clear to me how well different individuals do in particular brackets. And where I think there's largely a bust is if the question were "What is incentives for work?" That topic came up during the past election in a very large way, is essentially absent from this tax bill.

Since the big 1986 reform, I think a lot of us have **[**20:00**]** learned different things about how the economy works. The much greater focus today on corporate taxation I think reflects a learning about the greater responsiveness of the locations of an investment in corporate capital around the world.

The second is an increasing body of work changing views on the incidence of the corporation income tax. When I was a student many years ago, we were taught that the burden of the corporate tax was borne by owners of all capital. I think that's not the mainstream view anymore. My own work, among others, suggests a lot of the burden of the corporate tax is borne by labor; it's not hard to write down a simple textbook model where more than 100% is borne by labor.

And then finally the importance of non-corporate business has risen in thinking about tax policy.

Three pathways for tax reform -- one is obviously the classic "broaden the base, lower the rates", and there are two ways of doing that. One would be what I would call the high road, something like uniform business **[**21:00**]** taxation — as for example with the Treasury and ALI proposals from a generation ago. A lower road is what we're talking about now which is a menu approach -- I'm going to cut something, and then I'm going to reach into a bag of revenue raises to try to pay for it.

A second route, which I think is attractive but isn't coming up is some sort of shareholder allocation that dramatically reduces or perhaps even eliminates the corporation income tax, but allocating income to shareholders.

And a third approach would be a realization that it is difficult to accomplish meaningful tax reform without a new tax.

Of course, the original House Better Way Plan did that, it was essentially Alan's handiwork in a destination-based cash flow tax, which had border adjustments. Under many conditions, such border adjustments are not present value revenue-raisers, but are revenue-raisers within the window Congress considers.

A second would be to use a consumption tax to pay for income tax rate reductions.

What I like about the present plan is the business tax piece. **[**22:00**]** I think reducing the corporate rate to 20% and moving to a territorial tax system makes a lot of sense, and I agree with what Alan had said about the Alternative Minimum Tax, which to me serves no real tax policy function, and cutting back on some of the tax expenditures. I am less enamored about the pass-through pieces. There's simpler ways of treating pass-throughs. The Senate bill is a little bit simpler, but still I think we'll have to see what comes out of conference.

I think there will be a lot of discussion, not just about economic growth, but on the consequences of tax reform for workers' wages. There's a big range of estimates of those effects. Some of the larger estimates make little sense, but some of the mid-size estimates make a great deal of sense to me.

In terms of effects on GDP, we'd have to see obviously what's in the final bill. But the CEA did an estimate of a 20% rate cut with temporary expensing **[**23:00**]** for five years producing a long-run GDP gain of just under 3%. So I think that becomes a marker about which economists can disagree on either side.

On corporate taxes versus investment incentives, I think it makes a lot of sense to do both. We know that there're some discrete choice margins that the corporate rate affects, so it's not simply about getting a zero tax on a marginal investment project, which is what expensing and corporate taxes do, but increasingly, we're a world of imperfect competition and international location decisions. **[**24:00**]**

While the tax bill being debated has many positive attributes, there is room for improvement. Again, I think the treatment pass-through business could have been done much simpler. Reform of the estate tax could have centered on a shift to a carry-over-basis regime.

Finally, returning to the longer-term point I raised earlier, I don't think we can continue to have these sessions, as fun as they are, without the discussion — and not in too many years — of some new tax if we're going to continue to talk about tax reform. Unless, of course, we want to shrink the size of government — a good outcome from my perspective — but the body politic may not share that view.

John: **[**24:24**]** Thank you.

Kent...

Kent Smetters: **[**24:26**]** I also agree there are certainly some positives in the plan. That's what we say before we shoot it down. [laughter]

But let's start with a plan that I think most of us, at least one standard deviation from the left and the right, would say had a lot more agreement amongst economists, which was Alan's Better Way or Blueprint plan in 2016. Specifically, I think there would be a lot more agreement amongst economists **[**25:00**]** of a focus on expensing, paying for a lot of that by removing interest deductibility, and having a destination tax. The plan also allowed for some income shifting from C corporations to pass-throughs as well as a lot less of an arbitrage. It wasn't perfect in many ways; it had some revenue losses that were not really necessary for growth. But nonetheless, I think that was a pretty solid plan. It even got some of the tax loss offsets right, as Alan pointed out.

I think the real debate, putting distributional issues aside, is where does growth really come from? How do you get the most growth from a good tax design?

And I still believe that expensing is still the most effective way of increasing growth, since it focuses your deficit dollars on new investment without rewarding existing investment.

There are some common arguments for pouring rate cuts on top **[**26:00**]** of expensing. Some say expensing may be great for physical capital but not for intangibles. That's not quite right. Intangibles are part of CAPEX, so they could be part of expensing. A lot of other intangibles, for example brand equity, are already part of OPEX, so they effectively are already being written off every single year.

I think the biggest argument for rate cuts on top of expensing -- and by the way this is why these plans that have temporary expensing I don't think have a lot of juice, especially given that they're not being paid for with interest deductibility -- but a lot of their arguments for rate cuts are on the international side. However, I would argue that if you get the international side right -- not territorial but destination -- you are going to have less emphasis on rates in that world and more emphasis still on expensing.

But what I think the big question is, and it's unresolved in my opinion, **[**27:00**]** is how do you think about rents in these models?

Most models are Cobb-Douglas production, so we don't worry about rents, but in the real world there are rents. Are these rents because of market power, such as the network effect we see with Facebook, Google and so forth? Those rents we do want to tax, because those are efficient to tax. Or are they rewards for risk-taking? In which case, we actually want to give away those rents.

