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Tax Policy Challenges

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Woodworth Memorial Lecture
May 8, 2008

Tax Policy Challenges

MICHAEL J. GRAETZ*

I. INTRODUCTION

In 1995, when the late, great Jack Nolan asked me to deliver the inaugural lecture in honor of Larry Woodworth, I was both honored and flattered. I had come to know Larry Woodworth beginning in 1969, when I was a rookie treasury tax policy staffer. At that time, he had already served the Joint Committee on Taxation for 25 years and had been the third Chief of Staff in its history beginning as chief of staff in 1964. Larry Woodworth was not only as knowledgeable about the tax law as anyone you would ever hope to meet, and as savvy about congressional politics as anyone I have ever known, but he was also an exceptionally kind and generous man. He was courteous to a fault, virtually always had a smile on his face and was always calm, no matter how tired he was or how much pressure he faced. Larry always had time to chat with the lowest persons on the totem pole. I know that, because, in those days, I was the bottom. Larry had his policy views, but he always “played it straight” with the members of Congress. He was the finest example of a public servant I have ever known.

During the last year of his life, while he served as Jimmy Carter’s Assistant Treasury Secretary for Tax Policy, Larry asked me to serve as a consultant on a major tax overhaul that he expected the President to offer. We will never know for sure, but I am convinced that Larry’s untimely death played a key role in derailing that ambitious project.

This year, about a month ago, when Ken Gideon and Bob Shapiro called me and asked me to deliver today’s lecture, it was not nearly so great an honor.

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They made it clear that I was no better than their second choice. This year's lecture was supposed to be delivered by Eric Solomon, now serving as Assistant Secretary of the Treasury for Tax Policy. Eric had claimed—and I believe him—that he was simply too busy at the Treasury to give this lecture the time and energy it deserved. I am also hoping that when we hear from Eric next year, he will be in a better position to address us candidly about his experiences at the Treasury.

Ken and Bob knew that I had just published a book entitled *100 Million Unnecessary Returns, A Simple, Fair, and Competitive Tax Plan for the United States*,¹ and they assured me that I could simply give to this group the same talk about that book that I have often given this spring both here in Washington and elsewhere in the country.

But, deep down, I knew that that is not what Larry Woodworth would have done—nor is it what he would have wanted me to do. So my intention here today is pretty much to begin where that book leaves off. I want to highlight and explore four or five of the major challenges for our nation's tax and economic policy in the years ahead. Each of these issues is discussed in my book and, in combination, they led me to offer the tax reform structure that I urge there. But I view my tax reform plan as only a crucial step in tackling these issues, not a complete answer. In my view, the issues I will talk about today are the fundamental challenges that will inevitably shape tax policy for at least the early part of this century.

For those of you who came hoping I would summarize my book, let me instead urge you to read it. It is quite short. People tell me that it is an easy read. And it is available on Amazon.com for under twenty dollars. For those of you without the patience to read even a short book of this sort, let me urge you to read my prepared testimony before the Senate Finance Committee on April 15, which is reprinted in this week's Tax Notes.² For those of you without the patience to read even my testimony, there are two rather different talks that I have given recently on the book, with commentators in both cases, and they can be found on the websites of the American Enterprise Institute³ and the Kaiser Family Foundation.⁴ For the rest of you, I have no suggestions.

1. Michael J. Graetz, *100 MILLION UNNECESSARY RETURNS, A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES* (Yale Univ. Press 2008). Much of the research, herein, can be found in *100 Million Unnecessary Returns, A Simple, Fair, and Competitive Tax Plan for the United States*. GRAETZ, *supra*.

2. Michael J. Graetz, *Graetz Outlines Tax Reform Plan*, 119 TAX NOTES 513 (2008).

3. Michael J. Graetz, Address at the American Enterprise Institute for Public Policy Research Conference: Toward Fundamental Tax Reform (June 6, 2005) (transcript available at <http://www.aei.org/events/filter.eventID.1083/transcript.asp>).

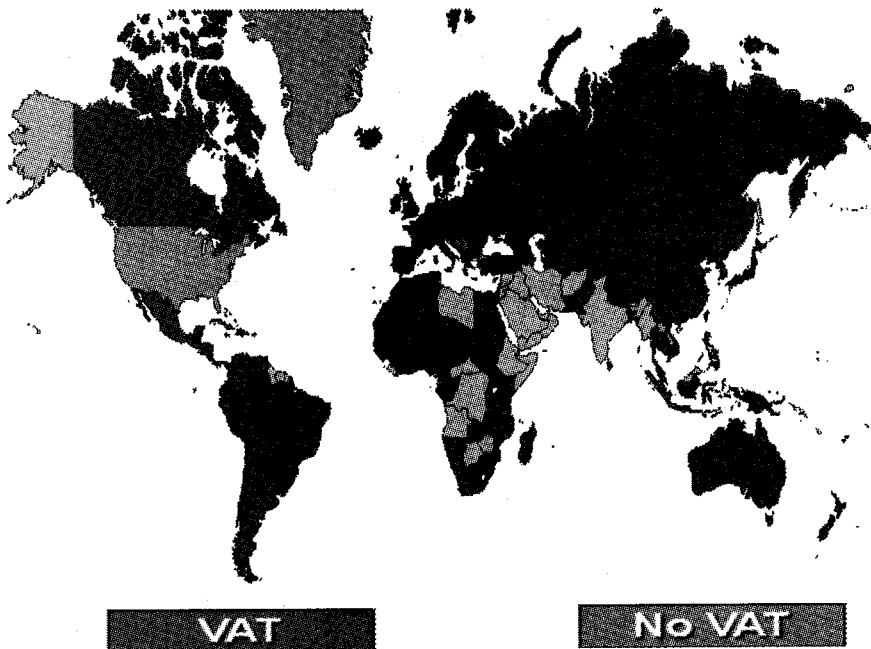
4. Michael J. Graetz, Address at the National Academy of Social Insurance: Paying for Health and Retirement Benefits in the 21st Century: Exploring a VAT (April 10, 2008) (transcript available at: http://www.kaisernetwork.org/health_cast/uploaded_files/041008_nasi_VAT_transcript.pdf).

As a prelude—in case anyone here does not yet know how my book ends—let me describe briefly the tax reform proposal that it advocates. This, I think, will serve as an important underpinning for the issues I intend to address here today. For those of you who know only too well what my plan entails, having heard it many times before, please forgive the repetition.

In this book I advocate a tax reform plan composed of four essential pieces, which the book discusses in some detail:

- First, enact a value added tax (“VAT”)—a broad-based tax on sales of goods and services now used by nearly 150 countries worldwide—at a 10%-14% rate. We are the only Organization for Economic Cooperation and Development (“OECD”) country that does not have a VAT.

Countries with Value-Added Tax Systems, 2001⁵



5. LIAM EBRILL, MICHAEL KEEN, JEAN-PAUL BODIN & VICTORIA SUMMERS, *THE MODERN VAT*, at xiv, fig.1.1 (2001).

- Second, use the revenues produced by that consumption tax to finance an income tax exemption of \$100,000 of family income and to lower the individual income tax rate to 20%-25%.
- Third, lower the corporate income tax rate to 15% or no more than 20%.
- Fourth, replace the Earned Income Tax Credit ("EITC") and provide low and middle income families with tax relief from the VAT burden through payroll tax offsets and "smart" (or "debit") cards.

Following the important precedent of the 1986 Tax Reform Act, this proposal has been designed in a manner generally to be both distributionally neutral and revenue neutral.

This plan has many significant advantages over current law and other tax reform alternatives:

- First, it would eliminate 100 million of the 135 million income tax returns and, in doing so would reduce compliance and administrative costs and counteract the widespread public cynicism now generated by income tax complexities.
- Second, this new tax system would encourage saving and investment in the United States, stimulating economic growth and creating additional jobs for American workers. Importantly, unlike most other tax reform proposals designed to enhance economic growth, it would not shift the tax burden down the income scale.
- Third, a 15% corporate income tax rate would be among the lowest in the world and would mitigate or eliminate most of the vexing issues of international tax policy.
- Fourth, this plan would avoid most of the difficult issues of transition to an entirely new system that have haunted other proposals to move away from the income tax towards consumption taxation.
- Fifth, with far fewer income tax filers and an administrable VAT, this system would reduce the IRS workload so it can do its job.
- Sixth—and of great importance—with only a relatively very few high-income Americans filing tax returns, there will be far less temptation for politicians to use the tax system as if it were a solution to the nation's most pressing social and economic problems. This is a point I shall expand on in a few minutes.
- Seventh, this plan takes advantage of our status as a low-tax country by making us a low-income tax country.

- Finally, by combining taxes commonly used throughout the world, this system would facilitate international coordination and would fit well with existing international tax and trade agreements—something that most other consumption tax alternatives fail to do.

With this background, let me turn to the main theme of my talk here today: the tax policy challenges of the 21st century. Of course, I am not so naive to believe that from this vantage point so early in the century I, or anyone else, can foresee the developments coming far down the road. At this time in the 20th century, there was no income tax; the 16th amendment had not yet been enacted, and the income tax that would soon emerge would be limited to a thin slice of the highest income Americans until the Second World War. Neither our system of using payroll taxes to finance retirement income, nor public forms of health insurance were even on the horizon. Two World Wars and the Great Depression changed everything that one might have foreseen in 1908 for 20th century tax policy.

