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DOMESTIC POLICY IN PRESIDENT BUSH'S SECOND TERM

PANEL TWO: TAX REFORM

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PANEL TWO: TAX REFORM

MR. FRENZEL: While our panelists are getting dressed, I'll remind you that their biographies are in the material in front of you. On my right is Bill Gale, a Senior Fellow at the Brookings Institution, and on my left is Bruce Bartlett, a Senior Fellow at the National Center for Policy Analysis. The topic of this panel is tax reform. In addition to talking about Social Security, the President has also indicated that he would like to move forward on comprehensive tax reform, and has suggested that he's going to appoint a committee that will advise him on this matter. And that he hopes that the Committee will report promptly. So, I will say to our two panelists, don't be too brilliant today or you may get picked to be on that Committee. And that would be a position of great peril, I'm sure. Let us move right ahead. Bruce, will you start this panel for us in your very brief 10-minute presentation?

MR. BARTLETT: Sure. I kind of like to defer the discussion about tax reform in a way to the Q&A session, because it's my belief that very, very quickly the whole issue of taxation is going to be overwhelmed by the need to deal with the deficit. I've been thinking about this for a long time, and people who know me know that I'm not a deficit hawk by any means. I think we can run a deficit, I'm speaking about the budget deficit here, of one or two percent probably of GDP, probably forever. The problem with deficits is that I think there's a threshold effect. I like to use the analogy of salt. Salt is something that is necessary for human life. If you didn't have any salt, you would die. A little bit more is harmless. A little bit more than that, and you start to develop, you know, high blood pressure and things like that. And if you eat enough salt, like, for example, if you drank a lot of salt water, you'd die. And so, I think we're getting to the point where we're on a--poised on a precipice, where I think something--we're getting ready to move

into that danger zone. And I think the trigger for this is going to be in the international sector. We've--I think we've had an unusually benign situation for a long time, or at least for several years, resulting from the fact that the Japanese and the Chinese in particular have been buying vast amounts of U.S. Treasury securities as part of their currency manipulation efforts. That is to say, they've been buying huge amounts of dollars with yen and yuan to keep their currencies from rising; that is to keep--the flip side of that, of course, is that it keeps from--prevents the dollar from falling. All other things being equal, I think the trade situation and the monetary situation, the relative interest rates and all that sort of stuff, we would have a dollar which is substantially below its current value. And even though it has fallen about 30 percent or so over the last two years, I think that it's very likely to fall considerably more. And I think that we're--you know, just last week, for example, there was some hints out of the Chinese Central Bank that they might just slow down their purchases of Treasury securities and this created a bit of a flurry in the foreign exchange markets. And I bring this up only to show that this was just a hint, just a possibility of a slowdown. Theoretically, they could, of course, start to unload their dollar portfolios and move into Euro deposits, things of that sort. All of that would have a massive impact on the dollar that I think would impact capital flows very tremendously.

And as everybody knows, the current account deficit has to be financed with the foreign purchases of U.S. dollar denominated financial assets. And if that were to slow down to some degree, I think we could have a very significant market crash.

Now, I remember very clearly the crashes of '87 and '89 and I remember that the very first thing that everybody said when these events occurred was, “we got to reduce the deficit.” So, I think that one of these days, fairly soon, some event, triggered

by something in the international sphere, is going to create this kind of action forcing event, where, you know, we're all going to have our collective faces slapped, and all of a sudden, everybody in this entire city is going to be running around like chickens with their heads cut off, saying we got to do something about the deficit. And why things happen this way, and don't happen gradually, why markets don't fully process this information and do these things gradually is a question for another day.

But my point is that I think that this situation is going to occur, you know, fairly soon, sometime after the first of the year. I think the presentation of the President's budget is going to be a triggering event that's going to force--is going to completely change the dialogue and discussion on taxation away from the idea of reform and more towards the idea that we have to do something to raise net federal revenue.

Now, that being the case, and I won't repeat, you know, the things that Peter said earlier about the long-term deficit situation, but that's another reason why I think that people are going become focused on this fairly soon. And I've just come to the conclusion, just as a political matter, that there's simply absolutely no will in this Congress or this Administration to do any kind of budget cutting; therefore, the bulk of the adjustment I think, when this time comes, is going to necessarily fall on the revenue side.

