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A SYMPOSIUM OF VIEWS

Can Tax Reform Save the U.S. Economy?

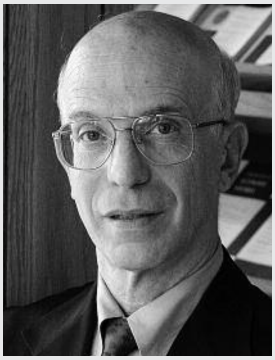
Some influential economic thinkers offer their perspectives.

With U.S. public debt rising as a percentage of GDP, reform of the personal and corporate income tax codes has been suggested as a solution to achieving the twin goals of deficit/debt reduction and higher rates of economic growth.

Two important American economists have reached opposite conclusions on this issue. Martin Feldstein argues that the Tax Reform Act of 1986 "showed how a tax reform that includes lower rates can change incentives in a way that grows the tax base and produces extra revenue." Feldstein argues that the 1986 experience "showed an enormous rise in the taxes paid, particularly by those who experienced the greatest reductions in marginal tax rates." In view of today's budget shortfall, he suggests that the flattening of the tax code after the 1986 tax reform "implies that the combination of base-broadening and rate reduction would raise revenue equal to about 4 percent of the existing tax revenue," potentially "more than $500 billion in savings over the next ten years."

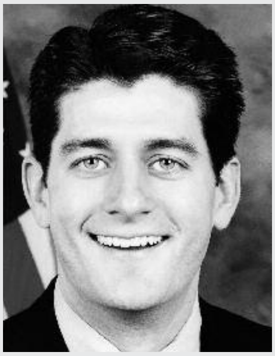
Martin Feldstein

Alan Blinder concedes that both the U.S. personal and corporate tax codes are "disgracefully complicated messes." He argues, however, that "flattening the rate structure won't make the tax code any simpler. It would, however, make the tax system far less progressive" and thus less fair. Blinder also notes the political difficulty of reforming the tax code: "Every tax 'gimmick' has an engrained constituency. I shake my head in disbelief when I hear politicians claim to be able to raise huge amounts of revenue by closing loopholes. Arithmetically, that's easy. Politically, it's almost impossible." Blinder adds that "many useful steps could be taken to simplify the personal income tax…but flattening the rate structure isn't one of them…The corporate income tax is virtually flat once a corporation passes a paltry $750,000 in taxable income. Is it simple?"



Alan Blinder

At a time of expanded public debt and below-trend growth, should enactment of tax reform be a top priority?



The real question: For whom does the tax code currently work?

PAUL RYAN
Member, U.S. House of Representatives (R-WI) and Chairman, House Budget Committee

Will tax reform work? Let's put the question another way: For whom does the tax code currently work?

It doesn't work for American families. The code is notoriously complex, as individuals, families, and employers spend over six billion hours and over $160 billion per year trying to negotiate a labyrinth of deductions and credits, a tangle of different rules for characterizing income, and a variety of schedules for taxing that income. Simply put, the code is too costly and too burdensome for hard-working families trying to make ends meet.

It doesn't work for small businesses, either. Many successful small businesses in America file as individuals. Their income is taxed at the top marginal rate, and the proliferation of artificial deadlines in today's tax code has left them exposed to uncertainty and the threat of higher tax rates each year. The expiration of current tax rates, scheduled for the end of next year, would raise the rate that these businesses pay to 44.8 percent, and proposals put forward by the President and leading Democrats would raise this rate to roughly 50 percent.

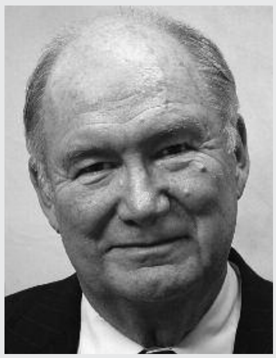
Nor does the current tax code work for U.S. employers that compete overseas. At 39.2 percent, America's combined federal, state, and local corporate tax rate is the second-highest in the developed world. Other developed nations tax their businesses at an average rate closer to 25 percent, meaning we are forcing American employers to compete at a disadvantage in global markets, or worse, encouraging them to move operations overseas.

For whom does the current code work? A code with high rates and lots of loopholes benefits those powerful interest groups that can afford the best lawyers and lobbyists in Washington. Rather than join together to argue for lower rates, those with political muscle usually take the path of least resistance by pushing for special deductions and carve-outs. This not only lowers their effective tax rate, but also enables them to use the complexities of the tax code to stack the deck against their competitors.