But, despite the twists and turns that have occurred and that will occur, many of the great themes of the last century endure into the current one. Today's tax reform debate—including, for example, not only proposals for "flat" taxes and the so-called FairTax, as well as the debate over repeal of the estate tax,—has reopened the contest between what Steven Wiseman in his wonderful book, *The Great Tax Wars*, labeled "virtue", on the one hand, which views "wealth as a product of hard work, thrift, ingenuity and risk taking"—something the state should both encourage and protect—and "justice" on the other hand, which, according to Wiseman, is taxation based on ability to pay with progressive taxes on income and wealth.⁶ Like most Americans, Wiseman views progressive taxation as necessary (in his words) to "soften the edges of the distribution of wealth in the interest of justice and fairness."⁷

Drawing appropriate lines in the ongoing battle between virtue and justice has always haunted tax lawmaking in the United States—and it always will. Advocates for replacing the income tax with a "flat tax" or a national sales tax, for example, are quite willing to sacrifice tax justice to promote economic virtue and to reward success. In some form, the tension between rewarding virtue and doing justice will continue to shape our nation's tax policy in this century, as it did in the past one. And the fundamental goals for tax policy—the quest for freedom, simplification, fairness, economic efficiency

6. STEVEN R. WEISMAN, *THE GREAT TAX WARS* 6 (Simon & Schuster 2002).

7. *Id.*

and economic growth—are as important today and going forward as they ever have been, perhaps more important.

But despite the continuity of the great themes that shape our nation's tax policy and that of other nations, changes have occurred since Larry Woodworth's time that he simply could not have imagined. Some of these important changes I shall address here today; others, I will not. For example, Larry Woodworth died before the enactment of Proposition 13 in California,⁸ at a time before income taxes and tax policy had routinely become a crucial issue of presidential politics. Perhaps blessedly, he did not live to see the rise of the Republican anti-tax movement, with its "starve the beast" mythology. Nor did he witness the dramatic changes in Congress, congressional staffs, and congressional processes that have so influenced the shape of U.S. tax policy in recent decades. Larry Woodworth lived and worked in a Congress of bipartisan respect and comity. I have no doubt that he would not regard today's tax politics as an improvement.

But I want to focus here today on the key underlying substantive aspects of tax policy, not its politics or processes. To clear out one last piece of underbrush, let me also say that I shall not deal here, except in passing, with the very important issues of energy tax policy, issues that I believe will play a significant role in the tax policy agenda in the years ahead.

Let me now turn to the challenges ahead, beginning with our nation's fiscal situation for both the short and long terms. The short-term issue will necessarily be on next year's congressional agenda. For the long term, the key facts relate to our nation's changing demographics and our inability—at least so far—to control the rising costs of health care. These factors will put unprecedented pressure on issues of social insurance, especially on the fundamental question of how we intend to pay for retirement income security and health insurance coverage going forward.

Secondly, I want to talk about the revolution in technology and the internationalization of the world economy, which, in combination, are having dramatic effects on the pretax distributions of income and wealth.

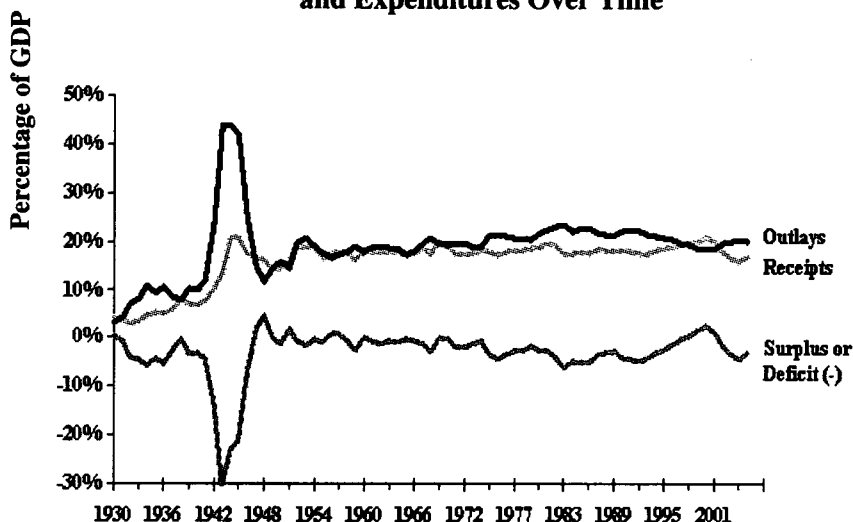
Importantly, all of these changes do not create challenges unique to the United States, but they will also have to be faced by nations throughout the world. Many other nations, for example, face much more extreme problems of an aging population than we do. These issues, however, do have critical implications for one crucial aspect of U.S. tax policy exceptionalism: our unique—I would insist excessive—reliance on the use of income tax expenditures as a favored mechanism to address our nation's most pressing economic and social problems. This, I will argue, is a luxury we can no longer afford.

8. CAL. CONST. amend. XIII.

II. OUR SHORT AND LONG-TERM FISCAL SITUATION

The first tax policy challenge of the 21st century involves the nation's fiscal condition.

Money in, Money Out—Overview: Federal Receipts and Expenditures Over Time⁹



In January 2001, Federal Reserve chairman Alan Greenspan famously told the Congress that looming surpluses were so large and, since they would occur into the foreseeable future, that without substantial tax cuts, the federal government would pay off all of its debt, and might have to invest in private assets like corporate stock—a scenario Greenspan abhorred. The good news is that that problem has now been solved.

Anticipated surpluses have been replaced by deficits as far as the eye can see. In January 2006, when Alan Greenspan left the Federal Reserve for private life, the federal debt was \$8 trillion—more than \$2 trillion greater than when George W. Bush took office. Today, the federal debt exceeds \$10 trillion and is still growing. Indeed, it is the size of the federal debt and projected deficits that raise the second challenge for tax policy in the 21st century.

As every schoolchild knows, the scheduled expiration in 2010 of the large tax cuts enacted in 2001 and 2003 builds a large tax increase into the current

9. See Office of Mgmt. and Budget, Budget for Fiscal Year 2006, Historical Tables 23-24 tbl.1.2, <http://www.whitehouse.gov/omb/budget/fy2009/hist.html>.

tax law. If Congress and the new president fail to act, income tax rates will rise across the board, as will tax rates on capital gains and dividends, and people will lose many other benefits, including credits for children and relief for marriage penalties. The alternative minimum tax is currently structured in a way to catch many millions more Americans, and it must be fixed or repealed. Under current law, the estate tax exemption rises to \$3.5 million next year with a 45% rate. The following year, in 2010, the tax is repealed, and in 2011 it reappears with a \$1 million exemption and a 55% top rate. These things cannot—and will not—actually occur. Congress must act before 2010—and it must re-examine much of our tax system in order to act intelligently.

In the press, the tax policy question *de jure* is: should the Bush tax cuts be made permanent? I must admit that I do not know what the word “permanent” means in this question. The fat lady never sings in tax policy or in tax politics. But, in any event, it is the wrong question—a question prompted, no doubt, by bizarre Congressional Budget Office (“CBO”) budget scoring rules which necessarily assume the one thing that we all know is *not* going to happen, that all of the tax cuts scheduled by law to expire will actually expire.

Why do we all know this is not going to happen? Because John McCain, the Republican nominee for president, has indicated that he wishes to extend the Bush tax cuts indefinitely. And from the perspective of the federal fisc, Barack Obama and Hillary Clinton are essentially in the same camp. In their Philadelphia debate leading up to the Pennsylvania primary, which was widely criticized for focusing on non-substantive matters, there was at least one crucial substantive moment. George Stephanopoulos asked Hillary Clinton, “Can you make an absolute read-my-lips pledge that there will be no tax increases of any kind, for anyone earning under \$200,000 a year?”¹⁰ By evoking the “read-my-lips” phrase Stephanopoulos was channeling a blunder as big as any in modern presidential campaigns. He was echoing George Herbert Walker Bush’s promise never to raise taxes, a promise made when he accepted the 1988 Republican nomination for president. Bush said, “Read-my -lips, no new taxes.” Two years later, in 1990, courageously facing the pressing need to take control of spiraling budget deficits in negotiations with a Democratic Congress that insisted that tax increases accompany spending restraint in any budget deal, Bush negotiated and signed the 1990 Budget Act, important legislation that began the path to the balanced budget and surpluses of the late 1990s.¹¹

But Bush’s effort to explain that changed economic circumstances had forced him to “think anew” rang hollow with his Republican constituents, and he served only one term.

10. Obama and Clinton Debate (April 16, 2008) (transcript available at: <http://abcnews.go.com/Politics/DemocraticDebate/Story?id=4670271&page=3>).

11. JAMES V. SATURNO, CONGRESSIONAL RESEARCH SERVICE, THE BUDGET ENFORCEMENT ACT: ITS OPERATION UNDER A BUDGET SURPLUS (1998), <http://www.rules.house.gov/Archives/98-97.htm>.

Ignoring this history, Hillary Clinton answered, "I am absolutely committed to not raising a single tax on middle-class Americans, people making less than \$250,000.00 a year."¹² Stephanopoulos gave her a second chance to hedge: "An absolute commitment, no middle-class increases of any kind?"¹³ Mrs. Clinton did not waiver: "No. That's right. That is my commitment."¹⁴ Stephanopoulos then asked Barack Obama if he would "take the same pledge?"¹⁵ And Obama raised the stakes. He said, "Well, I not only have pledged not to raise their taxes, I've been the first candidate in this race to specifically say I would cut their taxes."¹⁶ Charlie Gibson, ABC's other moderator, closed the books: "You have both just taken this pledge."¹⁷

By repeating this colloquy, I do not mean to imply that there are not serious tax policy differences between Mr. McCain and the Democratic candidates. Unlike McCain, both Clinton and Obama clearly plan to raise taxes on people with incomes over \$250,000, sparing the bottom of 90% of Americans, which no doubt reflects their expansive vision of the "voting" middle class. But they have also promised, through broad tax cuts in Mr. Obama's case, or narrowly targeted ones in Mrs. Clinton's, to spend all the money they would raise from the additional taxes on upper-income Americans. And all of the candidates, in one way or another, have also promised to repair the nation's crumbling infrastructure, fix it's failing schools, address the coming gap in social security financing, stave off housing foreclosures, maintain a strong defense, protect homeland security, pay the ever-growing interest on the federal debt and, they claim, balance the budget. The Democrats have also promised affordable health insurance for all Americans. John McCain has said he would also enact major tax cuts for businesses, including not only a significant cut in the corporate tax rate, but also immediate expensing for plant and equipment. While only the Democrats appeared at the Philadelphia debate, which was produced by the Walt Disney Company, all of them seem to be living in Fantasyland.