I can easily write down a model where if there's a fixed cost for an entrepreneur to invest, you need really big, good giveaways for those entrepreneurs in order for them to take on risk with relative probability distributions, since those loss-offsets don't really apply to entrepreneurs as easily as they do to corporations. That's a big unknown in economics right now and I think we need to spend more time thinking about this.

I'm very sympathetic to the debt issue, because I work at the Penn Wharton Budget Model and **[**28:00**]** our dynamic effects are really muted by debt effects. But besides the debt issue, I'd like to focus on why I think the real Achilles heel in these plans is the pass-through structure. There are going to be huge opportunities for income reclassification both from W-2 to pass-through and from active to passive. There are many examples that you can come up with. Dentists and doctors are going to become two companies. One that owns the capital, the other the service provider that then rents the capital at some kind of transfer price. Similarly, lawyers are going to have one company to own their buildings and another to provide services. Salesmen will have two companies. One that owns the car and so forth. And the other one a service company.

Our static estimate at the Penn Wharton Budget Model is about 300 billion dollars more than JCT's **[**29:00**]** static estimate. A large part of it is that Richard Prisinzano works with us and he was the pass-through guy at OTA for many years. He presented his stuff here yesterday.

We think the guardrails on pass-throughs are extremely weak, and in my opinion they can't be made stronger. What are you going to do about these types of entity structures? It's not just about 10,000 new IRS agents to micromanage this. These new entities would be perfectly legal, unless you're really going to say – OK, doctors, you really can't have a separate company that owns the machines – but how are you actually going to rationalize that?

So I think it's the pass-throughs beyond the debt issue that are an issue. If anything we're probably even underestimating the revenue losses.

John: **[**29:48**]** Great. So I think we've touched on a lot of different issues, and I wanted to take the opportunity to dive into some of them in more detail.

Kent, you have a lot of the low-hanging fruit on the comments of the tax reform picked off by the beginning panel, so I wanted to start with you. You spent an enormous amount of time thinking about the elements of these dynamic models and how deficit increases, investment incentives, and other aspects of these reform proposals play into these long-run growth projections.

Can you give us a sense of kind of exactly what is driving a lot of the divergence you see between some of the different models in terms of, on the one hand, some projecting growth effects as large as say 5% and others projecting negative growth effects.

Kent: **[**30:33**]** I'll pick a little bit on both sides, because I think both sides of the debate are playing a bit with numbers. For those who are opposed to this tax reform, it's on the distributional side, and for those on the pro, it's the macro effects.

I'll come back to the question in just a second, but on the distributional side -- we just released a study yesterday that shows the traditional view of distributional impact, which essentially shows that a lot of this tax cut goes to the rich. **[**31:00**]**

But I think another way of looking at it is to look at tax sharers, which doesn't just focus on the deltas but actually looks at the levels. I think that's another way of looking at it.

I would like to see those on the left look at both of those measures. In fact, because of both real bracket creep and lots of other things, tax sharers by the top 1% are actually going up under the current law system. So even after this tax plan has passed, the tax share will basically come back to about what it is today for the top 1%.

I think both measures are legitimate, but I will first start by bashing that side, and say -- let's look at both of those measures.

Now on the proponents -- let's think about the macro effects.

There are multiple levers in these models that you can play with that really can dial up and down the macro effects. There are three in particular.

The first one is **[**32:00**]** at what rate of return are you applying the corporate tax rate or the effective tax rate in capital to? Is it something like the S&P 500 average return, which means that a very large return is being taxed? Or is it to something like the bond yield?

These macro models have a computational issue known as the curse of dimensionality, which means that though at least our model has uncertainty on the household side, it's a single rate of return on the production side. Because of this, factor prices are still perfectly predictable. We're working on that problem as a moonshot project on the side.

So the question is, what real world interest rate are you targeting? Is it the S&P 500? Or is it the bond yield? We at the Penn Wharton Budget Model present it both ways, but I think the most persuasive is the lower bond return.

In particular, at least with corporations, we really think the tax and the equity premium portion is more [33:00] of a risk-sharing with government through loss offsets. Domar and Musgrave in the 1940's taught us that.

The loss offsets system is not perfect. You don't get to carry-forward those losses with interest. But the House blueprint, Alan's Plan, did that. They even got that part right.

But nonetheless, we think it's most legitimate to think of the lower return, which creates a very different effect. If you start with a high return, it's a much bigger distortion than when you ignore the loss offsets.

The second lever is you can ignore the debt effects. In particular, if you have neoclassical, Ricardian, 1928 model, your model has no debt effects. In particular, it's an infinite horizon person, so the person infinitely lives, borrowing against himself. There are no debt effects, only pure marginal distortions effects.

If you have an OLG model and you have lump-sum taxes [34:00] in the background, which make everything revenue-balanced, there are no debt effects. But are we really modeling Margaret Thatcher style lump-sum taxes here?

Or if you have a small open economy model there are really no debt effects, because you're selling your country off to foreigners at that point. In that case, it's even faster than the Ricardian model, because this money comes zooming in instantly and crushes all the debt effects.

And then the third lever is how you characterize the initial tax rate and the change in that tax rate. Are you starting with the really high tax rate, because you're not doing a lot of adjustments, or are you starting with a lower effective tax rate?

So when you apply those different mechanisms, you are able to really juice up or down the results.

Next week, we'll release a brief that basically shows these different levers and how you can get different "oomphs" from the macroeconomy.

[35:00] We show it multiple ways. You can go in our model, design your own tax cut and run the simulator, so you can make these choices. But we think the most legitimate way is the lower risk return being taxed including the debt effects.

How we're doing it is, if anything, being generous. We assume by 2040, government gets its act together and finally deals with the exploding debt. We know if magic doesn't happen at some point, the whole thing backward-inducts and doesn't even solve to begin with.

