THE BROOKINGS INSTITUTION

AVOIDING THE FISCAL CLIFF:
A CONVERSATION WITH SENATOR PAT TOOMEY (R-PA)

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P R O C E E D I N G S

MR. HASKINS: Good morning. Welcome to Brookings. We have -- this is the second in a series of events about the so called, cliff that I will describe in just a minute. My name is Ron Haskins, I'm a Senior Fellow here at Brookings, and along with Belle Sawhill, I run a program here called, Budgeting for National Priorities and we've been calling attention to the deficit for almost a decade now doing all the kind of things that scouters do, publishing books and articles and having events like this one. And so far, we have failed miserably to have any impact as far as I can tell.

So we're going to try to do better. As I said, this is second in a series. Some of you may have been here last week when Senator Murray spoke about going off the cliff and made quite a surprising recommendation that we should go off the cliff. And we've done a secret survey; we know that there are 11 people in the room who don't have a good idea of what the cliff is. So for those 11 people, I'm going to tell you very quickly what it is, and the rest of you can take a little nap or -- don't talk on your cell phone though.

So first, the biggest part is the Bush tax cuts, probably worth around 3 trillion over 10-years. The Bush tax cuts would all expire and so tax rates would go up for virtually everybody and that would result in additional revenue of at least $3 trillion. And according to some estimates, that would go a long ways towards solving our problem with the deficit. And the second big item on the cliff is the sequester, so called. Thanks to the committee, the supercommittee, so called that resulted from the debt ceiling debate, and that would be impose immediate cuts in spending on the U.S. budget and it would result in about 1.2 trillion over 10-years in cuts in spending.

So -- and most of those will be across the board, so it's probably arguably, the worst possible way to cut spending. And then the spending bills for 2013, it seems slightly unlikely that Congress will pass all of the spending bills and so parts of the government could close unless there's some action by January 1. So that will be a third item. And possibly, there'll be something to do with the debt ceiling. The latest estimates that I've seem show February or March, so maybe that will not be a part of it, but a lot of members may want to make that part of it so they can get it out of the way.

So this is really a big deal. And as I said, Patty Murray said, let's just ignore those, go off the cliff, impose the sequester, and we'll have time to really get something done in January. So we -- and the *New York Times* by the way, said that this action would put the democrats in the driver seat, so to speak. They said it would give democrats the upper hand. I believe that's in the headline of the *New York Times.* So here we are anticipating a response to Senator Murray's proposal from our guest today. And here's how we're going to proceed.

After I get through introducing Senator Toomey, Senator Toomey will talk, he has a power point. I always love it when members of Congress and especially the Senate, have power points. It's really fun. So when he gets through speaking, he and I will have a chance to talk for a minute and then I'll give the audience a chance to ask a couple of questions. The Senator will then leave and we have a distinguished who will make comments about the Senator's presentation.

Two panel members are slightly left of the Senator and two slightly right of the Senator. I'll let you guess who they are. Maybe you'll be able to tell by their remarks. And then after they're done, we'll give the audience another chance to ask questions and then we'll adjourn and go home in knowledge that we have solved the problem of the cliff. So now, let me say a few things about Senator Toomey. You biographical materials, so we specialize in short introductions here at Brookings. I just want to mention four things.

The first is that the Senator is a republican Senator from Pennsylvania. He's in his first term. The second thing is, but he was in House for three terms. He was one of the people who ran for Congress and pledged to serve three terms and then leave and he actually did it. Most I think, actually did not do it, but he did it and then ran and was elected. He's on the Budget Committee, the Banking Committee, the Commerce Committee, and the Joint Economic Committee.

And then finally, he offered a surprising, comprehensive revenue and spending plan as part of the supercommittee; the Joint Select Committee on Deficit Reduction. And Senator Durbin actually referred to his plan as a breakthrough signaling I think, that it deserves some serious attention which we are about to give it. So he's here today to talk about his plan and I hope, the role that it might play in the negotiations to avoid going off the cliff. Senator Toomey, thank you so much for coming.

SENATOR TOOMEY: Thank you very much. Ron, first of all, thank you for that kind introduction and thank you for inviting me to be with you today and to share some thoughts with everybody on our budget circumstances, what really happened at the Joint Select Committee, the fiscal cliff, and most importantly I think, where we go from here. By the way, it's especially kind of you to invite me given my very well documented weakness in public speaking. My staff is forever reminding me. They like to say, Pat, remember just because you can't give a good speech doesn't mean you can't give a short speech. So I will try to keep their advice in mind and keep it relatively brief.

But the real reasons that I really do appreciate the chance to be here at Brookings, is -- well several. First of all, this organization does some very good work. Much of it I won't always agree on, but I have always respected as I think, people who observe Brookings have respected the intellectual integrity, the thoughtful analysis, and the honest debate that you folks participate in and contribute to. A second factor that I appreciate, is the fact that you chose to invite me to be here despite the fact that we do come from a different place philosophically, ideologically, and so naturally, we will often come to different conclusions, but you're still willing to have that discussion

I appreciate that. And I think you probably share with me that view that if we're ever going to solve these really, really tough challenges that we face as a nation, we need to have an honest debate. We need to be willing to look at and accept the facts of history, of arithmetic, of actuarial tables, we need to accept those facts as they are and deal with them. And if we're going to find common ground rather than just have another fight, then the truth has to count for something. So the first point I want to talk about is the truth. The truth is that our big entitlement program, social security included but especially, the mandatory healthcare programs are unsustainable.

I think we all know that. They're driving the medium and long-term fiscal disaster that's accelerating toward us. And it's not just me who says this. President Obama himself has acknowledged this. In a press conference last year, President Obama said and I quote, "if you look at the numbers, Medicare in particular will run out of money and we will not be able to sustain that program no matter how much taxes go up".

He went on to say, "I mean, it's not an option for us to just sit by and do nothing, and if you're a progressive who cares about the integrity of social security and Medicare and Medicaid and believes that it is part of what makes our country great and that we look after our seniors and we look at our most vulnerable, then we have an obligation to make sure that we make those changes that are required to make it sustainable over the long-term". President Obama said that just a year ago. President Obama was right. He identified the real problem.

In fact, if you think about it, no significant government program can grow faster than our economy indefinitely. It'll consume everything. That's just arithmetic.

That's inevitable. The fact is however, all three of our big entitlement programs are growing faster than the economy; some much faster. Take a look at CBO's March baseline. In nominal terms, they're projecting an average 10-year growth rate of 5 percent. In the short run, that's probably pretty optimistic, but that's what they're projecting. Social security they're projecting to grow at 5.7 percent, Medicare at 6.4 percent, and Medicaid and other mandatory programs, 11.1 percent. Think about that.

Medicaid and the other mandatory health programs are growing at more than twice the rate that we can reasonably hope our economy is going to grow at. This ladies and gentlemen, I would suggest is pretty close to the definition of unsustainable. And these programs are not trivial programs. As we know, these are already huge. This year, 2012, social security, Medicare, and Medicaid and other mandatory health programs already constitute 42 percent of federal spending. By 2022, these programs alone together with interest on our debt are projected to consume about 90 percent of the portion of GDP that we have historically collected in taxes.

So I mention this and I'm stressing this because these are the most salient facts that inform the judgment of the six republicans on the supercommittee. This is what we focused on and we wanted to solve the big problem. And this was it. What we wanted to do specifically, was to make the structural reforms, change the architecture of at least one of the big entitlement programs so that we could put it on a sustainable path and in the process, begin to put our federal budget on a sustainable path.

And so, we developed an initial framework that we discussed with our colleagues on the committee. And the initial framework included new revenue. What we said first of all, and let me be very clear, I don't believe that adding new revenue in the form of an increase in the total tax burden is either necessary or optimal or economically or fiscally required to solve this problem, because I think it's a problem that arises on the spending side. And as you know, it's anathema to us to propose an increase in revenue. But we did recognize that it was politically necessary because it was absolutely essential for our friends on the other side.

And so we were willing to do that provided that we would get the architectural and entitlement reform that we know we need. This is something -- this is an essentially consistent with the framework that Bowles Simpson has proposed. Again, President Obama acknowledged that you can't do this with taxes alone, you have to have reform to the entitlement programs. I think any objective observer has to come to the conclusion that if we're going to fix this problem, we have to do it with the entitlement programs.

And in our view, whatever revenue we would agree to put on the table would be commensurate to the scope and the nature of the reform of the entitlement programs. The democratic offer that we got was a trillion dollars in tax increases, a trillion dollars in mostly unspecified spending cuts, although there were some specifics, but absolutely no architectural reform of the entitlement programs. In other words, they wanted a huge tax increase but they were not willing to begin to solve the real problem. The actual specific one page summary that they circulated is here.

I know it's small print, probably hard to read. But if you look on the spending side, and you look specifically on Medicare and Medicaid, most of the spending reductions were to providers. Ratcheting down reimbursements to healthcare providers is something we've been doing, and that is not anything that's going to put this program on a sustainable path. There's nothing that remotely resembles structural reform, something that would change the architecture, change the incentives. On the revenue side, as you can see, the total revenue is a trillion dollars.