No matter who is elected president, we can be confident that most of the tax cuts enacted during George W. Bush's administration will be extended, and it seems a sure bet that the money raised by those that are not extended will not be used for deficit reduction. Let us hope that this turns out for the best. Given the fragile state of our nation's economy, 2009 or 2010 do not seem likely to be auspicious years for major tax increases.

12. Debate, *supra* note 10.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

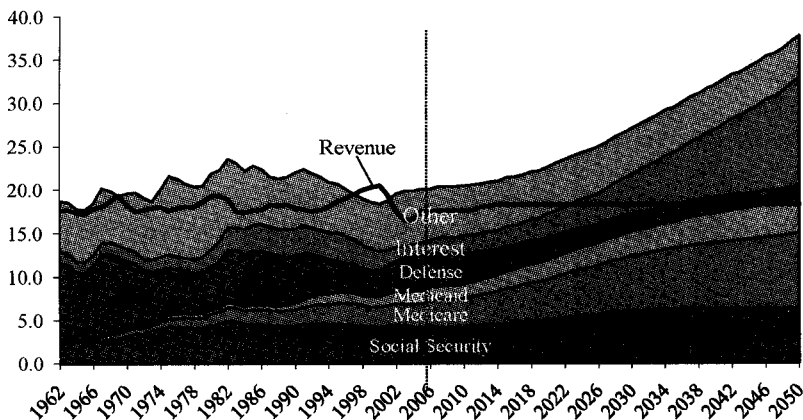
17. Debate, *supra* note 10.

In sum, it seems naive to expect any major deficit reduction effort in the short-term. But Congress cannot avoid addressing important issues of tax policy in the next two years. What should the capital gains rate be? Should the 15% rate on dividends be repealed, raised, or limited to circumstances where the corporations paying the dividends have already paid taxes at the corporate level? Should we repeal or just modify the AMT? How and at what rate should we tax inheritances? I could go on and on. But the key point is this: 2009 and 2010 will present a new president and the Congress with a virtually unprecedented opportunity—indeed a requirement—to re-examine the substance of our nation's tax laws. Their challenge, if they take it, will be to put in place a system that is fair, substantially simpler than the one we have now, and one that better promotes investment, economic growth, and good jobs for America's workers. This opportunity for real change is why I am spending as much energy as I am these days pushing a tax plan that I believe in.

But change is not inevitable; Congress may decide simply to kick this can down the road a bit by extending most provisions of current law and, perhaps, allowing a handful to terminate.

But our fiscal gap cannot be kicked down the road forever.

The Long Term Fiscal Outlook: Social Security, Medicare and Medicaid Spending as a Percent of GDP over Time.¹⁸



18. Note: Reflects CBO's intermediate-spending trajectory, which assumes that spending per Medicare enrollee grows one percentage point faster than per capita GDP (compared to 2.9% today); that defense spending gradually returns to its historical real level, and that non-defense discretionary spending and other mandatory spending remain at their historical levels as a share of GDP. Congressional Budget Office, *The Long-Term Budget Outlook* (Dec. 2005), <http://www.cbo.gov/ftpdocs/69xx/doc6982/12-15-LongTermOutlook.pdf>.

As this figure shows—and all reasonable projections look like this one—given the aging of our nation's population and the ongoing anticipated increases in healthcare costs, federal revenues at or about their current levels—and indeed at their historic levels—will, not too far down the road, be insufficient to pay for Social Security, Medicare and Medicaid alone, not to mention national defense, homeland security, interest on the federal debt, and the other expenditures of our federal government. Two big domestic policy challenges of the 21st century—challenges that inevitably will involve difficult tax policy choices—will be to put into place a tax system that is poised to meet our inevitable needs for future revenues without harming economic growth and to find a way to limit the ongoing rise in healthcare costs.

III. AN AGING POPULATION AND RISING HEALTH CARE COSTS

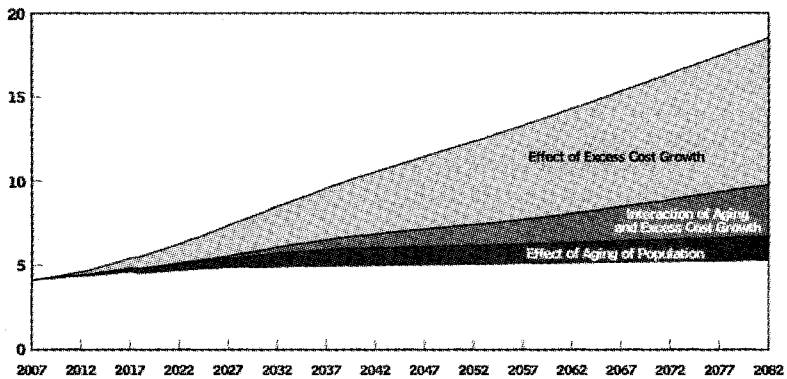
Demography may not be destiny, as some have claimed, but demographic changes in the composition of the American population will pose serious challenges for tax and other public policy in the years ahead. When Social Security was first enacted in the 1930's there were sixteen workers for every eligible Social Security recipient.¹⁹ Today, there are just over three workers per retiree. In a few short decades, even with expansions in immigration, there will be only about two American workers per retiree. To explain the implications of this demographic shift consider this: If today, three workers contribute thirty-three cents each to pay for a dollar of a retiree's income, two workers contributing the same amount will provide the retiree with only sixty-six cents. Or the workers will have to contribute fifty cents each if the retiree is to get a dollar. As we all know, this is creating a projected gap in social security financing that today in the aggregate represents about 2% of total payroll.

And Social Security is often called the "third rail of American politics." But fixing the Social Security system through a combination of relatively modest changes in benefits and taxes is child's play, when compared to dealing with the combined problem of an aging population and rising healthcare costs.

Time does not permit me to go into detail here about either the issues or proposed solutions to our nation's healthcare problems, but let me offer a little context. First, rising healthcare costs are a much bigger problem for the federal fisc than an aging population.

19. Mary C. Daly, Understanding the Social Security Debate, Fed. Res. Bank S.F. Econ. Letter, June 25, 1999, available at <http://www.frbsf.org/econsrc/h/wklyltr/wklyltr99/el99-20.html>.

**Sources of Growth in Projected Federal Spending on
Medicare and Medicaid²⁰**
Percentage of GDP

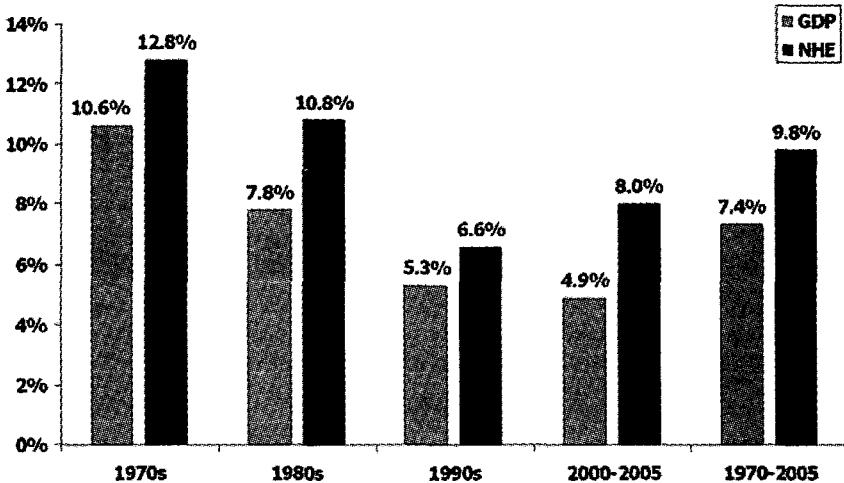


Moreover, while during Larry Woodworth's lifetime, the economy grew faster than healthcare costs, healthcare costs in recent years have exceeded the economy's rate of growth by 2½ to 3 percentage points annually.²¹

20. Cong. Budget Office, Presentation at Princeton University Health Care: Capturing the Opportunity in the Nation's Core Fiscal Challenge (Mar. 12, 2008), available at <http://www.cbo.gov/ftpdocs/90xx/doc9054/03-12-Princetonnews.pdf>.

21. See KAISER FAMILY FOUNDATION, HEALTHCARE COSTS: A PRIMER 3 (2007), <http://www.kff.org/insurance/upload/7670.pdf>.

Average Annual Growth Rates for Nominal National Health Expenditures and GDP for Selected Time Periods²²



In less than a decade—by 2016—healthcare costs are predicted to equal 20% of GDP—one out of every five dollars of the entire economy’s output.²³ Medicare and Medicaid finances are clearly inadequate going forward. And, in addition to escalating costs, our nation faces serious problems of inadequate health insurance coverage and also important disparities in the quality of care. There are a wide range of potential reforms to our nation’s healthcare system. The Democratic presidential candidates, for example, have emphasized individual mandates or individual subsidies as the best mechanism to achieve universal coverage. Many Republicans, on the other hand, seem to view health savings accounts and the shifting of costs away from third-party insurance payments to individuals as the best mechanism to control costs. They urge expansion of health savings accounts. The Healthy Americans Act, sponsored by senators Ron Wyden, an Oregon Democrat, and Bob Bennett, a Utah Republican, provides another approach to health insurance subsidies and new opportunities for health insurance coverage.²⁴ The economists John Cogan and Glenn Hubbard have proposed a tax deduction for individuals out

22. *Id.* at fig.2.

23. *See id.* at 2.

24. S. 334, 110th Cong. (2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=s110-334&tab=summary>.

of pocket spending on healthcare or health insurance.²⁵ In a Hamilton Project Paper, Ezekiel Emmanuel and Victor Fuchs have proposed a value-added tax dedicated solely to fund universal healthcare vouchers.²⁶ Republicans and Democrats alike are seeking ways to sever the link between health coverage and employment. And these are just some of the most salient proposals.