So if anything, we're being generous with these deficit financed taxes.

By the way, we're assuming the government downsizes the scale and does not pay for it with tax increases. That choice matters a lot, too. But even under the assumption that governments waste, and we're getting rid of just that government waste in 2040, the debt effects still play a huge role. By 2040, under our **[**36:00**]** preferred settings, the economy with these tax cuts is actually smaller than on our baseline, because of the big debt effects.

John: **[**36:10**]** Jason, you look like you want to jump in?

Jason: **[**36:14**]** Let me just jump in on one. Because Kent bashed me, I'll...

Kent: **[**36:17**]** I bashed you?

[chatter]

Jason: **[**36:21**]** There's a reason I think that we have primarily shifted to looking at changes and after-tax income, because that tells you the changes in the well-being at different levels of the income distribution.

When you look at the shares, that can be especially even more problematic when you don't factor in the financing. We don't know how to factor in the financing, because we don't know how it will be financed.

That being said, even looking at the shares, if you look at the JCT tables for households above a million dollars a year, they get the 32% of the tax cut in the House Bill in the last year. They currently pay 19% of taxes, so they're paying a smaller share of taxes after than before. **[**37:00**]** And remember JCT tables doesn't include the estate tax. And in the Penn Wharton Budget Model, you showed three scenarios. Even for the scenario with 75% of the corporate tax being born by labor and 25% being born by capital. You have the top 1% share of taxes going down after the reform at every horizon.

Now, the top 5% moves the other way, because the state and local are hitting those people. But no matter how you are slicing this. Shares, percent change in after-tax income, or maybe even let's be crazy, and look at how many dollars different people are getting -- it turns out to very hyper-aggressive if you look at the top 1 versus the bottom 99.

The other thing I'd say though is these discussions on tax reform always depress me, because I agreed, I think, with every single word that Glenn said. And...

Glenn: **[**37:56**]** So there's learning.

[laughter]

Jason: **[**38:00**]** Expensing and rates, eliminating interest deductibility. A new source of revenue, in an ideal world, pushing this down to the individual level rather than at the corporate level.

So if we had to come up with a tax deal on this panel or in this room, I think we would have no problem coming up with one, and I suspect it wouldn't be one that ended the ability to expense

R&D, dramatically reduced NOLs, created a new pass-through loophole, maintained the deductibility of interest, had temporary expensing, and added the 1.5 trillion to the deficit.

So it's all depressing to me.

John: **[**38:38**]** So I think that if there's one thing that I take away from the panel so far is that we will all be better when we declare that Alan is tax dictator. [laughter] So short of that world, I wanted to ask about the international side.

You've seen both the House and the Senate bill which have relatively similar, although importantly different approaches. Both of those approaches are unfortunately not a destination-based cash flow tax.

So I wanted to ask -- do we think what we've got in these proposals on the international side, broadly including things that might be added or subtracted, is going to land us in a place that's a significant improvement in terms of the taxation of international business?

Alan: **[**39:25**]** So, first of all, I should issue a disclaimer that I'm talking about particular versions of the House and Senate bills, because their versions are multiplying quite rapidly, at least on the House side.

To me, what the House bill and the Senate bill have both revealed is what you need to do if you're trying to maintain **[**40:00**]** the existing approach to taxing corporate income that the US follows, which is some mixture of residence-based and source-based corporate tax.

Just to review what those main provisions were in the House Bill, they were, obviously, a cut in the corporate tax rate, which we know lessens all distortions associated with corporate tax, and as Jason pointed out, zero is better than 20% in that regard.

Second, a tax on offshore income above some normal rate of return of US resident companies as a way of preventing income-shifting by US-resident companies. Of course, the problem with that approach is it only applies to US-resident companies, and so as with a worldwide system in general, the more you tighten worldwide provisions, the more you reduce income **[**41:00**]** shifting and the more you worsen the distinction between US resident and US non-resident companies.

Then there was the worldwide interest allocation which basically said you couldn't deduct a lot more interest in the US relative to your assets or income than you could in other countries. And that's a provision in both bills.

All three of those things are in the House and Senate bills. The Senate bill also has a tax on high offshore income of US-resident companies.

And then, there's the final thing, which has gotten the most attention and which the House and, I think, the Senate have some version of. As far as I can read the Senate bill -- one way of interpreting the way it's been written is as an attempt by **[**42:00**]** lawyers to continue to impose barriers to entry to economists, [laughter] to make sure that they have an important role in the tax policy reform process; and they've been very successful -- as I read the provision, and I may very well be corrected by someone here, the Senate bill has a provision related to that of the House bill.

The House bill had an excise tax on related party imports, which might sound to you like border adjustment, because it is at the same rate as the corporate tax rate. Of course, it would be much more limited than the border adjustment because it only applied to related party imports not all imports, didn't apply to exports at all, and could be avoided by opting instead to declare the income underlying those imports as US income.

So for example if BMW **[**43:00**]** US is importing parts from BMW Germany, it would either pay a 20% excise tax, that is not deduct the import of parts from Germany, or it would say -- well, we know we're a German company and we're making this stuff in Germany and we're already paying tax to Germany on the profits of Germany. But we'll declare it as US income as well, and let the US tax it, and not give a foreign tax credit to Germany.

That was how the original House provision was written. That might seem like a strange provision; it seemed that way to a lot of businesses.

My interpretation of it is, if you learn the lessons of what border adjustments can do for you, but you don't want to adopt a border adjustment, this is what you might try instead, thinking you might be able to sneak it through without anybody really noticing. **[**44:00**]** Well, that didn't work.