They wanted to maintain current progressivity which is no surprise. They wanted to keep the top rate, no higher than 35 percent to their credit, I think. And proposed generating a lot of the revenue by limiting the value of deductions. But at the end of the day, it was a trillion dollar tax increase without solving the problem, without even taking a big step in the direction of solving the problem. And as such, this was not going to work for the republicans on the committee. And so we remained deadlocked. We were deadlocked for many weeks without any real progress.

So I started to think about, is there another way we could approach this problem? Is there another way we could establish maybe, a different framework, a different paradigm that might allow us to find some common ground. I came up with the proposal when I decided that we were hopelessly deadlocked on the previous framework and decided that we would have to give up on the idea of getting the structural change to the entitlement programs that we needed. That I thought was a very big concession because I thought that's what we were there to accomplish.

But I wanted to accomplish these objectives as well, and so at that moment I was willing to give up on -- that structural reform. Here's what the proposal was meant to achieve. Reach the $1.2 trillion in deficit reduction, avoid the sequestration, achieve the legislative goal, have at least, meaningful entitlement curbs in spending, at least bend the growth curves a little bit in the out years. If we can't have the structural reform, we've got to at least make a difference, chain CPI was something that I stipulated.

It had to be part of this agreement. I want to say a little bit more about that in a moment. Very important to me, was avoiding this massive tax increase that's coming and that was part of this arrangement. I've quantified it here as an $800 billion plus, tax hike. Of course, that really describes only the affect on the top two brackets. The latest proposal from my friends on the other side, suggest that we might be in for a much, much bigger tax increase even than that.

I suggested that we have revenue and spending cuts that would occur in a similar ratio to that which was proposed by the Bowles-Simpson Commission. And as a fundamental aspect of my proposal, any new revenue had to come in the context of pro-growth individual tax reform which is also completely consistent with what every bipartisan commission has recommended. Let me get into the specifics, the dollar figures. We were proposing $750 billion in spending cuts, $500 billion in revenue, interest savings that would be $200 billion approximately over the course of 10-years, total deficit reduction of $1.5 trillion.

Again, let me just -- $500 billion of new revenue. We were meeting them at the halfway point. They had asked for a trillion, we put $500 billion on the table. If you look at how this breaks down in the ratio of spending versus tax revenue, just the tax portion -- and I will in a moment drill down into the details of the revenue number. But the total revenue was about a three to one ratio. If you look at spending against all revenue, it's one and a half to one against a Bowles-Simpson ratio of three to one.

What will the spending consist of? As I mentioned, at this point in the process, I had given up on the idea of having structural reform and thought we needed a different approach. The good news is, by then there had already been so much work done by others, the ground had been pretty well plowed in terms of spending reductions that weren't even terribly controversial. We were zeroing in for the purpose of this proposal, on items that had been at least tentatively agreed to by some kind of bipartisan group in the recent past. Either the Joint Select Committee itself, where we had had numerous presentations on all kinds of opportunities to reduce spending. The Biden talks, which had happened the previous year. The President's budget, in some cases, we lifted things right out of the President's budget proposal. The Rivlin-

Domenici plan and Bowles-Simpson itself. The idea is, on the spending side at this point, I was suggesting that we go after the lowest hanging fruit. In Medicare, it was about $225 billion. Much of that frankly, would have come from means testing of more affluent Medicare beneficiaries. Medicaid and other health, we had the same $50 billion estimate that our democratic friends had proposed.

Other mandatory was $100 billion. Chained CPI was $165 billion on the spending side and then discretionary spending of $210 billion for a total of the $750 billion that I mentioned. Now let me just digress for one moment on chained CPI, because it occurred to me then and I still believe now, that in some ways chained CPI is like the perfect metaphor or maybe a microcosm of exactly what we need to be willing to do if we're going to address this problem. So first of all, as everybody in this room probably understands, chained CPI is a measure of inflation that takes into account consumer substitution behavior.

And so, it is almost universally acknowledged as a more accurate way to measure real inflation as it occurs to real consumers. Switching from the current measure of CPI to chained CPI -- chained CPI tends of course, to estimate CPI at a slightly lower rate. Switching doesn't cut anybody's benefits, but it does curb the rate at which future benefits grow. It also generates additional revenue; tax revenue. Because it is the measure that is used to establish the thresholds for the various income brackets and if you move those brackets up more slowly, as wages rise faster than the increase in the brackets, people are paying more in tax revenue over time.

It was recommended -- it was a reform recommended by Bowles-Simpson, it was recommended by Rivlin-Domenici, it happens to have a ratio of savings to new revenue of about one and a half to one; it's politically painful for everyone, because everyone in office has constituents who would see a slightly slower rate of growth in their benefits. Everyone has constituents who pay taxes. At the end of the day, the fact is, republicans were for it and the democrats absolutely refused. On the revenue side, this first item was the most controversial and the toughest one, but I want to be very clear about this.

I was not asking my democratic colleagues to accept something that I believe, which is that if you have pro growth tax reform, you'll have stronger economic growth. A bigger GDP number means more revenue as a positive, dynamic matter of fact. I believe that. There was a lot of skepticism on the other side, so I didn't ask them to accept it. What we said we would do is put $250 billion of statically scored additional revenue on the table, as scored by the Joint Tax Committee. The chained CPI that described a moment ago, as I said, that generates additional revenue. We were advocating that we'd put some nontax revenues, specifically asset sales and some user fees.

Our proposal included a revenue neutral piece, so there's no dollar figure, but I thought -- many of us thought it would be very constructive. I actually put a lot of time in this. I really want to compliment Rob Portman, who really spearheaded this, but there was strong bipartisan consensus that we need corporate tax reform. Supercommittee had unlimited jurisdiction. We could have done that and I thought we should have and dropped that right into this package so that we'd have a broadening of the base, a simplification of the system, and a lowering of marginal rates so that we -- our workers and our businesses would be more competitive.

That was part of it. Again, Rob did a lot of the heavy lifting on getting the specifics of that. We advocated that we maintain current policy on capital gains dividends and the estate tax and make them permanent. That's the total of $500 billion. I want to drill down just for a minute on the static tax revenue piece on this, because that was -- you know, that was frankly, the hardest part for us to offer and the source of the pro growth tax reform. So the first piece was that we established a goal of lowering all marginal rates by 20 percent.

I say that was a goal because we had several simultaneous goals and this one was subordinate to the others. And I will specify what I mean by that. First of all, we'd have to generate the revenue that would not only offset the lost revenue from lowering marginal rates, but generate the $250 billion in statically scored revenue and we would do that in several ways. One would be by placing a hard dollar cap on itemized deductions. We'd maintain the standard deduction where it is, but we'd put a limit on the total amount of itemized deductions. We would suggest replacing the income exclusion on state and local bonds with the direct interest subsidy to the issuers, rather than an interest exclusion to the investors.

We'd repeal various miscellaneous business and personal credits, not the earned income tax credit, not those that are focused mostly on the lower income brackets, but more on the higher ones, and include as a taxable income, a portion of the health insurance exclusion. But let me stress, this was -- none of us, and certainly I, was not religious about exactly what mechanism would occur. These were the ideas that we knew in combination, would allow us to lower the marginal rates, generate the income we said we would generate, and so these were some of the ideas that we were choosing from.

Virtually every one of them is very dialable. You know, you can adjust the amount of revenue or savings depending on how you specify the levels. But this was the most important thing: we stipulated right at the very beginning, that in this arrangement all the net new revenue would have to come from the top two brackets. And I will be very candid with you. This why it is very objectionable to me when people who know better, suggest that I was advocating that we have some kind of tax increase on the middle class to pay for a tax cut for the rich.

The proposal specifically stated that we would generate increased revenue from the top two brackets exclusively, and we would adjust every dial needed to ensure that the lower brackets did not have an increase in the tax burden. In the process of course, the tax code becomes more progressive, not less progressive. So let me just summarize the proposal that I actually put on the table and consider the concessions that we were offering to our colleagues. First of all on the spending side, the spending to revenue ratio was favorable to the Democratic point of view than any bipartisan commission. The specific spending items were the least controversial ones. We had abandoned the idea of the architectural or structural reforms and were looking for only those that had previously demonstrated bipartisan support. We offered real statistically scored tax revenue, as Ron pointed out. Senator Durbin described it as a breakthrough. We met the Democrats half way on their proposal. We insisted on pro-growth tax reform as the mechanism by which we would generate that revenue so that we wouldn't be damaging the economy while we were doing this, and this is exactly the mechanism that every bipartisan commission has proposed. We proposed making the tax code more progressive by stipulating, as I said, that the extra revenue would come from the top brackets, not the others. We would have achieved our statutory goal of deficit reduction. We have avoided the sequestration. And maybe, most importantly, we would have demonstrated to the American people that we were capable of governing. Unfortunately, my colleagues on the other side walked away from the table.