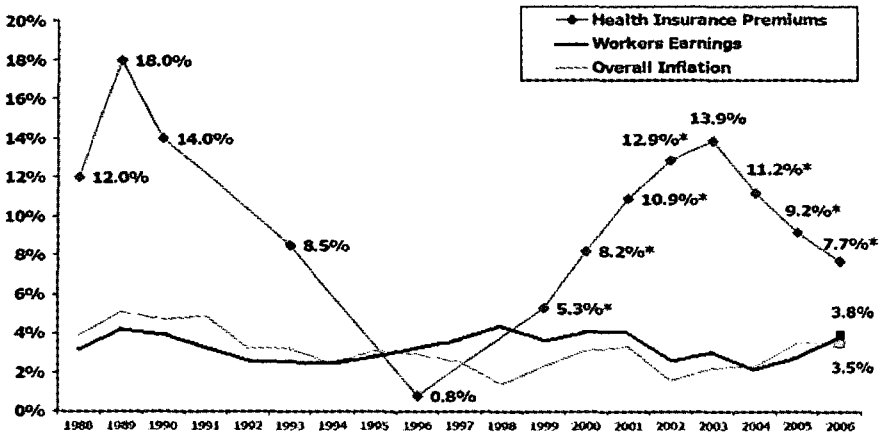
For my limited purposes here tonight, the details and even the pros and cons of these various proposals are not important. What is important is the one thing that they all have in common. They would all eliminate or dramatically restructure the existing tax exclusion for employer-provided health insurance and healthcare. This should not be surprising. Unlike many programs that essentially depend on tax expenditures for their financing, employer-provided health coverage was something of an historical accident. It received an important stimulus from the exemption of fringe benefits from the wage and price controls of the 1940s—an exemption that allowed employers to pay their employees additional fringe benefits when they could not increase cash wages. An enduring boost was provided to employer-based coverage by the income and payroll tax exemptions for recipients of employer-provided health insurance. And state income taxes, with top rates as high as 12%, also typically exempt employer-provided health insurance. As a result of these tax subsidies, most Americans who are not covered by either Medicare or Medicaid today receive their health insurance through their employers. And their health premiums are rising much faster than their wages.²⁷

25. John F. Cogan, R. Glenn Hubbard, & Daniel P. Kessler, *Evaluating Effects of Tax Preferences on Health Care Spending and Federal Revenues* (Nat'l Bureau of Econ. Research, Working Paper No. 12733, Dec. 2006), available at <http://www.nber.org/papers/w12733>.

26. Ezekiel J. Emanuel & Victor R. Fuchs, *A Comprehensive Cure: Universal Health Care Vouchers*, at 7 (The Hamilton Project Discussion Paper, 2007-11, July 2007), available at http://www.brookings.edu/papers/2007/07useconomics_emanuel.aspx (select “read full paper” link at bottom).

27. See KAISER, *supra* note 21, at 9.

**Increases in Employer-Sponsored Health Insurance Premiums
Compared to Increases in Worker Earnings and Overall Inflation,
1988-2006²⁸**



The view that the current tax law impedes sensible healthcare reform is not a new one. For example, more than two decades ago, Ronald Regan proposed capping the amount of the health insurance exclusion.²⁹ And Congress's stalemate over Hillary Clinton's healthcare plan in the 1990s remains fresh in our minds. Until now, Congress has always failed to act. What we now know, for sure, is that our long reliance on a tax benefit for employers and employees as our main mechanism for covering Americans who are neither poor nor aged has not worked. Health policy is the Titanic of American domestic policy. Our healthcare costs are the highest in the world³⁰ and more than 45 million Americans remain uninsured. Moreover these healthcare costs are making American businesses, workers and products less competitive in the world economy, and they are gobbling up the wage increases of American workers. According to the best estimates, workers today are spending about 10% of their wages on health insurance and/or out-of-pocket costs for healthcare.³¹ The more than \$12,000 average annual premium for family coverage amounts to 20%-25% of median income for a

28. Data on premium increases reflect the cost of health insurance premiums for a family of four. *Id.* at 9, fig.8.

29. Lynn Etheredge, *Reagan, Congress, And Health Spending* 2 HEALTH AFFAIRS, 14, 24 (Spring 1983) available at <http://content.healthaffairs.org/cgi/reprint/2/1/14.pdf>.

30. See KAISER, *supra* note 21, at 4.

31. See *id.* at 10.

family of four—about what such a family used to spend for housing.³² Tackling the healthcare issue will be an essential challenge for the next president and the Congress, and as we know, this will be no easy task.

The tax expenditures for employer-provided health benefits total about \$200 billion a year.³³ Transforming that expenditure, along with our direct government spending programs, into sensible and effective health policy is an immense challenge, but one we can no longer fail to address.

And, when tax expenditures as failed policy is the topic, the healthcare story is not an isolated example. Rather it is merely the most important and visible example of a much broader concern. The essential problem is this: presidents from both political parties and Congress today use income tax exclusions, deductions and credits the way my mother used chicken soup, as a cure-all for every economic and social ill the country faces. But all experience tells us that, with very rare exceptions, this method of addressing our nation's problems simply does not work. Consider, for example the income tax incentives for paying for higher education. There are eight tax breaks for current-year education expenses: two tax credits, three deductions and three exclusions from income. Five other provisions promote savings for college expenses. In 1987 there were only three provisions encouraging college expenditures or savings. The 1997 act alone added five provisions that were estimated to cost 41 billion dollars over five years. Together they represented the largest increase in federal funding for higher education since the GI Bill. But the GI Bill worked. And both Barack Obama and Hillary Clinton are proposing more tax credits for higher education.

The American public simply cannot comprehend the tax savings provided by these provisions, cannot know their eligibility requirements, cannot understand how they interact and cannot maintain adequate records and reporting to qualify. Each provision has its own eligibility criteria and definition of qualified expenses. They do not even provide consistent treatment of room and board, books, supplies, sports expenses, non-academic fees or the class of relatives whose expenses may be taken into account. A student convicted of a felony for possession or distribution of a controlled substance is not eligible for one of the education credits, but such a conviction is not a bar to another one. And this is just the tip of the iceberg.

Nor has our tax based energy policy with its off-and-on credits for alternative fuels, incentives for domestic drilling and so on, produced better results. Tax expenditures have been used as an instrument of energy policy

32. *See id.* at 1.

33. A July 30, 2008 report estimated the tax expenditure for the exclusion for employer-provided health care to be \$246.1 billion for 2007. JOINT COMM. ON TAXATION, TAX EXPENDITURES FOR HEALTH CARE 4 (2008), <http://www.house.gov/jct/x-66-08.pdf>.

almost since the inception of the tax code.³⁴ I wish I could say that our decades of experience have led to the adoption of a coherent tax-based energy policy—but the fact is we get precious little bang for the \$8.3 billion bucks these expenditures cost the Treasury. Nor do tax credits for working parents produce affordable child care.

I could go on and on.

And with regard to education and energy policies, at least—as with healthcare—we need a complete policy review, one that takes both tax and spending policies into account, and adopts far more effective answers.

I would single out only the earned income tax credit as an important successful exception to this criticism. And as I demonstrate in my book, it could be significantly improved and delivered by means other than through the annual filing of tax returns.

Relying, as we do, on income tax deductions and credits is about as successful a solution to our national needs as putting a band-aid on a cancer.

Our political leaders must be weaned away from using tax deductions or credits as a cure-all for our nation's ills. I believe that the only path to success in this critical policy domain is to remove most Americans from the income tax altogether. Income tax simplification, even with return-free filing, is simply not up to this task. These are not narrowly targeted special-interest provisions enacted through skillful lobbying. Rather they are tax breaks intended to appeal politically to the vast majority of American voters. And, as long as virtually all Americans are subject to the income tax, Congress will continue to look to the tax code as the mechanism for resolving the nation's most important problems. All we need do in order to see the truth of this is to look at the current congressional debates over the housing crisis, study the budget proposals of recent presidents, or look at the websites of the current presidential candidates. Tax expenditures have clearly been an inadequate solution to very important problems. This is a luxury we can no longer afford.

So far, I have focused my remarks here this evening essentially on domestic policy issues. But even these issues—health policy, education policy, and energy policy—today have important implications for our ability to compete in today's global economy. Indeed, in my view, the biggest challenges for our nation's tax policy in the years ahead reflect the internationalization of the world economy, with its ever increasing cross-border flow of goods, services, capital, and people, in combination with the dramatic revolution in technology that has occurred in the past two decades. These developments interact in important ways and together they pose unprecedented challenges to U.S. tax policy.

34. See CONGRESSIONAL RESEARCH SERVICE, *ENERGY TAX POLICY: HISTORY AND CURRENT ISSUES* 1-2 (2008), <http://www.fas.org/srg/crs/misc/RL33578.pdf>.

IV. INTERNATIONALIZATION OF THE WORLD ECONOMY AND TECHNOLOGICAL CHANGE

Our nation's basic tax structure came into place during the World War II era. The fundamental components of our international income tax rules date from the post World War I period, and from 1962, when Subpart F was enacted. This was a time when the United States essentially had all the money there was. Even a horrid income tax system—with rates up to 91%—could not then stall our economic progress. From 1946 to 1973, when the Organization of the Petroleum Exporting Countries ("OPEC") quadrupled the price of oil, the economy grew by an average of 3.8% a year and unemployment averaged 4.5%. Since 1973, however, our economy has grown much more slowly and so have the wages of middle income Americans.³⁵ Today, the United States economy must compete with many countries throughout the world for the investment capital essential for economic growth—capital necessary to produce a rising standard of living for the American people. This competition for investment capital now includes not only Europe and Asia, but also Brazil, Russia, China and India. Going forward, we must have a tax system that will advance the competitiveness of American workers and investors, not stifle it.