Also just another point, it doesn't deal at all with profit shifting on the export side; it's a lot harder to do that. Because you can say -- well, I'm going to deny BMW the US import cost. It's not exactly clear what you do on the export side unless you want to adopt a border adjustment.

The Senate bill, instead of an excise tax, has a minimum tax. So, the Senate giveth and taketh away. They're repealing the minimum tax but then they're putting this new minimum tax in. This minimum tax says that you've got to pay a tax instead of 20% on your income, 10% on your, some other acronym income, and the 10% percent is applied to income calculated ignoring related party imports. **[**45:00**]** So that sounds a lot like denying a deduction or imposing an excise tax on imports, at least under this alternative tax.

And that was just the Senate bill as described by the JCT in something released yesterday. So I'm sure by now it's been completely rewritten. [laughter] And so this is just a history of thought, [laughter] not actually describing anything going forward.

But I think the fact that the Senate and House bills have these provisions: corporate rate cut, tax on offshore income of resident companies, limits on differential rates of interest deductions in the US and abroad, and some tax on related-party imports -- suggests that that is what you need to do if you're trying to preserve the existing system.

Now, **[**46:00**]** one lesson you might take from that is that that seems to be what you need to do. Another is -- If this is what you need to do, you're probably going in the wrong direction.

And, of course, I came to the second conclusion several years ago, and so I'm simply reinforced in my belief that this is not a stable approach. It may be the approach that we take this year if we pass the tax bill. But I think that won't be the end of it.

John: **[**46:31**]** So we have a couple of questions from the audience about a topic that a number of you brought up. And that's the treatment of pass-through businesses or the increasingly important form of business. I think latest count, more than 50% of business income accrued to non-corporate entities in the US.

And I think that there are two different aspects that these questions bring. So first of all -- on the income shifting side, is there anything to be done to, even apart from the special rate, to limit the extent to which there are shifting opportunities.

And then second, now that the corporate rate, if one of these reforms passes, will go down significantly, how should we think about pass-through businesses in that world, given that's much more similar to the type of effective tax rates that they seem to be actually paying in the world today?

So, Glenn, do you want to start that?

Glenn: **[**47:30**]** Yes.

On both of those, I think that income shifting is going to be a problem. The simple way to get at it, of course, was rejected partly for revenue reasons and largely for politics. A simpler answer would have been to lower the top rate. The complicated proposal giving some rate in the 30s for a top-rate pass-through business, so one could just lower the top rate and then mitigate the income shifting problem.

But, unfortunately, politics made that outcome difficult. Policymakers can **[**48:00**]** try to say -- I'm eliminating this profession or that profession, but it's not too hard to ‘self-help’ in almost any profession; Kent gave some examples. I've certainly been thinking about it for myself on how to re-characterize income!

On the corporate side, as I mentioned, I don't think a lot of pass-throughs are going to run to be a corporation. There are still dividend and capital gains taxes to be paid. So it's not obvious to me that there's a huge gain for them of being a corporation. If that were the truth, they would have already been racing for corporate solutions. These businesses simply wanted a rate cut, which of course, we all do. But I don't think that turning into a corporation is going to make that many of them better off.

Jason: **[**48:43**]** So. One -- I just can't help myself but read Dan Shapiro, who had the best line on all of this of anyone, saying -- "It's unmotivated, industrial policy that sacrifices efficiency, simplicity, revenue, and progressivity in exchange for I can't see what." [laughter]

But I think a proposal that we should be thinking about and looking at and taking seriously was President Bush's tax reform commission which had all larger businesses. And I think they drew the cut off quite low. My memory is 20 million dollars in gross revenue, but I could be off.

-- Oh, there's Jim Poterba maybe he remembers.

And just said they, all large businesses had to file as C Corps, and then they'd all get a lower rate. And as Glenn said, they'd all get the capital gains and dividends as well and they'd get the exactly same treatment as C Corps. So I think bringing something like that back...

We also had proposed in the Obama Administration a surtax on pass-throughs, that was so unpopular that even we withdrew that idea. [laughter] So -- I got some sense of power of these groups.

John: **[**49:40**]** I remember that unfortunate meeting when that went down.

Jason: **[**49:45**]** Which side was I on? I can't remember.

John: **[**49:47**]** I can't remember, either. But that is not a popular idea, even in the room.

To what extent do we think that adding... Just take a step back from the accounting issues; to what extent do we think that actually providing lower tax rates on small businesses, these types of businesses, is good from a perspective of entrepreneurship and growth, the types of issues that Kent touched upon where you don't want to be taxing the rents that accrue as a result of risk-taking entrepreneurs, or to what extent is this just entirely driven by the political situation with the relative, broad-based support for small business.

Jason: **[**50:26**]** You have to take a risk if you go to school or undertake training to get a salaried job in a corporation, too. There's a... Royalties are taken... I guess that's falls under this... There's a lot of different risks we take. This doesn't seem like some optimal economic version of figuring out where the rents are of one type and another. It's 100% politics, I've never seen anyone...

Glenn: **[**50:50**]** I don't know if it's 100%, but it is largely politics, because if one is interested in entrepreneurship from a policy perspective, it's really the shape of the tax schedule that matters. The focus would be loss-offsets, thinking about whether you want a relatively flat or progressive tax system. Those would be the margins if entrepreneurship is the factor driving the discussion.

John: **[**51:08**]** Yeah I was going to actually follow up with you to close it to flip the question around. Suppose that we did want to try to provide some type of net subsidy relevant to the current code for entrepreneurs, would you be thinking about those questions about the R&D tax credit? Would you be thinking about some enhanced version of that? Would we be thinking about some kind of more extending the equity / premium risk-sharing from larger businesses to smaller businesses? How would you go about that?