So how do we make the tax code work for American families, small businesses, and U.S. companies that compete abroad, instead of just the influential and the well-connected? Fundamental tax reform—lowering tax rates while consolidating brackets and closing loopholes to broaden the tax base—offers a clear solution that would make the tax code fairer, simpler, and more competitive.

We have strong evidence that this approach works—and that it is politically achievable—because we've done it before. The landmark 1986 tax reform lowered tax rates dramatically, yet it also closed tax loopholes used primarily by high-income earners. The result was a more progressive distribution of the federal income tax burden. At the same time, lower rates strengthened incentives to work and invest, producing a rise in taxable income and an increase in federal income tax revenues.

There's a reason this approach has attracted so much bipartisan support: Fundamental tax reform is just what we need to restore economic growth and promote job creation today.



The Bowles-Simpson tax reforms make sense, but nothing about tax reform is politically easy.

RUDOLPH G. PENNER
Institute Fellow, Urban Institute, and former Director, Congressional Budget Office

Were it not for the growth in spending on Medicare, Medicaid, and Social Security, the United States wouldn't have much of a budget problem. The two biggest programs—Social Security and Medicare—are retirement programs that are extremely popular politically. Both need to be reformed, but they cannot be cut abruptly and they cannot be cut drastically. Consequently, it's hard to avoid concluding that some revenue increases will be needed to solve our fiscal problems.

Once that need is accepted, we have to ask, "What kind of revenue increases?" The least desirable approach would raise income tax rates in the current system without fixing its complications, inefficiencies, and inequities. If raising rates is rejected, we must either create a new tax—such as a value-added tax or an energy tax—or design a significant, revenue-raising tax reform.

A VAT or an energy tax is probably a nonstarter politically. Republicans see a new tax as a money machine that would finance a much larger government. Democrats worry about the complexity of making such taxes sufficiently progressive.

The Bowles-Simpson presidential fiscal commission showed that there are income tax reforms that can raise revenues progressively and efficiently. In one option, they got rid of a host of special tax provisions while limiting, but not eliminating, some of the most politically sensitive, such as the charitable and mortgage-interest deductions. That allowed them to lower the top rate for individuals to 28 percent while still raising $80 billion more in 2015. With three rates—12.7 percent, 21 percent, and 28 percent—the top 0.1 percent of the income distribution lost 11.8 percent of its after-tax income and the top 1 percent lost 7.8 percent. The middle three quintiles lost less than 2 percent.

Erskine Bowles and Alan Simpson achieved a high degree of progressivity by taxing capital gains and dividends at ordinary income tax rates. That imposes a very high double tax on corporate profits. A more radical option would limit the double tax by integrating the corporate and individual tax systems. An even more radical change would move toward a progressive consumption tax. Capital gains and dividends wouldn't be taxed if reinvested, but would be hit if used to finance consumption.

None of this discussion implies that radical tax reform is easy. The revenue-neutral reforms of 1986 were anything but. A revenue-raising reform greatly increases the ratio of losers to winners. Accomplishing reform seems easy only when compared to persuading Americans to accept a VAT or new energy tax.

Tax reform is a perfect complement to real spending control.

MICHAEL J. BOSKIN

Tully M. Friedman Professor of Economics and Hoover Institution Senior Fellow, Stanford University, and former Chairman, President's Council of Economic Advisers

Spending control is vital before debt levels or the tax increases necessary to pay the interest on the exploding debt cause another financial crisis and/or severe permanent economic stagnation. My calculations suggest current spending and entitlement policy left unchanged will require marginal tax rates of 70 percent on many middle-income families, 80 percent at the top. That's a recipe for disaster. While not a substitute for real spending control, sensible tax reform is its perfect complement.

The late Arthur Okun concluded the corporate reduction was the most powerful of the Kennedy tax cuts.

Virtually every major tax reform proposal in recent decades seeks to boost growth by lowering corporate and personal tax rates and broadening the bases toward consumption, thereby strengthening incentives to work, save, and invest. (The President calls for big rate hikes at the top, but our tax system is the most progressive in the OECD. We should eliminate subsidies for the wealthy, not raise their tax rates; we want our most productive citizens working and investing, not chasing government largesse.)