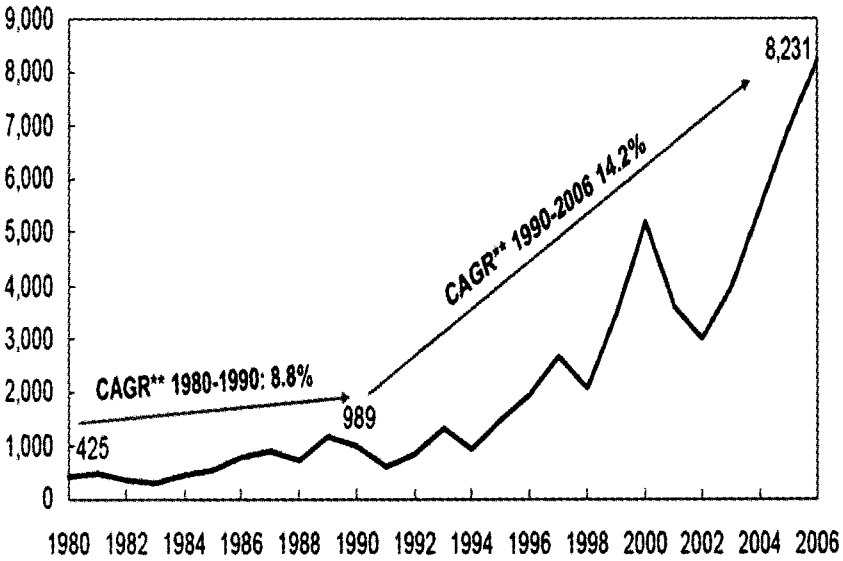
The magnitude of changes in the world economy is something that Larry Woodworth could not have even imagined. Dramatic changes have occurred since the last major tax reform in 1986—and even more recently, as the following figures demonstrate.³⁶

35. ISABEL V. SAWHILL AND JOHN E. MORTON, ECONOMIC MOBILITY PROJECT, *ECONOMIC MOBILITY: IS THE AMERICAN DREAM ALIVE AND WELL?*, <http://www.economicmobility.org/assets/pdfs/EMP%20American%20Dream%20Report.pdf>.

36. DIANA FARRELL, SUSAN LUND, CHRISTIAN FÖLSTER, RAPHAEL BICK, MOIRA PIERCE & CHARLES ATKINS, MCKINSEY GLOBAL INSTITUTE, *MAPPING GLOBAL CAPITAL MARKETS FOURTH ANNUAL REPORT 14* (Jan. 2008), http://www.mckinsey.com/mgi/publications/Mapping_Global/index.asp (No fee subscription required).

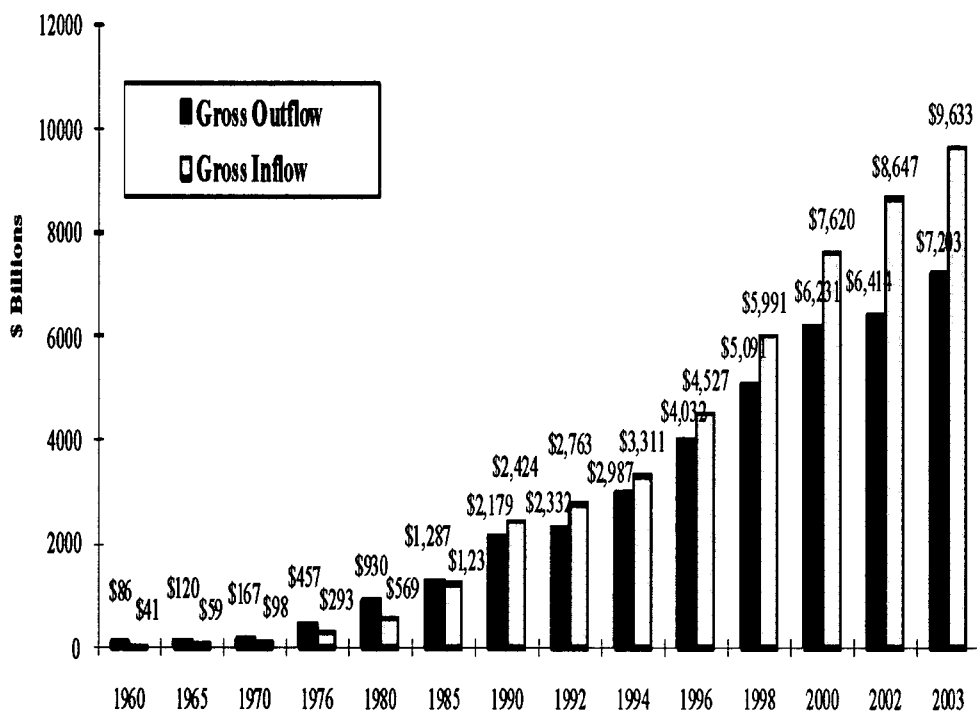
Growth in Cross-Border Capital Flows³⁷
Total Cross-Border Capital Inflows

\$ billion, constant 2006 exchange rates



37. See FARRELL ET AL., *supra* note 36, at 14.

Globalization: Investment Flows into and out of the U.S. Over Time³⁸
U.S.-owned assets abroad and foreign-owned assets in the U.S. using
current-cost accounting method



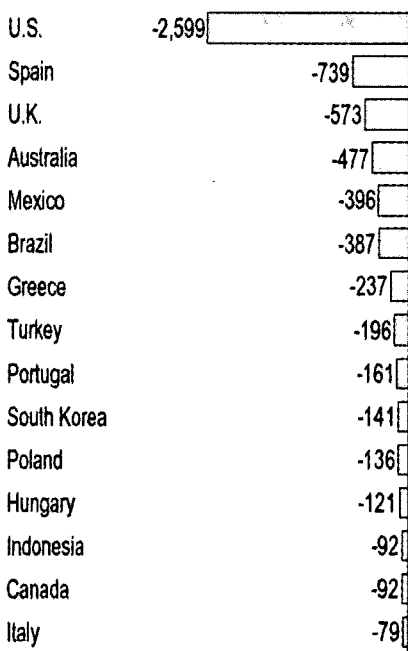
38. U.S. Dept. of Commerce, Bureau of Economic Analysis, International Investment Position of the United States at Year End, 1976-2005, <http://www.bea.gov/bea/di/home/iip.htm>; Russell Scholl, U.S. Dept. of Commerce, Bureau of Economic Analysis, *The International Investment Position of the United States: Developments in 1971*, 52 SURV. CURRENT BUS. 18, 21 (Oct. 1972), available at <http://library.bea.gov/cgi-bin/showfile.exe?CISOROOT=/SCB7&CISOPTR=1825&CISOMODE=print>.

When Larry Woodworth died, the United States was by far the world's largest creditor nation. Today it is the world's largest debtor. And the list of large creditor nations is not especially comforting. Much of the world's capital is now coming from East Asia and oil-producing nations.

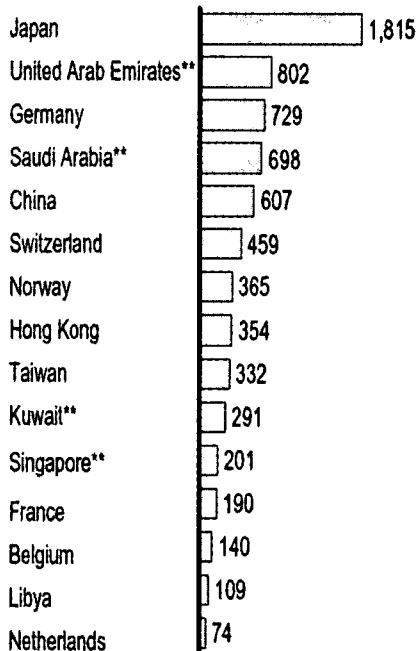
World's Largest Creditors and Debtors, 2008³⁹
Net International Investment Position by Country, 2006

\$ billion

Top 15 debtors



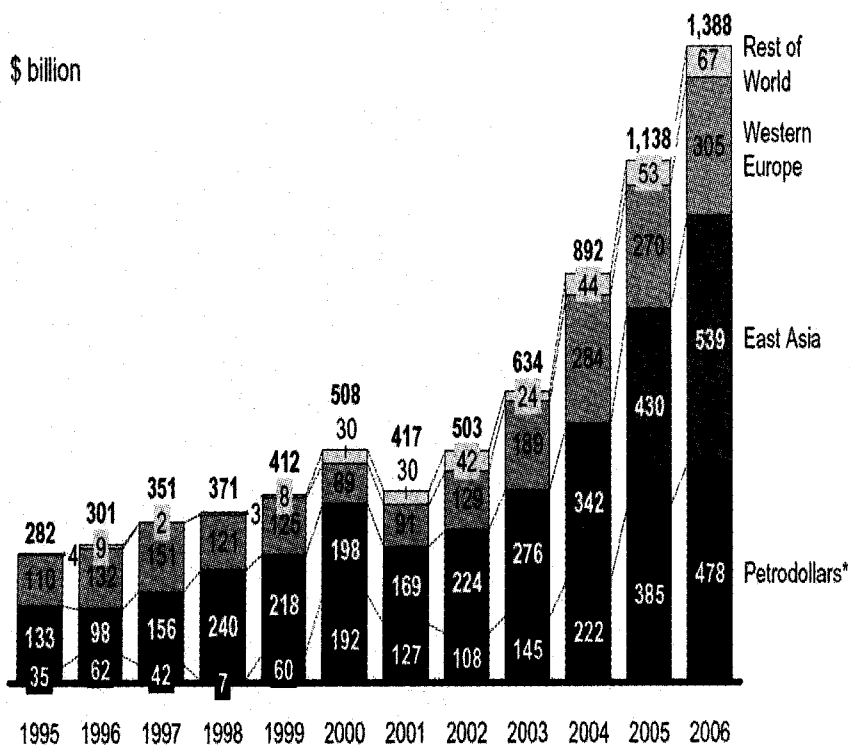
Top 15 creditors



* Foreign investment liabilities less foreign investment assets.