So that being the case, we have really two choices. One is to try to get more revenue out of the existing system by raising rates, for example, that I think basically would be disastrous. I think we have a really crappy tax structure right at the moment, and anything that is done to raise more revenue out of that structure is going to be very counterproductive economically. Therefore, the alternative is to add a new revenue source. And, as some of you know that I've been lately advocating that we need

to start thinking about imposing a value added tax. It's not a coincidence that every other major industrialized country has one of these taxes. And one of the reasons they have it is because their spending as a share of GDP is substantially higher than ours. And they recognized early on that they needed a more efficient revenue source to pay for this higher government spending, which we are gradually moving towards. Over the next generation, you know, our spending more than likely will move to European levels, and so I think we need a European type of taxation.

And there are lot of various technical arguments for it, but the main reason for the VAT, I think, is that it raises--it can raise substantial revenues at relatively low economic costs; that is the dead weight cost, the cost over and above the tax itself is the lowest of any significant tax that we know of. We could raise about--on a broad base--it was about 50 percent of GDP. A one percent VAT rate would, therefore raise about a half percent of GDP. You know, there's a transition issue, but the steady state. And even if you had a tax, even if the base were only 30 percent of GDP, you could still raise, you know, a third of a percent in revenue for each percentage point. And now, the average VAT rate in Europe is about 20 percent. And I'm certainly not suggesting we put in a 20 percent VAT right away, but I do think the VAT has the virtue of being the sort of tax one can raise a little bit at a time without too terribly much economic adjustments; whereas, you can't very well announce ahead of time that we're going to raise income tax rates in the future. That creates a lot of income shifting and a lot of problems. But you could raise the VAT, you know, tenths of a percent at time to deal with the long-term deficit situation as well as the short-term deficit situation. And you could raise enough revenue from, say, a 10 percent VAT to not only make a significant down payment on the deficit of perhaps $100 billion a year, but have enough revenue left over to fix the

alternative minimum tax permanently and to make all the current tax cuts that are expiring permanent, if you wanted to do that.

So, it has the potential to fix a lot of problems in our fiscal system. And I think it's important we think in longer term measures because the only time you can ever really raise taxes in our system is when there's a bit of a crisis viewed. And I think that it would be terrible if when, as I'm assuming, the crunch comes next year and a big deficit reduction package works its way through Congress that we don't deal with this by ad hoc, one-time revenue measures, such as selling assets and things of that sort that we saw so much of in the 1980s, but that we use this as an opportunity to both fix glaring problems in the tax code and do something meaningful about the deficit that also moves us down the path, long term, of fiscal solvency, because I think we're going to have to do this in order to deal with the economic problem that I think is going to become apparent very quickly, and, as I said, more than likely through the international sector that is going to see interest rates rise fairly sharply and perhaps, through Fed tightening as well as through market actions. And, you know, I hope I'm wrong. But I don't think I am.

MR. FRENZEL: Thank you very much, Bruce. Bill Gale.

MR. GALE: Thank you very much. I agree with everything Bill Frenzel said in introduction except that I don't think there's a real risk that I'm going to be chosen for the tax reform commission. And I agree pretty much with everything that what Bruce Bartlett just said. I want to supplement it with one point, which is that the people that are in the White House and are now the majority in both the House and the Senate, the Republicans in power, have overwhelmingly signed the no new taxes pledge. Almost half of the House has signed it. Forty-members of the Senate have signed it. The President has signed it. I think it's extraordinarily unlikely that this configuration of

congressman and the President is going to turn around and raise taxes. To do that, they would certainly have to violate the spirit of the no new taxes pledge.

Now, it turns out that there's a loophole in the no new taxes pledge, and they would not be violating the letter of the no new taxes pledge because the pledge doesn't say anything about entirely new taxes, like a value added tax. You can impose a value added tax. You can impose a carbon tax under the no new taxes pledge. What you can't do is raise income tax rates. So, maybe there's an out, and maybe they'll say, oh, what we meant all along was we didn't want to raise these taxes, but we're quite happy imposing a VAT or an energy tax. But I suspect that that's not the case, and so my fiscal prognosis is more dire than Bruce's because I see all the same problems that he sees, but I see a Congress and a White House that have systematically ruled out most of the solutions. They're spending like there's no tomorrow, and they've cut taxes, and they've pledged not to raise taxes.

So, my prognosis is more pessimistic than Bruce's.

Let me turn to actual tax policy issues. The key issue right now is not tax reform. It's making the tax cuts permanent. Making the tax cuts that we have right now permanent. The President is not talking about this. No one is talking about this. Why? Because the idea of tax reform has seduced everyone into dreaming about their favorite tax simplification plan or their favorite tax deduction precisely at the time when we ought to be talking about if we do make these tax cuts permanent, how are we going to pay for them?