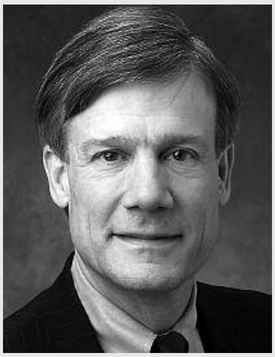
The Hall-Rabushka Flat Tax, the Bradford progressive consumption X-tax, a value-added tax, the Fair Tax retail sales tax, four decades of Treasury proposals, and the 2005 President's Tax Commission and Simpson-Bowles Commission proposals are all examples of pro-growth lower rate/broader consumption-oriented base reforms. The actual revenue produced by base broadening with lower rates is likely to be considerably higher than the static revenue estimates, as taxable income rises from faster growth and less tax avoidance. Any such "revenue dividend" should primarily be devoted to reducing deficits and debt.

Especially important is reducing the extremely high U.S. corporate income tax rate that severely retards and misaligns investment, problems that will only get worse as ever more capital becomes internationally mobile. Many major competitors such as Germany and Canada have reduced their corporate tax rate, rendering American companies less competitive globally. High corporate taxes are economically dangerous; the OECD reports that "Corporate taxes are found to be most harmful for growth, followed by personal income taxes and then consumption taxes." The late Arthur Okun concluded the corporate reduction was the most powerful of the Kennedy tax cuts.

Corporate income is taxed again at the personal level as dividends or capital gains. Between the new taxes in the health reform law and the expiration of the Bush tax cuts, these rates are soon set to increase 60 percent or more. Instead, we should do two things: Integrate the corporate with the personal income tax by attributing corporate income to shareholders and taxing it once at the personal level (exposing the fallacy in claims that corporate CEOs pay lower tax rates than their secretaries), and expense business investment (which cancels the tax at the margin on new investment) and expand or eliminate the limits on tax-deferred saving in the personal tax.

Replacing the current tax system with a revenue-neutral equivalent of the reforms mentioned above, phased in over a few years, would strengthen the economy both short- and long-term. American workers would benefit from more jobs in the short run and higher wages in the long run.

However, if tax reform includes a new tax that is used to grow government substantially, it will seriously erode our long-run standard of living. The VAT has served that purpose in Europe and, while better than still-higher income taxes, bloated welfare states and higher taxes are a prime reason European per capita incomes are 30 percent lower than American incomes. Trading a good tax reform for a much larger government is beyond foolish. No tax reform can offset losses that large. Hence, a VAT should only be on the table if it replaces other taxes and is accompanied by rigorously enforceable spending control.



Done right, tax reform can do a lot. But politics, not economics, will likely carry the day.

JIM GLASSMAN
Managing Director and Senior Economist, JPMorgan Chase

Will tax reform work? It would if given the chance. The United States faces a staggering fiscal challenge. No, it's not the one everyone is talking about and that spurs so much argument on the national soap box, the $1.3 trillion deficit we logged this fiscal year. Today's deficit is all about the recession. It is "cyclical." As the economy recovers, the red ink will dry up on its own and the federal deficit will fall back to where it was before the recession in 2007, back to around 1 percent of GDP. That is what the Congressional Budget Office (the official budget referee) says as well. And a deficit less than 3 percent of GDP is more than sufficient to lower the level of outstanding federal debt relative to the size of the economy.

The real fiscal challenge—the one only a handful of political leaders are brave enough to talk about—isn't yet visible. It's only in our mind's eye and it's why bond yields have fallen to record lows despite today's massive deficit. Federal spending for healthcare—Medicare and Medicaid—is projected to rise from 5 percent of GDP to 25 percent in coming decades. Interested observers know about this, because it has been in the CBO's mind's eye (and documents) for decades. It may be politically difficult to talk about it but talking about it is an important part of the solution.

What is the answer? Financing the future surge in federal healthcare spending by running a deficit—a structural deficit—is not an answer. It won't happen. No one, Democrat or Republican, would want this, because it would drive interest rates sky high and bring the economy to its knees. Some say that the growing healthcare burden should be financed by raising taxes. At the end of the day, most Americans will balk, given the historical resistance the electorate has to a federal tax burden that exceeds 18 percent of GDP. Even a balanced approach of across-the-board spending cuts and higher tax rates, what many observers say is inevitable, would do more harm than good, because it would hurt the economy while doing little to control rising healthcare costs.