** McKinsey Global Institute estimates.

**Petrodollars and East Asia: Largest Sources of
Net Capital Outflow, 2006⁴⁰**
Capital Outflows Less Capital Inflows From Countries
With Current-Account Surpluses



40. *Id.* at 60. The petrodollars category includes Algeria, Indonesia, Iran, Norway, Kuwait, Libya, Russia, Saudi Arabia, Syria, United Arab Emirates, Venezuela, Oman, Qatar, and Yemen.

Consider a few additional facts: Cross-border capital flows, including foreign direct investments, purchases of foreign equity and debt securities, and cross-border lending and deposits, were \$425 billion in 1980.⁴¹ In 2006 they reached \$8.2 trillion.⁴² As a percentage of global GDP, in 1980 cross-border flows amounted to 4.7%;⁴³ in 2006 those flows amounted to 17.2% of global Gross Domestic Product ("GDP").⁴⁴

In 1962, when our international tax rules were fashioned, we were able to focus only on cross-border capital flows among developed countries within the OECD. Then we thought of nations as *either* capital exporters or capital importers. We were a large capital exporter. Today countries routinely both import and export capital. And, rather than thinking of the world as divided between source and residence countries, as we once did, we now have to recognize that virtually every country is *both* a source and a residence country. For now at least, the U.S. remains the largest foreign investor in the world.⁴⁵

41. *Id.* at 14.

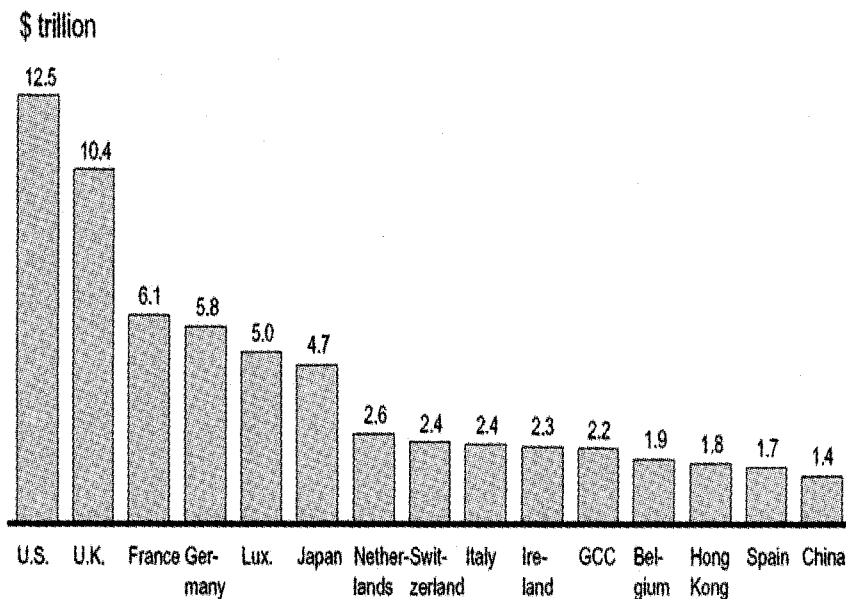
42. *Id.* at 13-14.

43. *Id.* at 14.

44. FARRELL ET AL., *supra* note 36, at 14.

45. *Id.* at 70.

U.S.: Largest Foreign Investor, 2008⁴⁶
Foreign Investment Assets, 2006



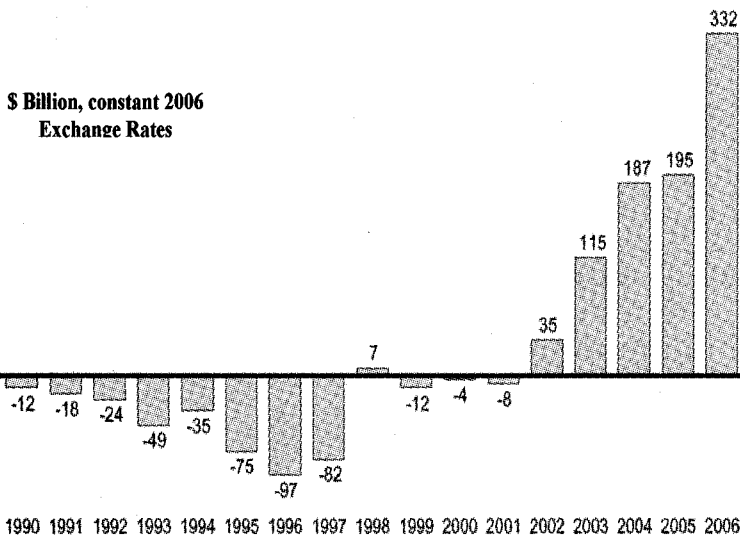
Recently, however, cross-border capital flows into emerging markets have grown at twice the rates of flows out of and to developed countries.⁴⁷ And, somewhat surprisingly, since 2002 capital outflows from emerging markets have exceeded their inflows, so developing countries today are net capital providers to the developed countries.⁴⁸

46. *Id.*

47. *Id.* at 14.

48. *Id.* at 54.

Emerging Markets: Net Providers of Capital Since 2002⁴⁹
Emerging Market Net Capital Flows (Capital Outflows Minus Capital Inflows)



Foreign investors now own one of every three government bonds around the world, one in four equities and one in five private debt securities; these are all triple the levels of 1990.⁵⁰ Global financial assets—the market value of traded securities, bank deposits and debt securities—reached \$167 trillion in 2006, compared to only \$12 trillion in 1980.⁵¹ In 2006 alone, global financial assets grew by 17.5%—more than double the average annual growth rate of 8% from 1995 through 2005.⁵² In 1980, the total value of global financial assets was roughly equal to world GDP.⁵³ By 2006 these assets were valued

49. FARRELL ET AL., *supra* note 36, at 54.

50. *Id.* at 15.

51. *Id.* at 18.

52. *Id.*

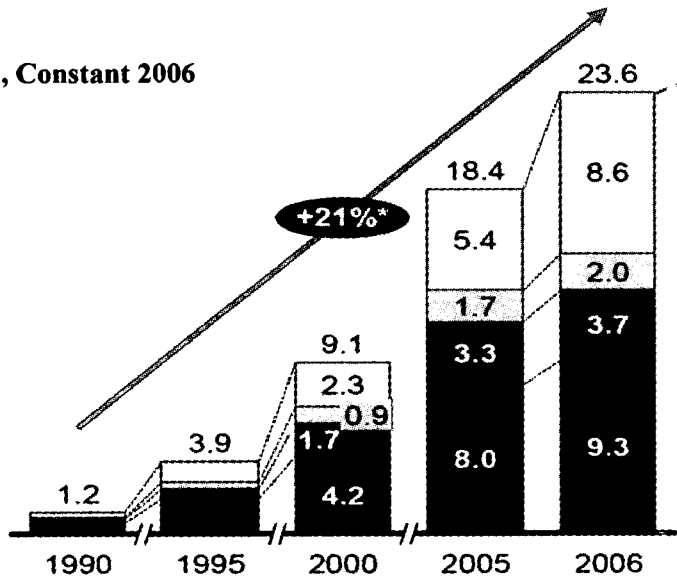
53. *Id.* at 21.

at nearly 3½ times world GDP.⁵⁴ In 1990 only two countries had financial assets exceeding 300% of their GDP; today, 26 countries do.⁵⁵

Again, emerging economies are playing a new role; they accounted for one-fourth of the total global growth in financial assets in 2006, and they have increased their financial assets from \$1.2 trillion dollars in 1990 to \$23.6 trillion in 2006.⁵⁶

Emerging Markets: Financial Assets Reach \$24 Trillion in 2006⁵⁷
Emerging-Market Financial Assets

\$ Trillion, Constant 2006



54. FARRELL ET AL., *supra* note 36, at 21.

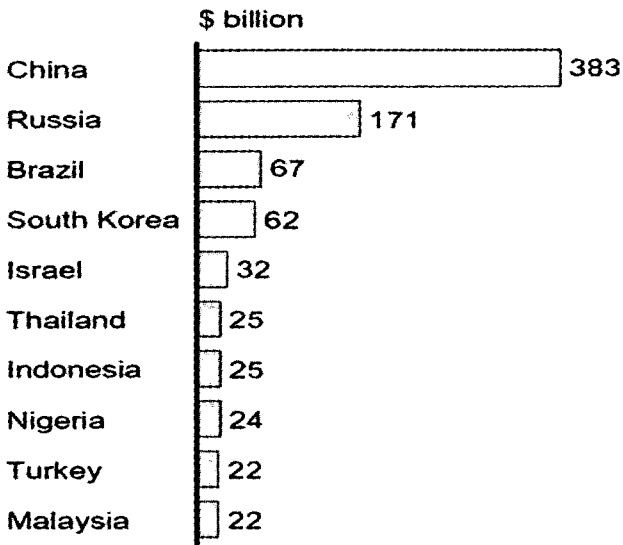
55. *Id.*

56. *Id.* at 34.

57. *Id.*

Obviously, China is an important part of this story, but it is not the only part.

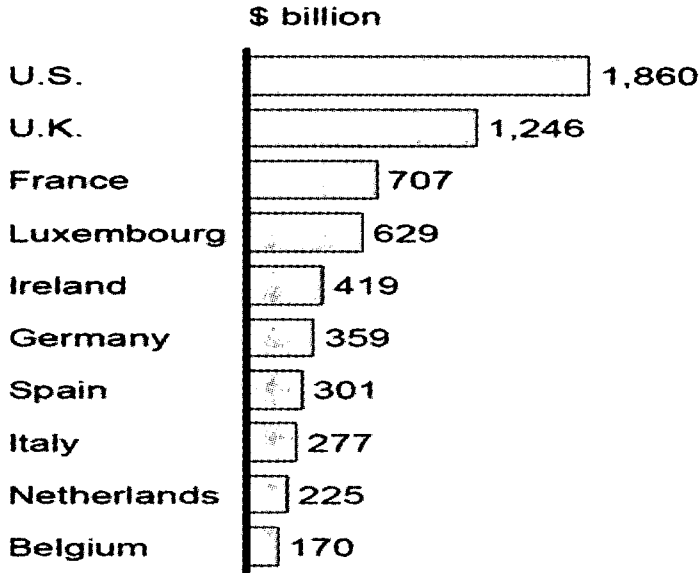
Capital Outflows by Country⁵⁸
Total Capital Outflows, 2006



As everyone here knows, the United States, for some time, has been running a large trade deficit, and we have been balancing our international accounts through large capital inflows. Europe has been doing much the same.