So, where are we now? Well, we're in a tough spot right now. Some of my Democratic colleagues are now doubling down on the tax hike message. Actually, that's not true; they're quintupling down. Senator Murray has called that all tax rates go up. It's a staggering increase. And what she said, I think probably from this very stage or thereabouts, and I quote Senator Murray, she says, "If we can't get a good deal, a balanced deal, that calls on the wealthy to pay their fair share, then I will absolutely continue this debate into 2013 rather than lock in a long-term deal that throws middle-class families under the bus."

I was on *Squawk Box* yesterday morning with Howard Dean, and he was a little bit more direct. He said, and I quote, "I think we ought to do it. Let's just go over the fiscal cliff." Governor Dean goes on to say, "Maybe 700,000 people would lose their jobs." That's stunning to me. It's disturbing that these very prominent folks, knowing that this multitrillion-dollar tax increase would very likely cause a recession, especially when you consider how fragile the economy is right now, and that knowing that it would put hundreds of thousands more Americans out of work, they want to do it anyway. And you have to ask yourself why.

Well, I know Senator Murray's theory is that after all the rates go up, after a little while we'll come back and lower the lower-bracket rates back to where they are today. Frankly, I think there's a certain level of cynicism in thinking that that kind of deception is appropriate or that it fools anybody. But, more importantly, no one knows how that's going to turn out. No one knows, after those rates go up and this damage is done, how much damage or whether it can be reversed.

But the other consideration is that if Senator Murray got her way and we had this massive tax increase on every taxpaying American and then we lower the rates so that the net tax increase remains in place for just the top two brackets, what do they get out of that? I would argue that you still get a recession. My own view is that it's the impact of those top two brackets that have the strongest influence on economic growth. And then on the revenue side, the joint tax will estimate that you get about $800 billion over 10 years; $800 billion is about 8 percent of the projected deficit over the next 10 years.

So, she's suggesting that we risk plunging this country into a perhaps very serious recession for who knows how long, put who knows how many hundreds of thousands or maybe millions of Americans out of work for an 8 percent solution? This looks to me like this is not actually a substantive solution. It looks more like a political and ideological idea. And since it certainly doesn't solve the problem, would the middle class be reasonable to worry that after this tax increase, they're up next?

See, I think there's a better way than going over the fiscal cliff, as some of my colleagues have, unfortunately, recommended. What I think we ought to do is extend all the current tax rates for at least one more year. These rates have been in place for 12 years now. There was a two-year extension, as we all know, that was supported with bipartisan majorities and signed into law by President Obama a year and a half ago. I think, actually, this is the approach that might have the best chance of succeeding. And then we use that time this next year to do what we really need to do on the tax side, which is fundamental pro-growth tax reform so that we have the growth that we badly need. I think there's really very little dispute that if we do that tax reform right, it generates very strong economic growth and the job creation that goes with it.

But we also -- it's at least equally important that we do the entitlement reform that is driving this whole fiscal problem in the first place. And let me just be clear. I know I'm not going to get my way on everything. The entitlement reform that we do isn't going to look exactly the way I would write the plan. But we do have to agree on the fundamental problem. We do have to face the facts that these programs need to be reformed. And just as I think I demonstrated on the Super Committee and many other times in the year and a half that I've been in the Senate, I'm willing to work with people on the other side for this very, very important goal.

And just think of the upside if we get this right. If we put our biggest entitlement programs on a sustainable path, not only do we ensure their survival, but that's by far the most important thing to avoid this fiscal crisis that we are courting so irresponsibly, in my view. If we also enacted pro-growth tax reform, that everybody knows we need, I think we would kick off a surge of investment and economic growth and job creation and corresponding consumption. I think we would see the recovery that we've been waiting for if we did those two things.

So, I think a strong recovery is well within reach, but it's up to us. If we can finally get it right here in Washington with the right kinds of policies that demonstrate we have the political will to put our country on a sustainable fiscal path, and we've got the ability to create a pro-growth tax and investment environment, I am convinced the 21st century can be another great American century.

Thanks very much for listening tonight.

MR. HASKINS: So, let me shock you by a first question that's political in nature. I want to make sure this doesn't get lost in your talk. When you were describing a situation in the Super Committee --

SENATOR TOOMEY: Yeah.

MR. HASKINS: -- you said that you were willing to do things that you don't philosophically agree with, because it's politically necessary.

SENATOR TOOMEY: Right.

MR. HASKINS: Namely, some kind of deal on revenues as well as on spending.

SENATOR TOOMEY: Right.

MR. HASKINS: How many other Republicans agree with that, that in order to get a deal and to get the big spending cuts that we need, we're going to have put revenue on the table?

SENATOR TOOMEY: Well, I think it depends on the circumstances. At the time, every Republican on the Super Committee supported my framework. So, it was six for six. And when the parameters of that framework came out generally, I was very grateful for the nearly unanimous support that I got within the Republican conference for having offered something that was tough but that made sense in that context.

MR. HASKINS: So, the context is the key here.

SENATOR TOOMEY: Context matters. Absolutely.

MR. HASKINS: The implication is that if we had a big deal that did especially things to Medicare that would at least move it in the right direction -- structural architecture, as you say -- that there is a willingness on the Republican side to compromise on revenues.

SENATOR TOOMEY: Again, you know, I want to stress I don't think it's necessary economically. I don't think it's necessary fiscally. I don't think it's necessary arithmetically. And so I don't want to do -- I don't think it's optimal either, so I don't want to do it that way if there's any other way to do it.

MR. HASKINS: But there isn't.

SENATOR TOOMEY: But at the time there wasn't. It's not clear to me whether or not there will be another way to do it in the future.

MR. HASKINS: All right. I want to clarify something else you said in your report, too, because I think this is really crucial for people who are trying to understand exactly the nature of your proposal.

Center on Budget and Policy Priorities published a study of your report and got a lot of circulation. It's widely quoted in the media, and a crucial part of it said that your plan would confer large, new tax cuts on the wealthiest Americans while forcing and low- and middle-income Americans to bear most of the plan's budget cuts as well as tax increases. Is that an accurate statement?

SENATOR TOOMEY: It's not at all accurate. You know, I mean, we started off by stipulating that we would make the adjustments necessary, and there are many, many dials to adjust, to ensure that nobody paid additional taxes except the top two brackets. Now, I said not any individual. Any time you do tax reform, obviously, within a bracket some people are affected differently than others. But each bracket would be treated the same as current policy.

Look, we're not unaware of the political environment. First of all, none of us wants to be raising taxes on working-class Americans, middle-class Americans. Certainly we know it's a nonstarter on the other side. The only way we were going to be able to -- could justify putting revenue on the table would be in the context of pro-growth reform that would offset the damage done by a tax increase and expecting it to come from the top brackets.

The analysis was not done with the benefit of the specificity in the actual terms. But the important point was what we stipulated in the beginning, that we would ensure that we ended up in a place where the additional revenue came out of the top two brackets.

MR. HASKINS: Does your plan violate the no-new-taxes pledge?

SENATOR TOOMEY: You know, it's a fair question, and it depends on your perspective on this. Let's face it. I've been very candid. I was willing to put this on the table in part as a way to avoid this giant tax increase. I don't know when we've been in these circumstances before when we've had looming in front of us a huge tax increase. And so if you compare what I proposed to the current law, it's a lower tax burden. If you compare it to the policy we have in place today, it's a higher tax burden. I just thought it made sense, you know, as a way to have some pro-growth reform, generate revenue relative to current policy. And, by the way, the framework that our Democratic friends proposed was based on current policy. So, we were consistent in the baseline that we were using.

MR. HASKINS: Yeah, okay. Well, one of the points that Patty Murray made was that the advantage of going off the cliff, as in almost every tax proposal, could be regarded as a tax cut; therefore, Republicans would be released from the no-new-taxes pledge, and there could be a serious negotiation. Do you agree with that logic?

SENATOR TOOMEY: No, I don't agree with that at all, because it is transparently cynical. Let's face it. I mean, it pretends that the American people can be that easily deceived, that we're okay with raising taxes as long as we create enough smoke and mirrors so that we can pretend we're doing something different? No, the outcome that I want is not to have a higher tax burden. So, I'm not interested in this gymnastics of let's have a big tax increase and then go back and cut them and say that we're cutting taxes. I mean, we're not going to fool anybody, and I wouldn't want to try.

MR. HASKINS: Well, similarly, a lot of people have not -- there has been so focus on what happens at the top if the Bush tax cuts expire, but there are also a lot of taxes at the bottom, and especially refundable taxes at the bottom.

SENATOR TOOMEY: Right.

MR. HASKINS: They also would go out --

SENATOR TOOMEY: Right.

MR. HASKINS: So, you would have a situation where Republicans might be motivated to increase taxes relative to current laws -- I mean, relative to the Bush tax cuts and Democrats would have motivation because of all the benefits for low-income families, child tax credit, EITC, and so forth.

SENATOR TOOMEY: Right. Right.

MR. HASKINS: So, both sides might be a lot more motivated to reach a bargain that includes revenue. Do you agree with that?