Federal spending for Medicare and Medicaid is projected to rise from 5 percent of GDP to 25 percent in coming decades.

The best answer is two-pronged: reform the healthcare industry and promote faster economic growth. Reform that empowers the industry to prevent costs from soaring, what competitive practices in most industries do, makes most sense. Reform means fundamental change, including tort reform, strengthening competition, giving users of healthcare more responsibility to make choices (many economists believe that ending the business tax credit for health insurance costs is necessary), morphing the Medicare and Medicaid programs into more of a catastrophic insurance plan, and changing the 65-year age trigger that shifts people from the private healthcare insurance system to the government's (is it a mystery that the health insurance industry has little reason to encourage behavior that minimizes risks that arise after the age of 65?). Healthcare reform isn't the only answer. It should be combined with policies that boost the economy's growth potential. After all, the federal government is a shareholder in the U.S. economy and a stronger economy means stronger federal revenues.

That's where tax reform can do a lot. Done right, it can boost the economy's growth potential. There is little disagreement among economists about the principles that bring the best for the economy from the tax code. Tax policies that are permanent tend to bring about a stronger response from individuals. A tax code that is transparent is more effective than one that is laced with a jumble of tax credits and exemption phase-outs. Tax reform that boosts the incentive to save and invest would do more to spur the economy's growth potential than one keyed only on income. In that regard, the bipartisan effort by Senators Sam Nunn and Pete Domenici years ago to morph the current income tax code into a consumption-based income tax was a promising step in this direction. Tax reform that rewards work has important payoffs. And tax reform that lowers or eliminates the tax on long-term capital gains, what homeowners now effectively enjoy, would encourage the right kind of risk taking.

Is tax reform, done the right way, a pipe dream? Probably. Tax reform, by its very nature, involves a mix of politics and economics. When that happens, politics usually wins the day.

Despite claims that rate-flattening will accelerate economic growth, our experience with the Bush tax cuts suggests otherwise.

ANDREW FIELDHOUSE
Federal Budget Policy Analyst, Economic Policy Institute

The United States is overdue for tax reform, and the dual challenges of stabilizing the long-term fiscal outlook and rebuilding the middle class necessitate that this reform raise more revenue and distribute the tax burden more fairly. These realities, however, render the Tax Reform Act of 1986—which was designed to be both revenue- and distributionally neutral—a wholly inappropriate benchmark. Given valid concerns about widening income inequality and unsustainable long-term budget projections, it makes zero sense to lock in the tax code's revenue levels or distribution.

In fact, these problems were actually caused in part by the very policy now being promoted, namely flattening marginal tax rates. The Bush-era tax cuts cost $2.6 trillion over the last decade, accounting for roughly half the public debt increase over this period. Over the next decade, a continuation of these tax cuts represents the difference between a sustainable and unsustainable fiscal outlook. Roughly half the tax cuts went to the highest-income 10 percent of earners, even though the top 10 percent of earners captured more than 90 percent of national income gains between 1979 and 2007. Average tax rates for the top 1 percent have been cut by one-fifth over that time, to the point where more than a quarter of millionaires now pay a lower effective tax rate than middle-class families earning $40,000 or more annually.

Despite claims that rate-flattening will accelerate economic growth, our experience with the Bush tax cuts once again suggests otherwise; these cuts coincided with the worst U.S. economic expansion since World War II. By just about every economic indicator—gross domestic product, nonresidential fixed investment, employment, and total compensation—the Bush tax cuts failed to generate even mediocre economic performance. There is no reason to believe that further flattening tax rates will yield better results.

The Tax Reform Act of 1986 is a wholly inappropriate benchmark.

To address some of our most pressing economic challenges, tax reform must adhere to two basic principles. First, it must restore the basic tenet of a progressive tax code that effective tax rates are supposed to rise with income. This means crafting a tax code to reflect today's income distribution, not the distribution three decades ago. Flattening the rate structure will hardly simplify the tax code but will almost certainly undermine progressivity, shifting the tax distribution away from upper-income households and toward the middle class.

Second, reform must raise revenue. Taking revenues off the table—as revenue-neutral tax reform would do—would render a sustainable fiscal trajectory practically impossible.

There are, however, valuable lessons from the 1986 reforms. Equalizing the tax treatment of wealth and work, as we did in 1986 by raising capital gains tax rates, would drastically improve the tax code. But tax reform should restore a greater degree of progressivity by equalizing the treatment of income derived from work and that derived from investments across a schedule of tax rates more closely mirroring the income distribution. Further flattening marginal tax rates will only succeed in exacerbating inequality while failing to generate meaningful economic growth.