58. Some numbers do not add up to 100% due to rounding. *Id.* at 53.

Capital Inflows by Country⁵⁹
Total Capital Inflows, 2006

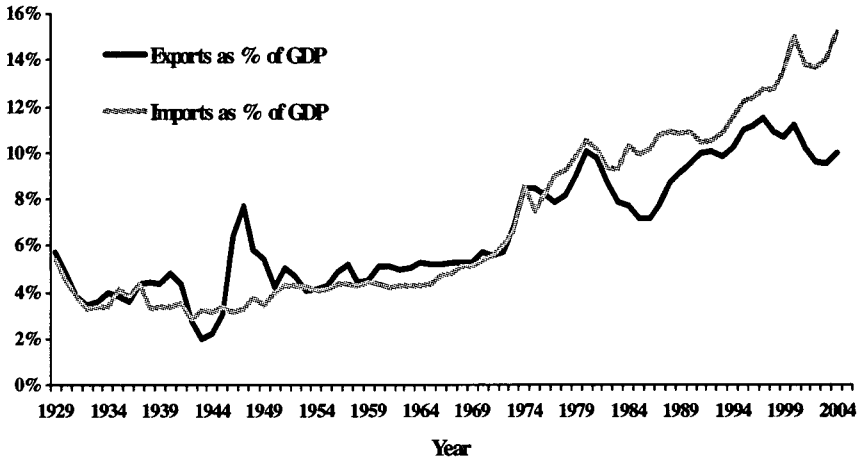


International trade has also increased dramatically, and, although exports have recently been a great strength to our economy, we are importing far more goods and services than we are exporting.⁶⁰

59. Some numbers do not add up to 100% due to rounding. FARRELL ET AL., *supra* note 36, at 49.

60. See U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, NATIONAL ECONOMIC ACCOUNTS: GROSS DOMESTIC PRODUCT (Aug. 28, 2008), <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=5&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=1929&LastYear=2004&3Place=N&AllYearsChk=YES&Update=Update&JavaBox=no>.

Global Trade: U.S. Imports and Exports over Time⁶¹
Global Trade: U.S. Imports and Exports as a Percentage of Gross Domestic Product: 1929-2004



Fiscal deficits increase our economic vulnerability when they are coupled with a substantial imbalance in trade. As the Harvard Economist Benjamin Friedman has put it, “Government deficits, sustained year after year even when the economy is operating at full employment, reduce net capital formation and induce foreign borrowing.” Both effects accumulate over time, both are harmful. Paul Krugman has recently described the U.S. economy, (before the recent housing slump), as one where “we made a living selling each other houses, paying for them with money borrowed from China.”⁶² In effect, foreigners have been transferring income to U.S. persons and we have been spending that money on consumption—in many cases on imports, thereby sending the money back outside the country.

While the evidence is not conclusive, it may well be that trade with developing countries, including trade in goods such as electronics and computers, is today exacerbating the inequality in wages of skilled versus unskilled laborers. But protectionist trade and tax policies are no answer.

61. See *id.*

62. Paul Krugman, *Trade and Wages, Reconsidered* 16 (Princeton, Brookings Panel on Economics, 2008), <http://www.princeton.edu/~pkrugman/pk-bpea-draft.pdf>.

Moreover, whatever the effects of trade in goods and services on our pre-tax distribution of incomes, it is beyond any doubt that the recent technological revolution—especially in information technology and financial products—has helped to produce a more unequal distribution of pretax incomes than any we have experienced since the gilded age of the 1920s. And no one is suggesting that we try to halt technological improvements.

The combination of technological advances and the opening of world markets for goods, services, labor, and capital have created unprecedented challenges to the U.S. economy and to tax policymakers and tax collectors throughout the world. In particular, imposing and collecting taxes on capital income have never been as difficult as they are today. And this produces major new challenges to our nation's ability to achieve the distributional justice that we aspire to provide. For example, the internationalization of businesses, along with the greater mobility of capital, has made collecting corporate income taxes much more difficult throughout the world. Companies today routinely manipulate their corporate structures, finances, and inter-company prices to take advantage of lower corporate tax rates in other countries.

Not only do these developments in technology and in the world economy make it more difficult to collect taxes, but they may even be changing the very nature of some important elements of our tax system. Take the long standing and difficult question: Who actually bears the economic burden of corporate income taxes? To be sure, this issue has tormented public finance economists since the tax first came into existence. But, for many years, the conventional wisdom among economists has been that the tax principally reduced returns to capital, at least in the short run. Thus, most of us have considered the corporate tax to be quite progressive, even if it is economically distortive.

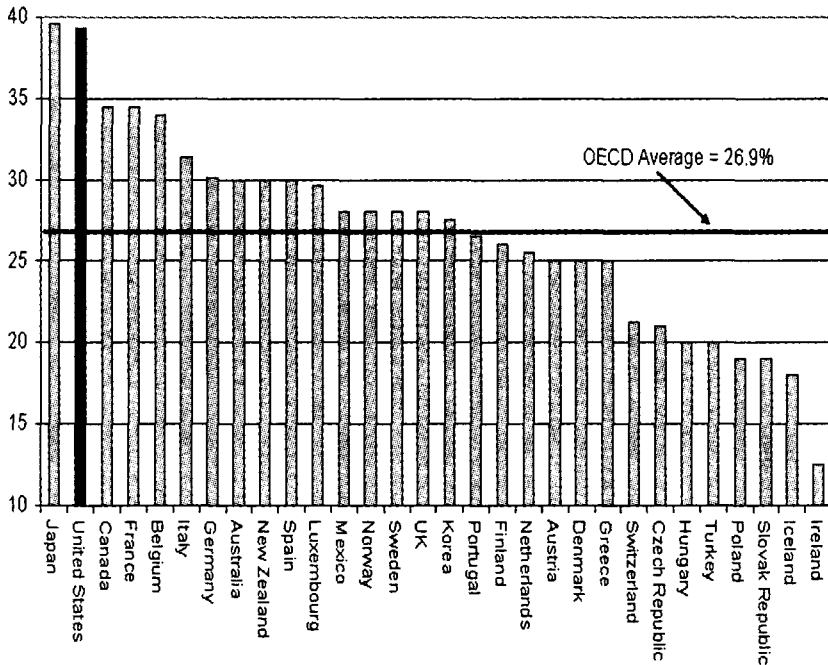
Ultimately, however, even in a closed economy the reduced capital due to the tax might result in lower wages, so in the long run workers might pay the corporate tax. And, as the economy has become more open internationally, a number of recent economic studies have concluded that the tax is less likely to be borne by capital generally, but rather by consumers or workers. Several recent studies claim that more than half the burden, maybe three-quarters, burdens workers.⁶³ The uncertainty in the economics profession contributes to the public's view that the tax is probably paid by somebody else.

To be sure, more multilateral cooperation and collaboration, both in tax enforcement and in establishing the rules of the corporate tax game, is essential. But there are limits as to what can be accomplished multilaterally. No country is going to give up its sovereign power to set its own tax rates.

63. See, e.g., William C. Randolph, *International Burdens of the Corporate Tax*, CBO Working Paper 2006-09, Aug., 2006, available at <http://www.cbo.gov/ftdocs/75xx/doc7503/2006-09.pdf>

After the 1986 tax reform, the U.S. had one of the lowest corporate tax rates in the world,⁶⁴ but not today.⁶⁵ Now, our corporate rate is the second highest in the OECD.⁶⁶

Combined Corporate Tax Rates for OECD Countries, Tax Year 2008⁶⁷



And we have stood pat while other OECD countries have substantially lowered their statutory rates.

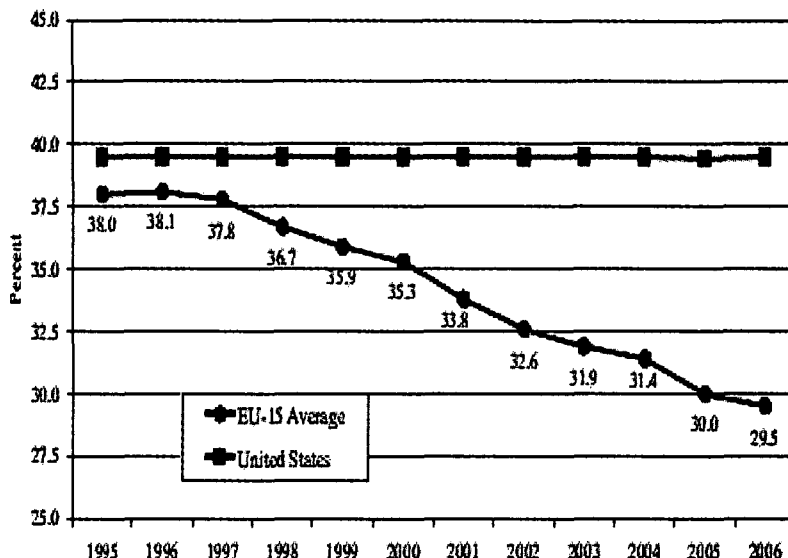
64. Haroldene F. Wunder, *Tanzi (1987): A Retrospective*, 54 NAT'L TAX J. 763, 764 (2001), available at [http://ntj.tax.org/wwwtax/ntjrec.nsf/914BFAOA45199C6785256B4B006682B2/\\$File/vS4n4763.pdf](http://ntj.tax.org/wwwtax/ntjrec.nsf/914BFAOA45199C6785256B4B006682B2/$File/vS4n4763.pdf).