SENATOR TOOMEY: Well, you know, a year and half ago, we faced this very same question on the tax policy, and both sides were sufficiently motivated to extend the current rates. That's what we want to do. And I do want to very clearly stipulate that I want to use the opportunity to do the structural reform that we need. But that's where we are. I think there is some support on the other side of the aisle for that. We may find out later this week just how much.

MR. HASKINS: All right. If your plan, as you just explained it, really does make the tax code more progressive and simultaneously raise revenues --

SENATOR TOOMEY: Right.

MR. HASKINS: -- and all net increase in revenues come from the top two brackets, why did the Democrats reject it?

SENATOR TOOMEY: Because there wasn't enough revenue. There wasn't a trillion dollars. And there is a vocal segment of my colleagues who feel very, very strongly that the people at the top end of the bracket have to be hit with a very, very big tax increase, and they're not interested in settling for something less.

MR. HASKINS: So, one might observe at this point that when we're in the lame duck and we're facing the cliff and it's more than just a speech, we might actually go off it, and you put something down like you're proposing that actually does make the tax code more progressive, and even though it doesn't raise either 800 billion or a trillion dollars but raises 250 or 400, depending on which number you want to use, would it be a lot more acceptable to the other side, do you think?

SENATOR TOOMEY: You know, honestly I don't want to speculate on this. I'm not very good at guessing what the other side is going to suggest. I would never have guessed that they would suggest now that we go off the cliff.

MR. HASKINS: Mm-hmm.

SENATOR TOOMEY: I find that very surprising. So, the only guess I would make is that the environment will be driven very significantly by how the elections turn out.

MR. HASKINS: One last question.

SENATOR TOOMEY: Yeah.

MR. HASKINS: Everybody talks about the ideal tax reform. I think we have virtually universal agreement among experts and members of Congress and so forth --

SENATOR TOOMEY: Right.

MR. HASKINS: -- and the public that understands this, that the best tax reform is broaden the base --

SENATOR TOOMEY: Right.

MR. HASKINS: -- and lower the rates, and you lower the rates by closing so-called loopholes or tax expenditures.

SENATOR TOOMEY: Mm-hmm.

MR. HASKINS: All right, having watched what happened in 1986 when we did something like that and the lobbyists, who are extremely powerful --

SENATOR TOOMEY: Right.

MR. HASKINS: -- real estate, lobbyists for the states, lobbyists for virtually every interest in the country -- and they are going to come out of the woodwork. What do you -- do you think it's really possible to have the kind of tax reform we need? In other words, that people like you and your colleagues on both sides of the aisle, in both the House and the Senate, and in the administration, can resist these lobbyists that are so powerful and have mangled the tax code beyond recognition relative to ’86?

SENATOR TOOMEY: Yeah. It’s a great question. I don’t know the answer. One of the reasons I thought it was so important to do both individual and corporate tax reform in the Joint Select Committee was precisely because we had an opportunity. And I’m not a big fan of this process as a general matter; I’m a big fan of regular order and increasingly so as we have less and less of it. (Laughter) But it certainly was an opportunity to work this out and then present it as a package where it couldn’t be peeled apart piece by piece by these special interest groups, which is the normal -- the ordinary fare that you have if you go through tax reform in an ordinary way. So, I don’t really know whether we’ll have that.

Well, I will say this. I am pleased by the extent to which there is a bipartisan consensus about the general direction. I’m pleased by the consensus about the need to do it. I think it absolutely takes strong presidential leadership. We haven’t had that about tax reform. We need a President who’s going to stand up there and make the case for why this is so important and what it ought to look like. If we have that, I think we do have a fighting chance.

MR. HASKINS: Okay, good, thank you.

A few questions from the audience. Notice that I use the term “questions,” not “statements.” Let’s have short questions so we can get to as many people as possible.

Here on the right.

A microphone will come. Please stand up and introduce yourself and ask your question.

MR. GHOSH: Tip Ghosh. I wanted to ask you if you can elaborate more on the pro-growth agenda, because a number of people estimate that there's probably at least 2- to $3 trillion sitting on the sidelines from an investment perspective that would be willing to put that back in the economy if we have some growth. So, if you want to elaborate on the individual approach that you talked about.

SENATOR TOOMEY: Well, as you might imagine, I'm crisscrossing Pennsylvania all the time, and I'm talking to people from all walks of life. And I spend a fair amount of time talking to small business owners, entrepreneurs, people who ultimately decide whether investments are going to get made or not, and I think right now we've created a chilling environment. And, you know, my view is it's a combination of the fact that we have a completely unsustainable fiscal policy right now.

The United States of America cannot continue running trillion-dollar-plus deficits indefinitely. That is completely unsustainable, and we have not demonstrated the political will to fix it. And so everyone rationally worries that we're in store for either a massive tax increase or serious inflation if we continue to monetize it or some combination. Well, that in and of itself has a chilling effect on economic growth and investment. You combine that with a regulatory environment that, I would argue, has become very problematic.

Health care bill raises the cost of hiring a worker. I think that's an objective fact. I think Dodd-Frank is dramatically increasing the cost of banks providing capital. I think other regulatory agencies, including the EPA, for instance, have adopted a very aggressive tone, and I hear this every day from people who are dealing -- I'm not making this up. So, I think the combination is having a chilling effect. And so if we get that right, if we have sensible regulatory environment that is not perceived as hostile but, rather, cooperative in achieving the goals that their supposed to achieve, if we demonstrate that we can get on a sustainable path and we have the pro-growth tax reform for which there's broad bipartisan support, I think that would be enormously encouraging to our entire economy.

And that's what I said. I think it would trigger a huge wave of new investment and business creation and corresponding job creation. And then you get consumer spending, and it all takes off. But right now I think we are the reason -- we, Washington, are the reason -- that we're lagging behind.

MR. HASKINS: Next question. Here on the aisle, right behind you.

MR. SCARLIS: I'm Basil Scarlis. I have a question. You've mentioned the chilling effect on private investment of some proposals, but it looks as if your proposal on the budget would also have a chilling effect on public investment, and one of the engines of growth in the past has been adequate public investment in infrastructure and education. Would you support using higher tax revenues directed toward massive or major public investment projects in the United States?

SENATOR TOOMEY: I don't think we need to raise taxes to do that. I mean, if you look at the amount of spending, in the 10 years the federal government spending has doubled. Over the next 10 years, we're going to spend something like $45 trillion. And what I was proposing is we cut 750 billion. My math's not that good, so I can't do that off the top off my head, but it's a really small percentage of everything we're going to spend our money on. And so there's plenty of spending going on. I think it needs to be reprogrammed. I happened to think infrastructure spending is very important and pro-growth if it's done right, because it builds enduring assets that allow the economy to expand, and so that's very constructive. But it's not as though we're not spending enough money. I just think we're spending too much on the wrong things.

MR. HASKINS: Next question. Let's go all the way back on the aisle there. Come up this way on your right.

MR. BECKER: Alex Becker of the *Huffington Post*. It's been reported that Senators McCain and Graham have been basically looking at some of the tax loopholes that you identified. The Super Committee potentially offset sequester cuts on defense. I was curious, how much support do you see for closing certain tax loopholes with your Republican colleagues in the Senate, and perhaps what would you do to persuade them if you if you think it's a good way to go?

SENATOR TOOMEY: I'm not a fan of the defense cuts that are coming in the sequestration. I do think that it's a disproportionate hit that's going to come out of our defense budget, and I accept the consensus of all of our senior military leaders and our Secretary of Defense who have said that this is very problematic. But I also, at the same time, think that the changes in the deductions and other tax expenditures must be preserved for tax reform. So, I'm in favor of reprogramming the cuts, looking at other areas to do some of that, but I don't think it's a good idea to go into the tax code and start ratcheting down the value of these expenditures, because then we won't be nearly as able to generate the pro-growth tax reform that I think we need.

MR. HASKINS: Let's put three quick questions on the table and let the Senator have a choice of which ones he's going to answer. (Laughter) Start in the back on the left there.

SENATOR TOOMEY: I've got to member that.

MS. RANDOLPH: Hi, Jill Randolph, The American Benefits Council.

I just wanted to see if you could elaborate slightly on what you talk about with the -- on the revenue side, including tax splitting as a portion of the health insurance exclusion.

SENATOR TOOMEY: Am I supposed to --

MR. HASKINS: No. Next, let's come up here and on the left there. Good.

MS. CHOCKLEY: Hi, I'm Nancy Chockley. I'd be curious if you could elaborate on what are the most important structural changes you would like to make to the entitlement programs?

MR. HASKINS: Very good, and one more here on the left. Wait till you get to --

MR. BUHLER: Roman Buhler with the Madison Coalition. What do you think is the role for constitutional reform, some kind of restriction on the ability of Congress to borrow in excessive amounts in dealing with this problem over the long term?

MR. HASKINS: Okay, Senator.

SENATOR TOOMEY: I'll go real quickly through all of them.