The budgetthis year that comes out in a couple months will not have a fundamental tax reform proposal in it. But it will have a proposal to make the tax cuts permanent. And the issue there, quite simply, is how do you pay for it? Making the tax

cuts permanent would create a long-term shortfall that's bigger than the entire Social Security shortfall. So, even if we solved the Social Security problem, if we made the tax cuts permanent, we'd be right back where we started in terms of a long-term fiscal problem.

Now, this is interesting because in the third presidential debate, President Bush said, and I quote: "I want to remind people listening tonight that a plan is not to lay out programs that you can't pay for." That quote got me pacing fearfully back and forth in front of the TV, and my kids asking my wife what's a matter with dad? But the issue here is it applies directly to making the tax cuts permanent. If we finance the tax cuts with debt, that is, if we increase the deficit, then the growth effect is going to be negative all studies say. That is, the long-term effects of making those tax cuts permanent and increasing budget deficits is negative because of the salt issue that Bruce is talking about. The metaphor that we like is the termite. The deficits are sort of termites eating away at the foundation of the economic structure, but salt eats away at the foundation just as well. The analogy works fine.

And it turns out that those long-term cumulative effects are bigger than the positive benefits that you get from marginal tax rate reductions, and that's true from studies from the CBO, from Alan Auerbach, from professors at the University of Michigan and so on.

Let me just add as an aside President Bush proposed this tax cut in 1999. Here we are five years later. There's still no Administration study of the long-term effects of making these tax cuts permanent. To me, that's astonishing. I mean, they've been running on ideology for the whole time. There's never been an effort in the--at least to make public an estimate of making the long-term tax cuts permanent. Certainly, if

we're going to go that route, the Administration owes us an open accounting of the growth effects.

So, if they're debt financed, they're detrimental in the long term. If they're financed by spending cuts, or the sort of across-the-board cuts, then we estimate that about three quarters of people will actually be worse off, even when you account for the positive effects on economic growth that would occur from that.

So, it's not at all obvious that these are--that the tax cuts are a good deal for most American households.

On top of that, the spending cuts you would need to pay for the tax cuts are gigantic. Let me just give you one number: if you separated out defense, homeland security, net interest, Social Security, Medicare, and Medicaid, and just looked at all the rest of the government budget, you would have to cut it by half to pay for the tax cuts. You would have to cut everything else by an average of half to pay for the tax cuts.

The debate we should be having in this country is “is that worth it?” If people think that's worth it, fine, we should do it. But if people don't, we should find that out now before we make the tax cuts permanent rather than afterwards.

So, the question is how is the Administration suggesting to pay for the tax cuts? Well, they aren't. In fact.

They proposed a budget change that would make the cost of the tax cuts disappear from the budget documents. That is, they proposed a baseline that would show no cost to making the tax cuts permanent. I am guessing that that proposal is going to be in the budget again this year, and that's one thing to look out for in terms of what's coming down the pike.

Let me turn to tax reform just briefly. Whatever the Administration comes up with on tax policy, you know they're going to call it tax reform. But calling it tax reform doesn't make it tax reform. What most economists mean by tax reform is broadening the base of the tax system; that is, removing special deductions and exemptions and exclusions et cetera, and using some of the revenue to lower rates. So, the Holy Grail in tax reform is a broad base and a low set of rates.

The other Holy Grail there is revenue neutrality. The studies that have looked at moving to a consumption tax, which is what the Administration talks about, tells you that a well-designed consumption tax can increase economic growth. But the key words there are not "consumption tax". It's "well designed."

Now, what are the features of a well designed consumption tax? One, it's revenue neutral. Two, it broadens the base. Three, it does not subsidize existing asset owners. And that's a crucial point, and I'll come back to it in a second. And four, it does not create new tax shelters.

Let me talk about those. The current stance of tax policy is going against all four of those features. First, we aren't talking about revenue neutral changes. We're talking about tax cuts and making the tax cuts permanent and so on.

Second, although there's been a lot of talk about base broadening recently, most of the examples are not likely to happen. If we removed employer deductions for health insurance, we would increase the number of uninsured by between five and 24 million people, according to a study co-authored by MIT economist Jim Poterba, who's being discussed as a CEA Chair replacement. And in addition, the Administration is talking about removing the taxation of saving.

In 1986, we did broaden the base. We taxed all forms of saving or more forms of saving, and we taxed capital gains at the same rate as other income. That was the lynchpin to making tax reform work.