Glenn: **[**51:33**]** Part of this discussion requires one to clarify what one means by entrepreneurship? So sometimes entrepreneurship is a word that people are really talking about small businesses. And a lot of small businesses are wonderful businesses, but I'm not sure they're entrepreneurship in the classic sense of some person taking some bold risk. If it's that sort of business in which policymakers are interested — the bold risk-taker — then it's more about loss offsets in the shape of tax schedule.

Alan: **[**52:00**]** You can have a tax credit for skydiving.

Glenn: **[**52:02**]** Yes. Something like that. It's called the R&D credit. Yes.

Jason: **[**52:07**]** We also have a capital gains rate that is lower and a lot of your income ultimately comes in that form... [unintelligible].

Kent: **[**52:14**]** But one thing that makes an entrepreneurship a little bit different is the loss offsets. The question is, can they really repack? Suppose you drain your brokerage account, your savings account, and you bet it all on the startup that is likely going to fail. There's so much optimism, but most likely it's going to fail. For the rest of your lifetime, can you capture those loss offsets against your future gains? Are they really going to be that valuable?

A corporation could easily repackage those loss offsets and sell it. Possibly an entrepreneur could repack now that they did 83(b) election, but it’s much harder to do it. Where entrepreneurs really have the potential advantage, the subsidy in the tax schedule, is through 83(b) election. You buy your restricted stock at low par and you get capital gain's treatment, provided you **[**53:00**]** hold it one year.

I think that's the nice juice of a subsidy for entrepreneurs. I think if you get rid of that, you're going to have a big problem.

Keep in mind, entrepreneurship is a big fixed cost to start with. You really do need big payoffs in some cases-- and this is where I push back on the liberals a bit. It's not like going to college. You're working crazy hours, draining your bank account since most are not VC-funded, and you are probably going to lose.

You can easily write down a model with fixed costs and imperfect loss offsets that you need really big payoffs for people to take risk.

And, by the way, if you get away from expected utility and go to the behavioral stuff, I think that it’s even more the case.

Suppose the United States passed a law. "No more billionaires." You just simply said no more billionaires. The **[**54:00**]** typical expected utility approach would be that once you get beyond a couple hundred thousand bucks, it's all the same, even with log utility and low risk-aversion

If you pass a law, "no more billionaires," you're going to see a lot of entrepreneurship start drying up, because a lot of people really think "I'm going to be that dude." We have the Forbes 400; we don't have the Forbes 400,000 list of losers -- [laughter] -- that are getting all the attention.

Glenn: **[**54:28**]** You're bringing tears to my eyes. [laughter]

John: **[**54:35**]** So another aspect of this proposal that you all talked about a little bit in your opening is the choice between, or in this case the combination of, lower corporate rates and expensing.

So obviously these bills have both, although it's somewhat more weighted towards the rate side given the only temporary extension of full expensing.

So Glenn I wanted to ask you; you've done a lot of work in this area, how should we think about those trade offs, those policies independently? You commented that you thought those policies work best together. Could you elaborate on that?

Glenn: **[**55:14**]** Yes. I think the way one would approach this is to think about a cash flow tax. So, one would have expensing -- permanent expensing -- but would deny an interest deduction. We have this hybrid system here; there's some loss of the interest deduction. I agree with Alan; it's going in the right direction. But the expensing is only for five years. And most of the economic arguments would be much stronger for permanent expensing.

We would benefit from the cash flow tax structure, both for revenue -- which is the way people talk about it in Washington -- but, more to the point, efficiency. If one kept interest deduction and expensing, there would be too much stimulus for investment.

On the corporate rate, I still think there's an argument for a lower corporate rate. With the competition for international corporate capital with two kinds of **[**56:00**]** location decisions, one is a real one where you put something about location of physical assets, but the other much more elastic one is where you locate profits and that is highly sensitive to the corporate rate.

So I think it is not a surprise that many countries have decided to fund the government with some other form of taxation and most of our trading partners' consumption taxation fund lower marginal corporate tax rates.

In the United States, this bill is trying to do just that, but is running up against a key question: what we were all talking about. In doing that, how do we pay for it?

Kent: **[**56:37**]** But Glenn, would you agree that if we didn't move to territorial, we moved to something like destination, then things would be different than that? Your emphasis on rates.

Glenn: **[**56:47**]** Yes.

Kent: **[**56:47**]** Yes, OK, alright.

Jason: **[**56:49**]** In this bill, once you have interest deductible, going from a 28% rate let's say to a 20% rate, means you're raising the marginal tax rate on debt finance investments so that has a cost. You're lowering it on average investment which has a benefit in terms of location decisions; I agree with Glenn. So I think you want to think about all of that together.

The second thing is, in so far as average tax rates matter for location decisions, there's two things you can do to get more companies to locate in the United States. One is to lower the average tax rate in the United States, the other is to raise the average tax rate overseas. So how you tax the income on overseas subsidiaries, the conventional argument of -- you're deciding where to locate; do you locate here or there based on tax reasons -- start to have to take that more seriously if you're thinking the average tax rates matter.

Alan: **[**57:44**]** Two things on that. First of all, in relation to Jason's last point, that works for US companies, but then it doesn't apply at all to non-US companies. And so that raises the standard tension between making it look better for the US companies and facing US companies with --

Jason: **[**58:03**]** Just to be clear, I wasn't saying that meant you need to have the same tax rate overseas as here. I was just saying you would want to take into account average tax rates per the location of the [inaudible].

Alan: **[**58:12**]** Right. But the point is, you're lessening one distortion and you're worsening another. And obviously, there might be an interior solution. Just to point out, there is this cost of doing so.

The other thing that I wanted to point out is -- Glenn talked about other countries raising Value-added Taxes. The point has been made many times; I'll just make it again.