First of all, I think the health care exclusion, as you probably know, is, arguably, one of the single, biggest tax expenditures, and I think it contributes to the wrong set of incentives in the first place. So, I've long argued that we ought to have some comparable treatment on the tax side for both employers and individuals. There's a lot of ways you can dial that, and I'd be very open to how we would do it, but taxing, capturing the value of a portion of that benefit I think makes a lot of sense on a number of levels.

In terms of what I meant by structural reform of the big programs on the health care side, I think the fundamental fee-for-service model is doomed to fail. It has all the wrong incentives. There's no ability to control cost except to ratchet down providers until they just stop providing. I think we've got to change that dynamic, and there have been many proposals, including bipartisan proposals, of how we move in the direction of more individual ownership of health insurance and a different set of incentives.

The third question on the --

MR. HASKINS: Constitution.

SENATOR TOOMEY: Oh, on borrowing. You know, I can support a Balanced Budget Amendment to the Constitution, but, really, I think this is an ongoing political problem, a political question. I don't think we have the ability to pass a Constitutional Amendment right now. I'd welcome that if we could get to that point, but in the meantime we can't use that as an excuse not to deal with the serious problems we have. And there's a political question about what should be the role of government, and what should be the size of government.

MR. HASKINS: So I'm sure the audience is going to join me in thanking you for a nice presentation and a good answer to the question. Thank you very much.

SENATOR TOOMEY: Thank you. Thanks for having me.

MR. HASKINS: And now our panel. So the first question is obvious. Should we go off the cliff? Why or why not? Bill Galston.

MR. GALSTON: Not if we can avoid it. And I think there are a number of better ways available, and I hope we choose one of them.

MR. HASKINS: Well, what's the biggest downside of going off the cliff?

MR. GALSTON: Look, I could noodle, but let me just drop a footnote to the CBO report, which studied that question and came to a very clear conclusion that in all probability that would mean at least a mild recession for the first two quarters of 2013, and they estimate rather slow growth for the next two quarters and maybe longer than that. And by contrast, if you can believe this, they say that if we don't do that, we might expect an acceleration of growth. They use the number 4.4 percent, which I can hardly believe.

MR. HOLTZ-EAKIN: Those were the good old days.

MR. GALSTON: Those were the good old days, but we're talking about potentially, according to CBO standard analysis, a substantial reduction in the rate of growth at the time when the economy is staggering. I find it difficult to believe that we can't do better than that somehow.

MR. HASKINS: I think I read somewhere that you've advised Democrats in the past. Would that be true?

MR. GALSTON: In the distant past because nobody likes what I have to say anymore.

MR. HASKINS: But now they have to listen.

MR. GALSTON: No, they don't.

MR. HASKINS: Oh, yes, they do. They don't have to accept it, but they have to listen.

MR. GALSTON: No, they don't.

MR. HALSTON: Would you advise -- do you think this is a wise political move by Democrats, by one of their leaders, saying we're going off the cliff and the *New York Times* piles on and a lot of other Democrats have said yup?

MR. GALSTON: It makes some people feel good in the short term. I don't think in the longer run it represents either good politics or good policy.

MR. HASKINS: Doug, same question.

MR. HOLTZ-EAKIN: I think Bill has said everything that I would have to say much nicer than I would choose to say it because this is madness.

MR. HASKINS: Hey, we're here to have some fun. Say it in the worst way you can.

MR. HOLTZ-EAKIN: No one should contemplate this, and it's irresponsible to suggest it. It just is. I mean this is -- if you look at the total tax increases of $400 billion, the total spending cuts of $200 billion, $600 billion is 4 percent of GDP; we're growing at best at 2 percent. So we're going to throw two years' worth of growth at the economy. That's a huge fiscal shock. And to suggest that in the interest of fairness you should get rid of the 10 percent bracket, whack special education, housing vouchers, subject the middle class to the MT, and endanger the jobs of the most vulnerable, does that make any sense?

MR. GALSTON: We'll make a Democrat out of you yet.

MR. HOLTZ-EAKIN: It's just nuts.

MR. GALSTON: Good luck with that.

MR. HOLTZ-EAKIN: Worst thing is that I hate this more than I've said. The logic of this is we can go off the cliff, and it won't hurt the economy -- that's what you're hearing -- because we are wink-wink telling every American entrepreneur, every American business, every American family, international capital markets, that we can't get a deal. But if we go off the cliff, we'll get a deal so don't worry about it. Do you believe that?

MR. HASKINS: I'm the moderator. I --

MR. GALE: There are two arguments for going off the fiscal cliff that I don't like. One is this wink-wink nudge-nudge we need to tell the American people one thing and tell financial markets something else. That's not going to work. The other argument I don't like for going off the fiscal cliff was well, the Republicans were really reckless and crazy in the debt ceiling negotiations in 2011 and, therefore, the Democrats have the right to be reckless and crazy now.

Having said that, I don't like either of those two arguments going to a fiscal cliff, I think the bigger issue is the way Washington tends to take complex issues, which is what should we do for the economy in the short term, what should we do for the budget in the long term, and then it crystallizes those issues down to one ridiculous discussion, should we do this or should we do that? That is not the choice we face. The choice we face is not do we go off the fiscal cliff or do we not go off the fiscal cliff. The question, the issue, we face is how do we boost the economy in the short run? How do we deal with the budget in the long term? Those are the real questions. And it turns out, I think at least, given the structure of policy, the right thing to do now would be to enact a temporary stimulus package that did not involve the Bush tax cuts. It could involve payroll tax cuts. It could involve infrastructure investments like Senator Toomey mentioned. It can involve aid to the states, which are struggling right now, but enact an explicit, temporary, stimulus package. And, meanwhile, go over the fiscal cliff; that is, let the tax cuts expire. Let the sequester occur. The stimulus package then aim -- would need to be big enough to take care of the negative short-term effects of going over the cliff, and going over the cliff would do for the long-term budget what everybody has been saying we need do for the long-term budget, which is stop kicking the can down the road. Probably all five of us have said at some point Congress needs to stop kicking the can down the road. Going over the cliff would do that. It would put us on a better budget path.

Now, the rejoinder to that is well, it's not the optimal budget situation because the structure of the revenue increases is tax rate increases rather than base expansion. And it's not the optimal spending cut because it's discretionary spending and defense spending where a lot of government investments occur rather than the drivers of entitlement growth, Medicare and Medicaid. To which I would say, let's not let the perfect be the enemy of the good. Let's get on the good long-term path, and then the Republicans and the Democrats will have incentives to negotiate better structure of policy once we get there.

But the really important thing is, especially after hearing Senator Toomey speak today, I'm convinced of this, is if you want revenues to be any significant portion of a balanced deficit reduction package in the long term; that is if you don't want all the cuts to come out of Social Security and Medicare and Medicaid, the only way to get the Republicans to that point is to move to the new baseline, let the fiscal cliff happen, and then negotiate down.

And let me -- just one more thing. Letting the Bush tax cuts expire would raise revenues over the next decade by $2.8 trillion. If the Democrats want to get to $800 billion in increases relative to current policy or $1 trillion in increases relative to current policy or more than that relative to current policy, I guarantee you the Republicans will be more willing to negotiate taxes down from the higher $2.8 figure than they will be up from the current figure.

So I think a combination of a stimulus package and going off the fiscal cliff is the single best and most feasible way to address the short-term and the long-term issues. Let the hail storm begin.

MR. HASKINS: So we actually have a tax policy guru who thinks going off the cliff is not entirely a rotten idea. What do you think, Rudy?

MR. PENNER: I just have the feeling that we spread gasoline all over the place, and now we're playing with matches, and it just can't come to a good end. My nightmare is that we do, in fact, fall off the cliff. But then the Republicans and Democrats enter into protracted negotiations that could last weeks, could last months. Meanwhile, I think the effects of that would be worse than the kind of Keynesian effects that CBO is talking about because the uncertainty it would create by the total disillusionment with our political system that it would create. I suspect that business decisions would freeze. There wouldn't be any hiring at all. And Lord knows what would happen to bond and stock markets under those circumstances.

I just, like Doug, think it'd be total madness to enter into that. And as for negotiating bills, complicated stimulus, plus going off the cliff, plus reform, forget about it between now and the end of the year. There's just too much to do.

MR. HASKINS: Bill, do you wish to defend yourself?

MR. GALSTON: I talked for too long already.

MR. HASKINS: Okay. Doug?

MR. HOLTZ-EAKIN: So, first of all, Bill was saying let's just pass a $600 billion stimulus, which is going to be easy -- good luck -- and then go off the cliff. I mean I'm with Rudy. I think that's just politically way too complicated.

Let's just think about the political math here for a second. After the election -- everyone's saying nothing's going to happen -- after the election, whoever's in power by the election, whoever's perceived to be the victor and has a stronger hand, is going to want to kick these long-term reforms into 2013 when they will have more bodies in their chairs to shape the outcome. That's true for Republicans and it's true for Democrats. So right now we know that after the election the overwhelming instinct is going to be kick it down the road, and that is, by the way, the only thing that Congress does well. So we are playing to their strength and their political calculus.