65. Posting of Andrew Chamberlain to [taxfoundation.org](http://www.taxfoundation.org/blog/show/1471.html), <http://www.taxfoundation.org/blog/show/1471.html> (May 5, 2006) (ranking Corporate Income Tax Rates Around the World).

66. Gerry Seligman, PriceWaterhouseCoopers, Update on Relevant U.S. Tax Developments, Opening Remarks (May 13, 2008), available at http://www.pwc.com/il/heb/about/sucs/Tax/alerts/speech130508_1.pdf (slide 3).

67. *Id.*

Statutory Tax Rates, 1995-2006⁶⁸



The American economy—and its tax policies—need to be positioned to take advantage of the global economy. America needs to be an attractive place for both domestic and foreign investments. An important goal of tax reform should be to create better conditions for American workers and businesses, both domestically and internationally. But, this is an issue the public simply does not understand. Moreover, international tax policy is an issue that is susceptible to confusion, demagoguery and demonization by politicians. Not since the early 1970s when Congressman Jim Burke and Senator Vance Hartke advanced highly protectionist tax legislation has there been such a risk of bad tax policy concerning corporate taxation both domestically and internationally.⁶⁹

68. See EUROPEAN COMM'N DIRECTORATE-GEN. TAXATION AND CUSTOMS UNION, STRUCTURES OF THE TAXATION SYSTEMS IN THE EUROPEAN UNION: DATA 1995-2005 (2006), http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/Structures2006.pdf; Martin A. Sullivan, *Economic Analysis: On Corporate Tax Reform, Europe Surpasses the U.S.*, 2006 TNT 103-5 (May 25, 2006).

69. Victor Canto, *U.S. Trade Policy: History and Evidence*, 3 CATO J., 679, 682-84 (1983), available at <http://www.cato.org/pubs/journal/cj3n3/cj3n3-4.pdf>.

In my view, the critical issue is the corporate tax rate. My proposal calls for reducing that rate to 15% or 20% at the most. Some of the revenue lost can be financed by broadening the corporate tax base, but to get rates this low—without contributing significantly to future deficits—we need another revenue source. This is an important reason that we need a VAT. Substituting a VAT for much of the corporate income tax would improve the competitive position of the American economy, reduce tax sheltering behavior, and answer or minimize the impact of many of the questions now bedeviling our international income tax regime. And if done right, it need not worsen our fiscal position.

As recently as the early 1990s, when I participated in the Treasury's report on corporate integration, I thought it a matter largely of administrative convenience whether a single tax on corporate income should be collected at the business or individual level. But, given the dramatic developments in the world economy since then, plus legal developments in Europe that Al Warren and I have written about,⁷⁰ I no longer hold that position. Collecting taxes on capital income from high-income individuals—even though it puts the complexities of doing so in the wrong place—may now be the only practical alternative, if a nation intends to tax capital income at all. While I am not quite ready to disavow, for example, the Comprehensive Business Income Tax ("CBIT") proposal we at the Treasury advanced in 1992, I am no longer at all certain that it is the right approach today, even in theory.

And, in my view, we need to continue to tax the capital income of high income individuals, given the dramatic changes in the distribution of pre-tax incomes that we are now seeing. This is why I have rejected proposals that would replace the income tax altogether with a consumption tax and, instead, have urged that we substitute a VAT for the income tax completely only for the vast majority of Americans. At the same time, I have urged that we return the income tax to its pre World War II status, as a relatively low rate tax on a thin slice of high income American taxpayers.

V. INEQUALITY OF INCOMES AND WEALTH

Meeting the tax policy challenges I have outlined thus far here today—putting our fiscal house in order, restructuring tax policy toward healthcare and health insurance, shifting away from tax expenditures as our principal policy instrument for financing higher education, implementing energy policy, addressing long-term care needs and the like, and responding effectively to technological developments and the internationalization of the

70. Michael J. Graetz & Alvin C. Warren, *Income Tax Discrimination and the Political and Economic Integration of Europe*, 115 YALE L.J. 1186 (2006).

economy—are all Herculean tasks for both tax legislators and tax administrators. But I have saved the most difficult challenge of all for last.

In our country today, the gap between the wealthy and the poor is wider than it has been in a very long time. One has to go back at least to the 1920s to find a chasm so big between the ultra-wealthy and the least well off in our society. Some insist that even to notice this fact, much less to suggest that we do something about it, amounts to an endorsement of some utterly leveling socialism or even communism. This is nonsense and dangerous nonsense at that. As Andrew Jackson and Teddy Roosevelt, to name just two, understood, the establishment of a permanent economic aristocracy flies in the face of the American ideals of fairness and equality of opportunity for all of its citizens. Henry Paulson, in his first speech as George Bush's Treasury Secretary identified wage growth and income distribution as one of the major economic challenges facing our nation. He was right. Any serious restructuring of our tax system must retain as one of its basic principals the progressive tax structure we have relied on for nearly a century.

I hesitate to burden you with more statistics, but let me cite just a few more. In the period from 1979, shortly after Larry Woodworth's death, to 2003, the wages of a medium wage worker increased by 12.2% in real terms.⁷¹ At the 95th percentile the wage increase was 31.1%.⁷² At the 10th percentile it was less than 1%. And inequality in the distribution of wealth is much more severe than the inequality of income distribution. Today, the top 1% of wealth holders control over a one-third of total household wealth. The top one-fifth control nearly 85% of the wealth. The bottom 80% of households hold less than 16% of total household wealth.

Optimism is imprinted on the American psyche and dreams of upward mobility remain vibrant, thank goodness. But low wage labor markets persist, and the combination of technological changes and the internationalization of the world economy will continue to produce downward pressure on the wages of low-skilled workers. Throughout the 1990's, economic returns to higher education were great and securing such an education became everyone's favorite "solution" to this disparity in wage growth. But, the Dartmouth economist Matthew Slaughter has reported, during the period 2001-2006, even the college educated experienced a downward drift in their aggregate earnings. Needless to add, high school drop-outs and high school graduates also saw their real wages decline during this period. More surprisingly, those with master's degrees and PhDs also experienced earnings declines. The only

71. U.S. Census Bureau, *Income: Historical Income Tables—Families*, (2006), <http://www.census.gov/hhes/www/income/histinc/f07ar.html>.

72. DEAN BAKER, *THE UNITED STATES SINCE 1980, TURNING AWAY: THE UNITED STATES BREAKS RANKS* (2007), http://assets.cambridge.org/97805218/60178/excerpt/9780521860178_excerpt.htm (excerpt).

people who saw earnings increases in these years were those holding MDs, JDs and MBAs—doctors, lawyers and business school graduates. These trends raise new concerns about the economic bang-for-the-buck of a college education.⁷³

The integration of the United States into the global economy and the changes in that economy, coupled with the exponential growth in information technology, have changed domestic opportunities and transformed their character by increasing labor market mobility. They have pushed more workers toward temporary and contingent employment, and have restructured wages and benefits, especially of unskilled workers. Our society today is one where the rich are generally getting richer, the poor are staying afloat or getting poorer, and everyone in between is fearful of slowly losing ground. In a society where the rewards of work are slipping for so many workers, we must be especially concerned about our nation's productivity and its economic health.

While far from the only issue that must be addressed, our nation's tax system has a key role to play in addressing this dilemma. We must have a tax system that is fair, but we must also have a tax system that promotes economic growth and enhances the well-being of American workers. We must do so, while maintaining a safety net of adequate social insurance to protect American workers' incomes from what Franklin Roosevelt called the "vicissitudes of everyday life." Not only from the rising healthcare expenditures I discussed earlier, but also long and short term disability, long term care needs for the elderly, temporary assistance for needy families, a secure retirement income, and adequate income for relatively low-skilled full-time workers. Meeting these challenges will be the defining test of American public policy in the years ahead. Whether and how we perform will depend on courageous political leadership from our presidents and the members of Congress.

And we will surely fail that test if our politicians don't stop demonizing foreigners and international trade and stop treating middle-class Americans as if there is some bountiful free lunch pail coming around the next corner. With his grand and enormously successful Social Security experiment, FDR demonstrated that important and progressive public policies can be financed and sustained even with a tax that is not itself progressive. That experiment may be one we will have to try again soon a century or so later.

73. Kenneth F. Scheve & Matthew F. Slaughter, *A New Deal for Globalization*, 86 FOREIGN AFFAIRS 34, 40 (2007), available at <http://mba.tuck.dartmouth.edu/pages/faculty/matthew.slaughter/pdf/A%20New%20Deal%20for%20Globalization%20FA.pdf>.

I also believe the tax reform plan that I have proposed in my recent book would be an important step forward on all the challenges I have discussed here.⁷⁴

When Ian Shapiro and I were writing our recent book, *Death by a Thousand Cuts*, on the politics of the repeal of the estate tax, we interviewed a lot of people and also studied a great deal of polling data.⁷⁵ The most striking single question and answer we found was one poll where 40% of the American people said that they believed that they either were now in the wealthiest one percent of Americans, or would be by the time they died.⁷⁶ The American spirit is indomitable. But our challenges are difficult, serious and real. And, unfortunately, our political process at this crucial moment does not engender great confidence that the challenges I have described here this evening will be addressed in a thoughtful and serious manner.

Larry Woodworth was a great public servant. He would have looked at the daunting issues I have outlined here today, smiled and pressed ahead. He would have done so with incredible fortitude, consummate political skill, unbending integrity, and unyielding energy. He would have relished every change for the better, no matter how small, how incremental. This is the example he set for us and this is the example we should all try to emulate.

Thank you.

74. See generally MICHAEL J. GRAETZ & IAN SHAPIRO, *DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH* (2005) (discussed as the Paris Hilton Benefit Act regarding estate taxes).

75. See *id.*

76. David Moberg, *Class Consciousness Matters: What's missing From the New York Times and Wall Street Journal*, UTNE READER, June 30, 2005, <http://www.utne.com/2005-06-01/ClassConsciousnessMatters.aspx>.