If you moved in a direction of lowering business tax rates and corporate tax rates, raising value added taxes, offsetting the distributional consequences of raising value-added taxes by lowering employment taxes, like payroll taxes, that is an incremental version of a tax reform that is identical to adopting a destination-based cash flow tax.

Glenn: **[**58:52**]** I agree.

Alan: **[**58:53**]** And so, the fact that other countries have been moving in that direction suggests that that is a perhaps more stable outcome. And the US is sort of doing part of that -- we're lowering the corporate tax rate. But we don't have that new tax that Glenn mentioned which is the value-added tax.

Now, it could just be that this will all work out in the end. That this tax bill will undertake the first half of it, and then the next tax bill, which tries to clean up after the procession of elephants has walked by -- [laughter] -- will introduce the value-added tax, and so everything will work out in the end. It could be, and maybe not.

Glenn: **[**59:41**]** Are you suggesting that Congress finds it easier to deal with pleasure than pain? [laughter]

Alan: **[**59:46**]** Well, their pleasure anyway.

John: **[**59:49**]** Let me push on that, because I've actually gotten two questions from the audience that point in this direction.

So you all mentioned the need for new sources of revenue and one particular version of that would have been some kind of VAT-based system, whether implemented on the corporate side or on the consumer side from a sales tax perspective.

At what point had the parade of elephants passed? Or is this something that's just kind of forever going to be three years, five years, ten years in the future, but not doable at the moment?

Glenn: **[**60:27**]** Well, it can't be forever — perhaps three or five years in the future for the reasons that Kent mentioned. There's a choice at some point about the size of the state and how you pay for it. If the size of the state is on current path, then yes taxes will have to be raised to pay for that. Then the question is how. And I agree with Alan that some other countries seemed to have figured that out ahead of us.

So I think, certainly, within the next decade and arguably the next time there's a real thing for this audience to describe, in three to five years, we're going to have to have this **[**61:00**]** discussion.

It actually got teed up here I think in the BAT. Alan and I were speaking of this before. I think part of the problem was -- it wasn't clear that anybody knew how the election would actually turn out and that this would be a live discussion. To enact something like the BAT would have required a lot more socializing with the business community, with the American people, with even politicians themselves understanding what it was. And that didn't happen.

But there's still time to have these discussions, and using words that aren't the way we would necessarily do it. The true reason to want this has a lot more to do with tax policy, of course, than revenue, but both are part of the discussion.

Kent: **[**61:46**]** We at the Penn Wharton Budget Model do social security as well. We're more pessimistic than the official trustees; we think the trust fund's going to go under in about three years earlier than the trustees, 12 years from now, and the shortfalls are going to be a lot harder.

Given the commitment of both parties to do nothing about this big problem of $250 billion of shortfalls increasing over time, it's almost no question that this is going to be pushed into general revenue at this point. In my opinion, the idea of keeping social security as a separate system is just not going to sustain.

The question is: when we push it general revenue, how are we going to come up with that money? Because I don't think there's going to be the will to cut benefits except for higher income people. And I wouldn't be surprised if then the value-added tax plays a big role in trying to pay for social security and then Medicare.

Jason: **[**62:51**]** So I'd be in favor of just about any new revenue source that you wanted to have, and I certainly think we could more efficiently have a tax system with a BAT, with a VAT, with something like that.

I don't think we should lose sight, though, of the fact that -- if we had to keep something like our existing system, do something like the tweaks that are in the House and the Senate bill but adjusting them so they added up like a 28% rate instead of 20% rate, no pass through loophole, etc., (a) that that would be better than our current system, and (b) if we had to limp along with that for the next 50 years, instead of the new revenue source, that would be a bit worse, but that our current structure can actually accommodate the 18% to GDP we have now. It could accommodate the 21% to GDP that the Bowles-Simpson Fiscal Commission called for, and that my guess is if you did a social welfare analysis of new revenue sources, a carbon tax would be of far more first-order importance than all the little triangles we're all worried about closing with a VAT.

John: **[**64:03 **]** So most of this discussion has been focused on the business side, and I think that's rightfully where it should be, given all the economics on that side. I think we would be remiss to not address the individual side at all though. And I think just to kind of phrase the question in its most stark way -- do we think that there are, aside from the distributional aspects of what's going on, setting those aside -- do we think that there are really any interesting or first-order economic effects on the individual side? So with the elimination of the deduction of state and local taxes for instance or kind of a partial halfhearted swipe at the mortgages interest deduction -- do we think that there's anything that's first-order on the individual side from an economic perspective?

Glenn: **[**64:49**]** I don't know if it's a first-order issue, but I think those are definitely in the right direction. I happen to live in a very high-tax state. But I don't see why others should be subsidizing my state government's spending decisions, and me as a voter.

What I think was the biggest missed opportunity, is what I referred to at the beginning, is a lack of focus on work. I would've thought that some large expansion of the earned income tax credit for childless workers, or some other form of wage subsidy. If you're stepping back to, again, to the Jeopardy analogy, ask what were the questions that were being asked in the election, I think incentives for work were there. And that is just a huge missed opportunity.

Most of the changes on the individual side are small, but the hard part is going to be figuring out winners and losers; it's going to depend a lot about what state you're in, your home ownership tenure, and so on. It's going to be a fight. The only thing that I think is clear are the estate tax issues that I mentioned, and those seem oddly designed.

Alan: **[**65:50**]** Can I just say something -- it's worth keeping in mind on the issue of labor supply, something that people often forget, which is that when you cut back on tax **[**66:00**]** expenditures, you're raising the tax on labor supply, because tax expenditures are a component of consumption. That's not a reason not to cut them, because you're moving away from the distortion among consumption choices, which is a good thing. It's just that if you don't do anything to the marginal tax rate on labor income, then at the same time you cut back on tax expenditures, you're raising the disincentive to work. So you would actually need to cut the marginal labor income tax rate.