So all we should be worried about in thinking about the fiscal cliff is getting from here to 2013 when the long-term outlook's going to be shaped in some sort of safe fashion. This is about the bridge. It's not about the long-term fix. And so we don't want to have the big tax increase. You don't want to have these very, very bad policy-across-the-board cuts. This is all really, really difficult stuff.

So I liked what I saw on the one-pager from the Democrats that says let's have fast-track authority for tax reform. So if we know what we need is tax reform, kick the can down the road by giving a one-year extension, but stipulate in the legislation that does that the year you're going to get tax reform. And knowing the end-game has to be fundamental reform of our mandatory spending programs, kick the can down the road by getting rid of the one-year sequester and replace it with some mandatory cuts or a requirement that they get those mandatory cuts, serious stuff. That's not perfect, but this isn't about solving the long term. This is about getting to the point where we can actually solve the long term while we're growing because if we're not growing, we're not going to solve any of our deficit problems. And we have to avoid what is a really weak economy being endangered by the way we get to next year.

MR. HASKINS: Now, one of the great advantages of this panel is that we have a lot of people who understand taxes and spending, and that is what the Senator proposed. I think we need to really analyze his proposal.

So in responding to his proposal, I want you to pay attention both to the accuracy of the presentation and the slide show because there are some really disparate claims before us here because the Center on Budget and Policy Priorities makes the opposite claims about the proposal. And if I were in the audience, I would be perplexed about what's right here.

And then secondly, it's a bite out of the problem, but is it constructive? So let's start with Doug.

MR. HOLTZ-EAKIN: So I think the concerns about the middle class low end have to be on the spending side. I mean I presume that's where those impacts are, given the structure of the tax proposals being aimed at the high end. So until that gets laid out, that sort of bullet line for Medicare reform -- I don't know what those look like -- and so these distributional issues are always hard to adjudicate until you see the details of those things.

Having said that, I share a lot of the Senator's reflexes about the nature of the fix and when I look at the fix, I look at Bowles-Simpson as the political template for success. They said if the route to higher revenue is through tax reform, I believe that. So anything you do in the interim should not get in the way of tax reform, and his doesn't. It actually takes modest steps toward it. It says that the way to fix our fiscal problems in the main is on the spending side, and it ought to be sort of broadly distributed. And we need to have defense, non-defense, and especially mandatories on the table. He did that. And again, these were nixed at the edges that did those things. There was some discretionary, some mandatories.

So I liked the nature of those proposals. And I think that's somewhere on the road that is actually the feasible road to getting things done.

MR. HASKINS: Bill Galston.

MR. GALSTON: Well, first of all, in the interest of bipartisanship, let me say that I think Senator Toomey delivered a very fair-minded and constructive speech. And I have neither the inclination nor, frankly, the expertise to argue budget details. There are three other people on the panel who can do that.

But I do have the competence to argue fundamentals. And I think it's fair to say, as he did, that we have a spending problem. I think it's also fair to say that we have a revenue problem, and our challenge is to bend the first down and the second up so that they meet in a reasonable place. The historical average for revenues is not that place. Given the nature of our society, and in particular the fact that we're an aging society, those two lines are going to have to meet, and every bipartisan commission has acknowledged this, significantly above the historical average. So let us forget about that baseline. It is irrelevant to current circumstances.

So the fundamental question with pro-growth tax reform is not its architecture because we all agree on the architecture. The fundamental question is how the revenue gains from broadening the base will be divided between rate lowering and deficit reduction and helping to deal with some of the burden of the mandatory programs, which are baked into our demography and are not simply a function of bad program design.

So that's the challenge. And the problem I have with Senator Toomey's proposal, as I understand it, subject to correction from three tax experts, is that there is a base broadening that amounts to about $3.5 trillion over ten years, more than 90 percent of which is then taken back in the form of rate reduction, leaving very little at the margin for revenues. And so you have then baked into the tax code a permanent solution that rules out, it seems to me, the balance between spending and revenues that we're going to need. And let me be precise. If you broaden the base profoundly, which he's suggesting, you lower the rates by 20 percent. That is the new long-term baseline for tax policy and that does not generate, in my judgment, nearly enough revenue to deal with the three problems that are on the table.

MR. HASKINS: Go ahead, Doug.

MR. HOLTZ-EAKIN: I guess I didn't hear that. And so I'm not going to fight; I just want to clarify. What I heard him say was we couldn't get the long-run structural deal that set the new baseline. So I'm just going to try to solve the $1.2 trillion problem over the next ten years. So I didn't see this as a statement of where the tax code was going to be permanently when they were done. I saw this as a step and no more. And maybe I didn't hear it right, but I didn't see that.

The second point I just want to make on the arithmetic, Bowles-Simpson lowered rates by about 20 percent across the board. They raised a lot more revenue; in fact, so much some Republicans couldn't sign on. So the notion that these marginal rates are somehow inconsistent with your revenue goals just isn't true.

MR. HASKINS: Bill?

MR. GALE: Toomey's plan, as he describes it, is revenue neutral relative to current policy, which I would argue and -- echoing what Bill Galston just said -- is not sufficient to deal with our future revenue or budget issues. I mean basically he likes defense spending, he said. He likes infrastructure spending. He doesn't want to raise taxes. So it sounds like he wants to take basically everything out of Social Security, Medicare, and Medicaid. And he also appealed to the laws of arithmetic, and we all know that if you take everything out of Social Security, Medicare, and Medicaid, you're making enormous cuts in those programs.

So in terms of his tax policy, he described it as revenue neutral and distributional, actually a little progressive. What I understand about it is those two things are both correct in a technical sense, but may not be correct in an actual policy play-out sense. The revenue neutrality depends on the number of people on the AMT going up by three or four times what it currently is. And revenue neutrality depends on very sharp limitations on itemized deductions; while I would be in favor of doing that, that's one place to look for in terms of where the revenue might leak out. More generous deductions would either result in less revenue or higher required rates.

On the distributional side, there's a particularly difficult issue that sort of takes advantage of a loop hole in the way tax distribution tables are created. And let me give you an example to explain how this works. Suppose you eliminated all itemized deductions from the tax code. That would look like a big increase of taxes of upper, middle, and high-income households. So it would look like a progressive tax change. The rich would pay more, et cetera, et cetera. Now let's suppose you took those itemized deductions and refabricated them as spending, as outlays that gave each person exactly what they would have gotten in the deduction to begin with. So there's no net change in the overall outcome of the tax and spending system. But tax tables, the distributional tables that we, the Tax Policy Center, put out and JCT and other people put out when they put them out, would show that change, from a tax expenditure to a spending item, they would show that as a progressive change. And I have a feeling that some of the claimed progressivity in Toomey's plan results from that type of change, in particular the state and local income exclusion that he was talking about. Now that's not a criticism of the plan per se. It's just saying that the tax table is going to show the plan as more progressive than it actually is because the tax table doesn't include the spending side stuff.

So just to summarize briefly, broad-based tax reform is a good thing. Broadening the base, lowering the rates is a nice thing. Revenue neutral is way too little in terms of revenue. There are issues about the revenue neutrality and the distributional neutrality.

And last thing is I want to talk about taxes and the economy. We had a broad-based, low-rate change in '86. There was no discernable effect on the growth rate as far as I can tell. We had across-the-board tax cuts in '01. There was no discernable effect on the growth rate as far as I could tell. Growth in the middle part of the decade was all in finance and housing. It was due to low interest rates. We didn't really see any -- as far as I can tell -- any growth effects from the Bush tax cuts. So I would be suspicious of claims that we're going to get big economic expansion, especially once we've returned to full employment, I would be suspicious of claims that we get big economic expansion from structural tax reform. People at AEI have actually said the same thing, and I think this is a fairly consensus view in the economics world.

MR. HASKINS: Bill, it's worth clarifying, though, that the Senator said -- he said here in our meetings with his staff -- that he does not depend on these estimates he gave us.

MR. GALE: And I agree with that. He did, though, talk about one of the benefits of tax reform would be big, robust, economic expansion. And I don't think the data support that, especially for a revenue-neutral reform like in '86.

MR. HASKINS: But regardless if that's true or false, the estimates we saw today do not assume any dynamics --

MR. GALE: Yeah, yeah, I wasn't trying to imply that they did.

MR. HASKINS: No, I know you weren't, but I just think it's worth clarifying for the audience because this is something that often gets in the way between Republicans and Democrats. Rudy, what do you think of the plan?

MR. PENNER: Well, I can't help but wonder whether he gave up on more fundamental health reform and Social Security reform a bit too early. Compared to tax reform, especially revenue-raising tax reform, I'm not sure which side is more politically difficult. And one thing that I've not read in any press account is the fact that Paul Ryan's budget for Medicare is identical to the President's budget for Medicare; that is to say, both have targets for long-run growth and outlays, of GDP growth, plus half a percentage point. Now to get there very, very differently. But it does seem to me at least there's some promise that negotiations could be successful.