Now, the Administration is talking about going in the opposite direction and exempting more saving, exempting capital gains. That's going to shrink the base in a manner that ultimately will probably be destructive because of the third feature, which is the taxation of old capital, of existing capital. Consumption taxes raise growth when they impose a lump sum tax on existing capital. We can talk about that more in the Q&A. But the Administration has gone the other way. They're subsidizing old capital. That's every--every model we know of, every intuition we know, says that's going to hurt long-term growth.

The last thing to keep your eye on is the creation of tax shelters. If we just eliminate the taxation of capital income, and we don't remove deductions, we have created loopholes that are gigantic. And a tax--the thing about reforming the tax system is that it's actually a system. You have to pay attention to how different parts of it work in conjunction with each other.

So, if you remove the taxation of capital income, of interest and dividends and capital gains, but you allow interest deductions, then Bruce and I can make a heck of a lot of money. I “lend” him a million dollars. He “lends” me a million dollars. We both "pay each other interest." We're not taxed on the interest we “receive”, but we get a deduction for the interest we “pay” each other. So, you create enormous options for shelters if you don't reform in a systematic way.

So, one litmus test for consumption tax reform or tax reform generally is if they don't remove interest deductions, they should not weaken the taxation of capital income. Thank you.

MR. FRENZEL: Thank you very much, Bill. Neither one of you is terribly bullish on tax reform this morning. Is--has the old fashioned revenue neutral tax reform for various purposes--simplification, effectiveness, fairness, et cetera--is that not going to happen? Is that out of style this year?

MR. BARTLETT: Well, I don't hear much talk about that and one reason is because basically what you're talking about is redoing the '86 reform effort, and the problem with that is that one, we're starting from a position which rates were much higher to begin with. We had a 50 percent top rate in 1986, and getting that down to 28 was a dramatic enough movement that you could realistically do some things that you can't really do when you're starting from a top rate of 35. I mean, how much lower can you realistically go to buy off the people who would be hurt by losing deductions and loopholes and things. And number two, the tax system that we had in 1986 was, by and large, created by Democrats over a long period of time--the Tax Reform Act of '69, '76, et cetera. Whereas, today, the tax system is, by and large, a creation of the Republicans. And what they've been doing is--so it was politically easier for Republicans to talk about getting rid of deductions Democrats had put in. Now, they would have to get rid of their own deductions.

And as we've seen from this Congress, they have very little appetite for doing anything that is remotely painful in the area of fiscal policy. So, I just don't see any real possibility of doing that, and I think as a consequence people have drifted into

supporting pie-in-the-sky, ridiculous reform ideas, like this national retail sales tax idea that I'll let Bill discuss, 'cause he likes it so much.

[Laughter.]

MR. FRENZEL: We're not inviting you to discuss that, but is there a chance for some kind of tax reform? You both were so negative I had to pose that question.

MR. GALE: I view us as having a love fest up here of agreement, and you're thinking of us as negative.

MR. FRENZEL: Actually, I was trying to follow the program.

MR. GALE: We used to have the luxury of talking about revenue neutral tax reform. In '86, that's what everyone talked about. As Bruce mentioned earlier, we don't really have that luxury anymore, as the first session indicated as well. Sooner or later, we're going to have to think about raising the revenue, the level of revenues. It's possible mathematically to solve the entire Social Security and Medicare issue with cutting benefits. It may not be desirable. As a matter of arithmetic, it is possible to do that.

But in terms of realistic policy solutions, I'm thinking that we're going to need a new revenue source, as Bruce mentioned, and I'm thinking that the value added tax is the most likely candidate there. And, so we can't just think about revenue neutral reform. We need to think ultimately about revenue increasing reform.

MR. FRENZEL: Are there--oh, please. Go ahead.

MR. GALE: Let me just add that all of the traditional concerns with an efficient tax system and a fair tax system don't go away just because we're talking about raising revenues. In fact, they're even more important the higher the level of revenues,

because if you try to raise a lot of revenues from an inefficient or poorly designed tax system, you really screw up the economy. So, the statement that we need to raise revenues is really a statement that we need to concentrate extra hard on making sure the tax system is both efficient and equitable so that raising that extra level of revenues does not impose undue burdens on the economy.

MR. BARTLETT: If I could just second that last point. I think we've been able to get by for a long time with a lot of inefficiencies in our tax system because of the fact that we're a relatively low tax country. Taxes as a share of GDP here, all levels, are 10 percentage points below that of Europe. And, as we move towards European levels of taxation, the point Bill has just made I think becomes paramount. We can't afford those inefficiencies anymore.