You could do that in a revenue-neutral way -- getting rid of deductions, lowering labor income taxes, a revenue-neutral efficiency gain, in terms of removing consumption distortions, but it's worth keeping that package in mind, rather than just looking at the marginal tax rate on labor income and treating that as the only thing that affects the labor-leisure choice.

The second thing -- on the issue of whether one can justify a deduction for **[**67:00**]** state and local taxes. I basically agree with Glenn, but I think that there is one caveat one should keep in mind, which arises to whatever extent state and local expenditures have positive spillovers. If we think, for example, that differences in state and local taxes arise because some states are providing more services that are in the national interest, such as just taking care of poor people -- that is causing positive spillovers and optimal fiscal federalism says that you should have some sort of matching grants from a higher level government, the federal government in this case, encouraging lower levels of government to provide these services in the national interest. And that matching grant can come in in the form of allowing a deduction for state and local taxes.

Now, no one says that that this particular implied rate of **[**68:00**]** matching grants is the right one, and no one is saying that that's what the bulk of state and local taxes go for. Just that -- and this potentially holds for other tax expenditures, notably charitable deductions -- simply saying that a tax expenditure is bad and we should eliminate the deduction for it is clearly far too broad a statement; one should actually think of what you're trying to accomplish.

Using Glenn's Jeopardy analogy -- before saying it's a good idea to eliminate tax expenditures we should think -- well why are these tax expenditures there for in the first place?

John: **[**68:40**]** Jason, go ahead.

Jason: **[**68:41**]** On state and local, I mean I would get rid of the deduction for property taxes which were an awful lot like personal consumption for living in a certain area, and retain them for income taxes, which I think have a lot of the features that Alan had, but no one asked me.

I think broadly speaking, the structure of this plan **[**69:00**]** on the individual side, is a modest improvement with the number of changes, over the current system and over the way we've talked about reform in the past, which is from itemized deductions to the standard deduction, switching from exemptions to credits, takes more people out of the tax system, takes more people out of itemizing; it's minor simplification. And having a reform that's built around that type of structure, rather than measuring the magnitude of a reform by how much you lower the top tax rate, when the top tax rate is what affects less than one percent of tax payers, something that affects many millions.

So I think that structure and that direction reform has gone in is a good one and encouraging, as I said. I would say that about the state and local.

I think a really just sort of depressing thing here is I used to tell my staff, as we'd work on all sort of proposals that would never happen, and I'd try to make them feel better about that by explaining long and variable lags. And one of my examples was **[**70:00**]** confidently predicting that the childless CITC -- the next major tax bill, Paul Ryan supports it, Barack Obama supports it, it will definitely be in the next major tax bill. [laughter] And well I don't know...

John: **[**70:19**]** For something that you guys have both said, whether it is part of the state and local tax deduction or whether it is part of the direct credits itself, it seems like the reforms in this bill generally have not been super favorable to investments in education.

A lot of state and local, certain property taxes largely go to fund public schools; the tuition tax waivers are now... Tax is a really small thing but in gen, I think they're raising 7 billion dollars or something like that from education. Do we think that that's a major worry from this particular bill?

Jason: **[**70:55**]** And is there a consensus on this panel that we shouldn't tax university endowments. [laughter]

Glenn: **[**70:58**]** Yes. I was just going to say that there's some odd things there. I think that's... It looks small but I think it's dangerous. Now I represent an affected university that has an endowment of more than 250 thousand dollars a student.

John: **[**71:14**]** Alan is the one here... [noisy chatter]

Glenn: **[**71:19**]** That's very bad tax policy. It strikes me that the charitable deduction and things related to charity are clearly different from other things. Maybe Albany is different from Sacramento, but I can't think of too many things we do in New York, Alan, of generating important national externalities. The charitable deduction is very important and I think that going after the universities is inappropriate, though... I can imagine why that happened. I don't think it had a lot to do with revenue or tax policy objectives, but it's not a very good idea.

Kent: **[**71:47**]** I agree with the comments made on EITC. In terms of the broader question on labor supply, there are actually some potential freebies out there as labor supply and the elderly **[**72:00**]** age. Given that it's just a 10 year window, it creates the issue and I discussed a great paper by Alan last week at the NBER at Stanford about the social security earnings tax.

Due to what's called benefit recomputation, that is basically present-value neutral for the government. It is perceived by a lot of people as a big tax when they're at the age for social security and they're getting a lot of their social security lost because they're working. They don't realize their future benefits are being recomputed and so forth.

Just getting rid of that one, could almost be a free lunch. In fact, it could even encourage labor supply and on a dynamic score basis it could be a negative cost, but in a 10-year budget window, it's not going to look good.

So, I think we have distortions in just how we do that accounting that could have a big impact on labor supply at the older ages.

John: **[**73:02**]** So, we are coming up against time. So, we have about eight more minutes, so what I wanted to do was go down the panel and ask for two things -- first, for your prediction of what the US tax code looks like one year from now, and second, on the risky investment that this is not a conversation that will end in the near future, what would you recommend to those sitting in the audience as not low hanging fruit but areas where it would be both great and maybe feasible for us to learn more about how taxes affect the economy.

So, I started going this way, so why don't we start with Kent and come back over to the left.

Kent: **[**73:49**]** I think a year from now if this bill goes through and we have this panel again, we'll all be independent contractors of our universities. The ACA makes that a little bit harder but once you get rid of the ACA too, then we'll all definitely be independent contractors.