As for Social Security, Bowles-Simpson put a plan on the street that makes the system financially viable and does not cut anybody's absolute benefits over time. Absolute benefits continue to rise. They just don't rise as fast as is promised. Again, it shouldn't be so difficult to reach a compromise there.

Now, the difficulty with tax reform, first of all, I think the senator made a very powerful point in terms of whose estimates are accurate. He basically said, look, there are literally thousands of things you can push and pull here and adjust the system to achieve certain goals. He passed over very quickly, though, the most difficult part of it and he pointed out that if you do have a base-broadening, rate-lowering reform, he did admit some people, those who depend a lot on current deductions, even in the middle class and lower middle class, they're going to pay substantially higher taxes. And that's the key political difficulty and it's maybe even more difficult at the corporate level.

I was totally disheartened to meet a lady at a New Year's Eve party who was organizing a coalition to preserve (inaudible) accounting. And I thought if anything shows how hard it is, that certainly does.

MR. HASKINS: She'd probably had a few drinks, though, Rudy, so. (Laughter)

SPEAKER: But not enough. (Laughter)

MR. HASKINS: All right, so let me ask you the same question I asked the senator. Willing suspension of disbelief here, say that we're in, you know, the lame duck session and if the past is any guide, they're, you know, yelling and screaming at each other and saying all kinds of rotten things about their mothers and all, and here comes Toomey with this proposal that I think we've agreed is -- no one has sharply disagreed that it's more or less as he presented it here. Why wouldn't it get us out of at least the 1.2 trillion of the across-the-board sequester, which everybody hates as far as I can tell, and at least move the ball somewhat forward by reducing tax rates and closing some loopholes, so it at least has some of the characteristics that we think of as moving in the right direction? Wouldn't that be very attractive even to Democrats during a lame duck? Bill?

MR. GALSTON: Well, two points. First of all, I am intensely skeptical that anything even that substantive is going to be accomplished during the lame duck. So that's point number one.

Point number two, and Senator Toomey said this twice and he's absolutely right, a lot of this discussion depends on the outcome of the election. And let me give you a couple of envelopes. One of the envelopes contains unified government. You know, Governor Romney gets 50.5 percent of the vote, the Republicans end up with either 50 or 51 Senate seats, they hold the House, and under those circumstances, subject to correction from at least two colleagues who know better than I do, I suspect that there will be intense pressure inside the Republican Party not to make any concessions whatsoever in advance of January 20th of 2013, and then a very substantial movement in favor of a broad-based reconciliation bill that will enact in one stroke as much of the Republican fiscal policy as can be crammed into it consistent with Senate rules. So that's in the first envelope. And if that's not realistic, please correct me.

In the second envelope is a continuation in some way, shape, or form of divided government. Under that scenario, I think that you may have a formula for let us say a six- to nine-month negotiation that might produce some movement down the road we've all been exploring. But the idea that the Toomey plan will be the basis for compromise between November 7th and December 31st, I think, taxes at least my credulity.

MR. HASKINS: So under either of your scenarios we will, to use Bill's apt phrase, kick the can down the road.

MR. GALSTON: I think there's no choice.

MR. HASKINS: Yeah.

MR. HOLTZ-EAKIN: I 100 percent agree. I mean, this is what I said, after the election all the incentives are to go to the next year. And to be really successful in the mixed government envelope requires White House leadership to reach across the line and say, you know, you on this side of the aisle, I need this in, I won't sign unless you have it. And if some of my guys have to take a bad vote, I'll cover for you. You can't do that in a lame duck. You have to make those deals over a longer period in 2013, so that the White House can make them stick. And that is the recipe for getting our long-run fix is to have that kind of White House leadership across the bipartisan part of Congress. I mean, that's what's been missing and that's what we need.

MR. GALSTON: But Doug, talk about the other envelope now. That's the interesting part.

MR. HOLTZ-EAKIN: But the other envelope also involves kicking it down the road.

MR. GALSTON: Right.

MR. HOLTZ-EAKIN: And in my view, while mechanically 51 and reconciliation gives you a unified government, I think we have mixed government. The only question is which kind, right? Because they're not going to get 60 Republicans in the Senate, so there's going to be a substantial and quite powerful minority in the Senate for the next, you know, two years for sure, maybe longer. And that, as we have heard from your side of the aisle occasionally, can be claimed as blocking all sorts of things. And so I don't --

MR. GALSTON: But not a reconciliation bill.

MR. HOLTZ-EAKIN: I know mechanically a reconciliation bill could go through, but remember, there's life after the first bill. And you have -- you know, this is a repeated game and you can't pretend that somehow you're going to cram through everything on an agenda in one bill in the first year. I just don't think that's realistic.

MR. PENNER: Moreover, Bill's first scenario assumes total party discipline, and I guess I'm skeptical of that. If the Republicans do indeed win the Senate, it seems to me it'll be because of people like Scott Brown and other more moderates win their races. And I think it'd be very difficult to hold them together to pass a very severe kind of fiscal policy, certainly nothing like the Ryan budget would go through under those circumstances. So I'm not sure they could get themselves together to do the kind of thing that you're talking about.

MR. GALSTON: Well, if Democrats can get to 60, Republicans can get to 51. And, you know, look, under that scenario, let's grant the premise, there would be an interesting negotiation among different tendencies and factions within the Republican Party. But, quite frankly, with a new Republican president and the success of that presidency at stake, I find it very difficult to believe that as the first, you know, move out of the box that Republicans would not be able to get to yes on something that would not look like a compromise.

MR. HASKINS: And it's also --

MR. HOLTZ-EAKIN: Your argument says that in 2008 and '09 --

MR. GALSTON: Yes.

MR. HOLTZ-EAKIN: -- the Democrats solve this problem and raise the top rates, and they didn't. I mean, you had unified control. You had this objective that the President's talked about since 2007 and it still hasn't happened. So what went wrong? It's just not that simple is what went wrong. (Laughter)

MR. GALSTON: No, no, no. I think one of the issues is --

MR. HASKINS: Wait, let me just make one point here that I think ought to be considered and it's kind of against Rudy's scenario, but the Republicans have shown a lot of discipline in both the House and the Senate.

MR. PENNER: Indeed.

MR. HASKINS: And in the House for many, many years. So to think that they could achieve, especially with a new president that they have to support, I wouldn't count on them not being able to present a unified front and have 50 or 51 votes or whatever it is, and jam through a lot of stuff.

MR. GALE: Ron, there is some historical support for that and what Doug said in 2008 was right. In 2009, the Democrats came in with both houses and the White House and didn't do all these things. In 2001, when President Bush came in with the Republicans in both houses, he did enact the tax reform package that he had campaigned on and some stuff was added to it, the Portman-Cardin stuff.

MR. HOLTZ-EAKIN: A lot easier to get party disciplined behind to give away things --

MR. GALE: Well, that's true. That's true, too.

MR. HOLTZ-EAKIN: -- than take away things.

MR. GALE: But the other thing I was going to say is we're sort of in uncharted waters here in that we've been -- nobody has been around to see what the path toward a solution actually looks like because we've never faced this problem historically and solved it before, so.

MR. PENNER: In any case, all these scenarios involve some kicking the can down the road.

SPEAKER: Yes.

MR. GALE: Correct, that was sort of the point.

MR. PENNER: And I've been sitting with a lot of you trying to think of things we could attach to the can. (Laughter)

MR. HASKINS: It would make it kick more difficult.

MR. PENNER: That's right.

MR. HASKINS: Let's go to the audience.

MR. HOLTZ-EAKIN: It's time to break a few toes.

MR. HASKINS: Yes, right here in the white shirt. Somebody needs to come up here and give him a microphone. Yeah, you need a microphone.

MR. BRAZELL: David Brazell. I think this is directed mainly to the two Bills because, Bill Galston, you mentioned that it was the level of where these two lines meet the revenue line and the historical level of revenue and spending is irrelevant. And I would argue against that because I think we have a system where we've had -- we have Social Security, which was passed and I think supported because it was supposed to be self-financing. We have Medicare which was supposed to be self-financing and everything else was coming out of general revenue. And I think there is a feeling in the country that says there should be a limit on that. And I think the 2010 election particularly was a statement, saying that this is going too high in terms of how much money is being funneled through the federal government.

MR. HASKINS: Bill?

MR. BRAZELL: And so my question is -- my statement is that I don't think this is an irrelevant issue. I think it is a very relevant issue coming up in this election now and don't you agree with me?

MR. GALSTON: There is a very famous and extremely politically incorrect Henny Youngman joke that's only two lines long, but I will take a deep breath and tell it. And it goes like this: How's your wife? Pause. Compare to what?

And that is always the right question. (Laughter) And it's especially the right question in politics.