MR. FRENZEL: Thank you. Questions from the audience? Behind you, Peter Orszag.

MR. ORSZAG: [Speaker is off mike. Inaudible] . . . how crucial the movement toward the real income tax was as part of the 1986 reform. In the sense of the crucial provisions being that . . . that capital gains preferences were shut down, that depreciation allowances were tightened, that IRA eligibility was tightened, which is precisely the opposite of many of the directions in which the Administration appears to want to move. So, how important were those pieces to the ’86 reform and is it therefore completely inappropriate, or not, to be holding the ’86 reform up as a model when at least from one perspective it moved in, at least what I see, as an opposite direction of where the Administration wants them.

MR. FRENZEL: Well, we have two veteran observers of that act. Bill, do you want to start?

MR. GALE: I think the capital income provisions in '86 were central to the '86 Act. There—are these stories about people going out and having a beer and talking about how low they could get the rate if they only shut down this deduction or that deduction and so on. And ultimately, that's what pushed tax reform. And interesting, that's a tax--that was a tax reform that broadened the base and lowered the rate, so it was headed right toward the Holy Grail I was discussing. And you couldn't get that right now. You certainly couldn't get the distributional neutrality that you had in '86 if you exempted a large share of capital income. And that's--the distributional neutrality came from the fact that we closed an enormous number of loopholes and that allowed us to reduce the top rate by almost half, which is a pretty stunning reduction.

MR. FRENZEL: Bruce?

MR. BARTLETT: Well, I think to go--one of the differences between now and '86 is I think the depth of understanding of fundamental tax issues was much, much deeper in Congress in particular. We had had a major tax reform dialogue for, you know, 30 years or so before that, that frankly the Brookings Institution had a great deal to do with, that was behind the idea of the 1969 tax reform and the 1976 tax reform, which were mostly loophole closing measures. And that became married to the idea of the flat rate. And after '82, or after '81 rather, it was no longer possible to really talk about tax cuts anymore, so the people who cared about lowering tax rates, President Reagan in particular, had to channel that interest into tax reform. And so, the two ideas became married together of lowering rates and broadening the base in a way that I think has just been lost. Nobody really understands anymore about the economic costs of having a Swiss cheese tax system where some forms of income are not taxed at all, and others are taxed very heavily. And also, this Administration, and frankly the Republican Congress,

has kind of lost its direction. They had a vision at one time that lowering the statutory rate of taxation was the Holy Grail. Now, I'm not really sure what they think they're trying to do other than buy themselves reelection.

And so, I think that what we--I think one of the reasons I'm very skeptical about the prospects for fundamental tax reform is that we haven't even begun that dialogue. I mean, why--we have to ask a question: why is President Bush appointing a tax reform commission? Why doesn't he just tell the Treasury Department what he wants them to do, as Ronald Reagan did back in 1984, and we'll have a discussion about that, and we'll debate it in Congress, and we'll see what comes out. I mean, after four years in office, does he need somebody to tell him what his own tax policy ought to be? Apparently so.

So, if that's the case, then we're only at the earliest possible stages of a tax reform effort that I do believe is going to be overwhelmed by the need for higher revenues very shortly.

MR. FRENZEL: Peter, I was present at that time as well, and I did not think the '86-'87 act was worthy of casting a vote in favor of. The 28 percent rate that lasted I think four years, and within six years it had been raised by 50 percent, back up to about 40 percent. The carnage that was wrought to achieve it was not particularly good for the economy in my estimation, but I think it is also true that things are different now. I think both of our discussants here have indicated that whatever opportunities were around at that time probably aren't going to be available to us. There's no room apparently for transition money, and it's very hard to pass a tax reform bill unless you can grease it with a little transition. And it's very hard to get to keep the burden tables if you

believe that they are in the right place now or somewhere close. With the tax code we got today, I agree it will be very hard to do that.

So, my judgment is the task is much greater today. Now, who--Alice?

MS. RIVLIN: Both of you have talked favorably about value added taxes. But neither of you has said anything about the impact on state and local government which, after all, do draw heavily on consumer taxation. How are they going to be impacted by a value added tax?

MR. BARTLETT: Well, historically, state and local governments have viewed sales or consumption taxes as their tax base. And they have complained in the past when the discussion arose. But perhaps from their point of view, the alternative is getting rid of the deduction for state and local taxes, which I think they would view as far worse.