But, in any case, I still think it comes back to this discussion about: how do you stimulate growth. I remember that years ago in the Bush administration, I used to informally survey economists on both sides and there seemed to be general agreement that you have a progressive tax system, but you stimulate growth with expensing and really focus your dollar spent on new investment. I think you saw that in the Bradford X-tax years ago and in lots of what I think are really well-designed tax plans.

So if this thing blows up, hopefully, there will be an opportunity to have the big reset button and the barriers to entry by lawyers will come down a little bit in tech and economists can play a bigger role.

Glenn: **[**74:57**]** I think in terms of a year from now, there will be a tax bill that passes. The political imperative is too great, and I think the corporate rate cut it is likely to happen. What I fear is that it will be something that sunsets, that it will be done, if it can't solve the budget problem and it simply sunsets.

John: **[**75:21**]** You're talking about the second-decade problem for the Senate.

Glenn: **[**75:23**]** Yes. So it's hard to imagine that a Congress 10 years from now would take the corporate rate from 20 to 35. The question would be -- how do business people feel about that, in their planning. So I think we will see a tax bill.

The Senate is more binding political constraint than the House in terms of votes, so probably the Senate bill looks like a path forward.

On more general, going forward, I think there are three things on which to focus — one is work. Again we should focus more on incentives for low wage work. I think there is too little attention on the buy-in for growth. Sometimes as economists, **[**76:00**]** we will talk about pro-growth policies as if they're a hundred dollar bill on the floor. And of course there are no hundred dollar bills on the floor. And the question is why is there not more buy-in? We just ran an election that gave us part of that answer, and yet we're not talking about the work incentives that many of those voters face.

The second point is for more work on effects of the corporate tax on wages as has turned out to be a big issue here. I think we don't have very diffuse answers. It would be nice to know more.

And the third point is continuing to work on cash flow taxation which I still -- in agreement with Alan -- think is a large part of our future. I'm a big believer in writing for the file in economic policy. You try to write things thinking that a politician 5 years from now, 10 years from now, is going to say I wish I knew X, and you have X in the file. That's the one I'd keep working on.

Jason: **[**76:54**]** So I can't predict, so I'd to give my fantasy, which is that the current "deficit finance party line sunsetting after 10 years" approach blows up and that there's an alternative path, that rather than getting 50 out of 52 votes in the Senate, aims for 70 out of a 100 votes in the Senate, is paid for, is permanent, has buy-in and is designed by Alan Auerbach, so... [laughter]

Alan: **[**77:24**]** As an independent contractor.

[laughter]

Glenn: **[**77:27**]** Can I just say, can I still keep the lower pass-through rate? That's all!

Jason: **[**77:31**]** That's tricky... In terms of going forward, I would say two things. One is, what is needed is more cutting-edge research. I don't know what it is, but Danny Yagan does, and Owen Zidar does, and I wanted to [unintelligible] and lots of other people in this room, so whatever you all want to do is great. I'll leave it.

The second note is I think we do need to do a little bit of a better job of taking the stuff that's already sitting inside our models, is really of first-order of relevance for policy makers as they make **[**78:00**]** decisions, and figure out how to then show it to them.

And in particular I'm thinking, and I think Kent may be doing this next week, that we have this debate about the direct effects and the distribution tables. And we have this debate about the growth. Bring those two together, and show people dynamic distributional analysis that shows the impact of the direct tax changes, the impact of the income tax changes, the impact on welfare -- a lot of these models have large declines in consumption in the first decade to generate growth later; people care about whether they're working more, whether they're saving more, so show welfare -- and integrate into that the financing so you're showing the impact of your financing assumptions that you use to get that growth line. And I don't think we all have the same social welfare function; I don't think we can have a single sufficient statistic out of that. I think if we, the tax community, were presenting things that let people **[**79:00**]** see the growth, the distribution, and the welfare together, that's already in there in our models, we should let policy-makers see that, and they can then decide what they think of it.

Alan: **[**79:14**]** I was going to say a couple of things. First of all, in terms of research, I think it's already been happening, but there was movement in the profession to focus more upon individual taxation, less on business taxation, over the years. I think things have been moving back towards looking more at business tax provisions; doing analysis that's capable of studying such sophisticated provisions as this legislation includes is, I think, really important.

Second, in terms of the policy process, if one thing **[**80:00**]** has been made evident from this process, it is that dynamic scoring is here to stay and we need to do a better job.

I've been thinking about this for many years and pointing out that there are costs and benefits of dynamic scoring, and one of the costs is it's a whole lot more difficult to do than traditional budget scoring. There's information there, but there's a lot more disagreement about what the information is.

In the spirit of what Kent is doing, we should be trying to do realistic modeling. That's in contrast to saying, I have a very simple macro-model that's going to produce very extreme results and that's the answer. I think it would be very valuable to get more of a consensus on that.

Finally, in terms of predictions, I don't really want to make a prediction; I should talk about an aspiration. My hope **[**81:00**]** is for a rain-out. [laughter] That is that we have to postpone the current process. I think tax reform, particularly on the business side, is really necessary. It's been necessary for several years. It's sort of like dealing with the long-run budget cap. We've not done very well on both.

It would be wonderful if there was something in the process that slowed it down, because given the speed with which this is moving, if something does pass, not only are there going to be a lot of things in it that we don't like, but there are going to be a lot of things that just don't work very well because of inadvertence and because we just didn't really have time to think through what the effects of the provisions are. Given such a large change in the tax system, and that we want it to be as permanent as possible, I just don't see it as feasible to come up with something very good in the short run.

John: **[**81:59**]** Great. Thank you to all who gave questions; we got through six or seven of them; I'm sorry we did not have time for more. Lunch starts downstairs where Larry Summers will talk in about 15 minutes. Please join me in thanking our four panelists today. [applause] I'll see you guys next year at this time.