And I have done a lot of analysis and a lot of thinking. You know, I've stared at the demographics. And I have come to the conclusion, first of all, state my priors, I agree with Senator Toomey philosophically. I think we need "architectural changes," not in Social Security, but in the health care programs. I absolutely agree with that and I have crossed the bridge that separates me from some of my colleagues. I am in favor of some reasonable version of premium support, something not too far removed from what Bob Reischauer and Hank Aaron put on the table 15 years ago and the sort of --

MR. HASKINS: And deny paternity now. (Laughter)

MR. GALSTON: Well, all right. But I think a blood test would reveal the truth. (Laughter)

But having said that, I believe that the American people, when faced with real choices, will decide on the kinds of adjustments to the entitlement programs that would place the long-term spending line substantially above the historical average by at least 2 or 3 percentage points. And unless you believe in 6 percent budget deficits ad infinitum, which nobody does, then I think we're going to have to talk about revenue adjustments to match that public commitment to the kind of country they want to have. If I'm wrong about that and if Americans are really willing to commit themselves to a Medicare "reform" à la Paul Ryan, which according to CBO would leave consumers in 2030 paying two-thirds of their health care bills out of pocket, well, then you're right and I'm wrong.

MR. HASKINS: Next question. On the back there, on the left, blue shirt. Yeah.

MR. DENNISON: Hi, Ben Dennison. I'm with the LaRouche Political Action Committee. I'm a little bit shocked at some of the lack of reality in some of this. This would be -- I think William Gale might be the best to address this. But how can we sit here and claim that the crisis right now is simply a tax-and-spend crisis? I mean, I look at the news and I see Libor, I see the fact that the biggest banks have been conspiring to loot the United States. They've been lying about their rates, proven for two facts. One, to game the entire market for which now a number of cities, counties, municipalities are suing because they've been ripped off to millions of dollars, which has resulted in firefighters being cut, hospitals being closed, teachers being fired because these cities are being gutted and being looted by the biggest banks in the entire market. And the second time -- just to --

MR. HASKINS: We need to get to a question here, okay? I'm not going to wait much longer, so get to a question.

MR. DENNISON: Okay. The second point is that they also lied to make themselves look better to ensure that they would get the bailout in 2008. So to claim that this is a tax-and-spend crisis currently just shocks me that we could sit here and play partisan games, pretending that there's not a real crisis beyond just the tax-and-spend issues.

And my question then is what about addressing that issue of Wall Street and London looting the United States? And there's a massive growing movement to reinstate the legislation of --

MR. HASKINS: Okay. We get the question.

MR. DENNISON: My question is what about the reinstatement of Glass-Steagall to separate out the banking system, to cut out this looting and gambling that's ripping off the American people? Why not bring that, put that on the table?

MR. HASKINS: Bill, do you want to answer that?

MR. GALE: I'll start. First, I want to thank you for not breaking out in song like the last LaRouche person that was in this room.

I think there has been discussion here about the economy. Doug said it well that if you don't fix the economy, you can forget about worrying about the budget. And my emphasis on the stimulus as well as a fiscal cliff really, you know, emphasizes the point that you've got to get the economy going. There are numerous aspects of that. The fiscal side is what we were enjoined to discuss this morning, but there are other issues.

I'm not the right person to address Glass-Steagall, but there's been a lot of discussion of financial reform.

MR. HASKINS: Rudy is because he lobbied for it originally.

MR. GALE: Rudy? (Laughter)

MR. HASKINS: So Rudy, tell us.

MR. PENNER: Well, I think Bill and others have put it well, the economy is very fragile. One of the reasons it's fragile is what happened to our banking system. The Libor situation is an outrage, there's no doubt about that. It helped a lot of people as well as penalizing them. So there's elements, the truth is all of that.

And I actually do think it was a mistake to do away with Glass-Steagall. The Volcker Rule is a kind of version of Glass-Steagall and banks should be limited on what they can use insured deposits for, it seems to me.

MR. HASKINS: So someone agrees with you.

MR. HOLTZ-EAKIN: Just briefly, I mean, we can disagree on Glass-Steagall. I don't think there's any evidence, at least from the time I spent on the Financial Crisis Commission, that proprietary trading was at the heart of the financial crisis, so I think that misses the main point. But put that aside, we need to have a set of rules for a while and stick with them because, at this point, the sector that could give us some real economic growth is housing. That is the upside potential in this economy and one of the many things that is difficult in the housing market right now is even very creditworthy borrowers cannot get a mortgage. I mean, 30 percent down, 780 FICO, they say no, and that's ridiculous.

And so, you know, when we think about these financial market reforms, yes, sir, people should obey the law and they shouldn't misrepresent things, but it's time to let us settle this out, let the financial system sort of work through the new set of rules because there are parts of the economy that could give us some growth that really would benefit from that.

MR. HASKINS: Okay, let's have two more questions and then we'll depart. Yeah, behind you. Did you ask a question before?

SPEAKER: I did and this is --

MR. HASKINS: Okay, wait, wait. No, no, no, we can't do that because we've got too many other people. Raise your hands again. You asked a question last time.

All right. The panel has answered every --

SPEAKER: No, there's one over there.

MR. HOLTZ-EAKIN: There's one there and there was one there.

MR. HASKINS: The LaRouche has already asked a question, so we're not going to -- all in the back on the right there.

MR. FARRELL: Yeah. Jack Farrell from National Journal. If you go to that envelope that has all Republicans being elected, the day after Election Day they're still too full months where the Democrats do have some clout. Would they just fold because they had been repudiated by the electorate or do you think that they would try to use that last leverage in those last two months to get something before the New Year occurs and the fiscal cliff happens?

MR. HASKINS: Good question.

MR. GALSTON: Beats me, but I suspect the latter. Right? I think that in modern politics defeat never crushes people, it emboldens them and it stiffens their spines. And I doubt very much that a defeated Democratic Party would just roll over and play dead. You know, they would already be, I fear, plotting some version of what so many Republicans vowed right after Barack Obama's election and what the Senate minority leader gave voice to so memorably. And so your question has to be inserted into the broader template of the rise of partisan polarization to a level that we haven't seen since the 1890s.

MR. HASKINS: Doug, do you agree with that?

MR. HOLTZ-EAKIN: I don't know. I mean, you know, I think the election's really going to shape both obviously the lame duck in 2013. And the example that I remember is simply the Tax Reform Act of 1986, which raised the bottom marginal tax rate from 11 to 14 percent -- hard to imagine that in this environment -- cut the top marginal tax rate from 50 to 28, and passed the Senate, I think it was 93 to 7 with the votes of Ted Kennedy, Chris Dodd, Robert Byrd, and other notable folks not really super conservative. And the question was why? How could that happen? And the answer was Reagan won 49 states, so elections matter and we'll see what goes on.

MR. GALSTON: But that's not -- well, first of all, speaking as Walter Mondale's issues director, which I was; there's a big difference between winning 49 states and 59 percent of the vote, which is what Reagan did, and if my guy had had another day to campaign I think we probably would have lost all 50 states. (Laughter)

MR. HOLTZ-EAKIN: I won't talk about my experience, okay?

MR. GALSTON: But that --

MR. HOLTZ-EAKIN: We campaigned too much, too long, too.

MR. GALSTON: There's a big difference between that and winning a very narrow victory, which, I believe, is the best that Governor Romney can do. That's number one.

MR. HOLTZ-EAKIN: Okay, I agree with that. I agree with that.

MR. GALSTON: Number two, the question I was being asked was not about the farther future.

MR. HOLTZ-EAKIN: It's the lame duck.

MR. GALSTON: It's how Democrats will respond in the lame duck, and I stand by what I just said.

Here's my third point. If you look -- and you know this history as well as I do -- if you look at how tax reform got enacted, a lot of it had to do with the fact that before the election Ronald Reagan stood up and said this is going to be one of my principal policy goals for after the election. He set in motion a process, an orderly process that led to a report that teed up the issue starting at the beginning of 1985 and it still took 18 months to get to yes. So if I ask myself are the stars in alignment for that scenario, well, we already know that two conditions prior have not been fulfilled and so it's going to be harder this time.

MR. HOLTZ-EAKIN: Right. So, first, I want to agree with a lot of what you just said. On the tax reform thing, you know, next year's the hundredth anniversary of the income tax. And we can count on less than one hand the number of comprehensive reforms we've had. So as a going-in proposition tax reform is really hard.

MR. GALSTON: Right.

MR. HOLTZ-EAKIN: The good news is that everyone running for president said we need tax reform. The House and the Senate are both -- in the Ways and Means Senate Finance Committee they've held hearings on tax reform, they have templates. So, you know, the stars aren't going to align perfectly, but, you know, we have a lot of the pieces going and so we may get there next year. And one of the reasons I like the idea of fast-track legislation is since it's always hard, let's grease the skids and try to get something serious done.

But the key to tax reform, in my view, is the spending side. '86 unraveled and unraveled quickly in part because we faced what then seemed to be dauntingly high deficits for the foreseeable future and those revenue needs unwound it. So I think if we don't get serious about the spending side, no matter what we accomplish on the tax reform side, it will be very short-lived.

MR. HASKINS: So in my sneaky way as a former Republican, I give a Republican the last word.

MR. GALSTON: God bless you.

MR. HASKINS: Thank you all. You've been a great audience. We'll see you soon. (Applause)

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