So, I think that the potential of that to raise revenue, and also keep in mind there's likely to see some significant cuts in aid to state and local governments in the next budget. So, you know, weighing all those things together, the possibilities of something worse, I think, will limit their objections to a VAT when the time comes.

MR. GALE: I would have practically said exactly the same thing. I just want to add one thing, which is that state sales taxes are administered incredibly poorly. They tax the wrong things. They don't tax the things they're supposed to. They may actually benefit from being able to piggyback on a VAT in terms of administrative structure the same way that state income taxes benefit from being able to piggyback on the federal income tax.

MR. FRENZEL: That's assuming the VAT is a good one.

MR. GALE: Yes.

MR. FRENZEL: Belle.

MR. GALE: Goes without saying.

MS. SAWHILL: I want to shift gears a little bit. Some of you may have noticed that this forum is being sponsored by the Welfare Reform and Beyond Project at Brookings, and I want to thank several of our sponsors, in particular some of whom are here from the Mott Foundation, also the Casey Foundation.

And I want to bring back this conversation back to what does this have to do with lower income families?

One of the things that is not often realized is that we have expanded some benefits for low-income working families in recent years, things like food stamps, the Earned Income Tax Credit, child care subsidies, and the like. But it's also the case as your earnings rise, just a little bit above the lowest levels, the government claws back most of those benefits, with the effect that the effective tax rates on lower income working families are extremely high. In fact, some studies done by Gene Steuerle at the Urban Institute show that those tax rates can be close to or even greater than a hundred percent. Does either of you want to comment on this problem of very high marginal tax rates for low- to middle-income families who have some government benefits in their income portfolio?

MR. GALE: Just a couple of comments. One is that over the past 15 years, programs for low-income households have migrated from the spending side of the budget to the tax side of the budget. There are a number of reasons for that. One is the caps on discretionary spending. One is the seeming inclination in Congress to favor "tax cuts" but oppose "spending increases," even when the programs

are identical in nature. Just one that's run through the tax code. One is run as a separate spending item.

The key issue, though, is that this change is here to stay. I don't see any way that we move back toward the old system of running benefit programs through the spending system and other stuff through the tax code. So, there's this increasingly strong connection or link between tax policy and policies toward low-income households. Basically, everything has been done through the tax code the last 15 years, except welfare reform, and that, of course, was a cut back.

Now, in terms of how you structure these things, you have these high marginal tax rates regardless of whether you've run them through the tax code or the spending system. So, it's not a tax issue. It's not. The high marginal tax rate is sort of there. It's not a function of running it through the tax code or as an outlay.

The issue, though, is what to do about it? You face a tradeoff. if you want to keep the amount of resources constant, Either you phase out the program fast as income rises, which creates very high marginal tax rates over a very short range, or you phase it out more gradually over a long range, which requires you to lower the benefit level if you want to hold revenues constant. And there so you still have a higher than normal marginal tax rate, but the increase is lower, and it affects more people.

So, you have this tradeoff. It's not obvious to me that there's a single right answer for what the optimal phase out or what the optimal effective tax rate is there, and so I think it's probably best determined on a program by program basis, and with evidence-based analysis that in some cases the marginal tax rate matters a lot, and in some cases it doesn't. But I'll stop at that.

MR. BARTLETT: Yeah. I would agree with what Bill said. It's--there's an extreme limit to what you can do to fix that problem on the tax side, because it's in the nature of the benefit formula. But I do think that one of the main arguments for tax reform is that we have very high implicit and actual tax rates all throughout the tax code because of crazy phase outs and things like that, and it would be really nice if we could kind of straighten that whole mess out. And I would mention just on top of the program we had before, that one of my concerns in terms of Social Security reform is the very high implicit tax rate we're going to be imposing on workers who take early retirement, because we got rid of the earnings test for those over age 65, but we've kept it, and I think it's 50 percent, for those age 62 to 65. And, of course, as we raise the retirement age to 67, we're increasing the pool of people who will have to pay this high implicit tax rate on Social Security, and given that 50 to 60 percent of people take early retirement, we're talking about a not insignificant portion of the labor force that is going to be pushed out of working by the Social Security system, and this is one of the main reasons why I think we need Social Security reform of some kind.

MR. FRENZEL: Thank you very much. We have run out of time for this panel. Again, there will be no break period. And a new panel will magically appear before your eyes, very quickly. And we'll begin the next panel on the fiscal outlook.