Tax reform should be a top priority. We have few bullets left.

MARK A. BLOOMFIELD
President and CEO, American Council for Capital Formation

Tax reform should be a top priority, provided that the right approach is taken.

As the United States grapples with the twin goals of deficit/debt reduction and the imperative of restoring economic growth, there are very few bullets left in our economic policy arsenal. We've tried stimulus, monetary policy, and tax cuts, and need to do more. Economists of all stripes as well as the American public believe true tax reform can help get us back on our feet economically and restore confidence in our political system.

We have two models for tax reform in our recent history: the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986. Tax reform in 1981 cut tax rates for individuals and corporations and also reduced taxes on saving and investment. Tax reform in 1986 did the right thing in cutting tax rates but the wrong thing by "paying" for it with higher taxes on saving and investment. The capital gains tax went up; IRAs and Keoghs were not expanded; the tax treatment of business investment became much harsher. It may be no coincidence that real economic growth averaged 3.5 percent over the 1982–86 period and only 2.5 percent from 1987 to 1991.

Again, there is little disagreement among economists and the public that our current tax system is broken. "Tax gamesmanship" is often the order of the day for individuals and businesses. Lower tax rates will truly spur economic decisions, grow the economy, and generate more needed revenue for our treasury.

Our experts and the American public also understand that a major obstacle for U.S. economic growth is our low saving and investment rate. Whether it be personal, business, or government saving (our deficit is dissaving), we'd be shooting ourselves in the foot if we paid for lower tax rates with higher taxes on savings and investment—the engine needed for reducing our growing debt and growing the economy.

Take capital gains, which have been prominent in the news recently thanks to Warren Buffett and his secretary. Many politicians believe that we could pay for lower tax rates by taxing capital gains the same as ordinary income. But they are dead wrong if they think that this will have no bearing on savings and investment decisions.

An econometric study by respected economist Allen Sinai notes that the economic activity sparked by eliminating the capital gains tax increases GDP by a little over 0.23 percentage points per year. Jobs increase by an average of 1.3 million annually while the unemployment rate drops 0.7 percent at its lowest point. Conversely, Sinai found that raising the top rate from the current 15 percent to 20 percent, as suggested in several deficit reduction plans, would cut annual economic growth by an average of 0.05 percent per year and an average of 231,000 jobs would be lost from 2011–16.

As the wise seventeenth-century philosopher Thomas Hobbes said, "It is fairer to tax people on what they extract from the economy, as roughly measured by their consumption, than to tax them on what they produce for the economy, as roughly measured by their income." It also makes economic sense and should be kept in mind as we begin the great debate on tax reform.

Comprehensive tax reform is essential in any grand bargain to reduce the deficit.

DAVID M. WALKER

Founder and President, Comeback America Initiative, and former Comptroller General of the United States

Comprehensive tax reform in the United States is essential and can help to achieve economic growth and address the federal government's structural deficits. The current federal tax system is far too complex, contains certain inequities, is not competitive internationally from a business perspective, and does not generate adequate revenues. In addition, key provisions of the current tax code will expire on or before December 31, 2012, thereby creating uncertainty and hampering investment decision making.

Engaging in comprehensive tax reform that addresses individual, corporate, and estate taxes appropriately can serve to enhance economic growth. Businesses and investors must be provided more certainty to encourage them to invest—and such investment will enhance economic growth.

Comprehensive tax reform that makes the tax system simpler, fairer, and more competitive, while generating revenues above the historical average (as a percentage of GDP) can and should be a key element in achieving a so-called "Grand Bargain" in connection with meaningful deficit reduction. This reform would include, among other factors, a broadening of the tax base combined with a lowering of the top marginal tax rate for individuals, corporations, and the estate tax to no more than 25 percent. It would also include eliminating the difference in the rate of taxation between capital gains and ordinary income and providing a reasonable exemption from the estate tax. It should also include moving to a territorial form for taxation for multinational corporations and allowing a deduction for dividends distributed.

The size of our nation's fiscal challenge combined with the current polarized political environment will require that any major deficit reduction package include certain elements. Specifically, it will need to include social insurance program reforms, defense and other spending reductions, and comprehensive tax reform that will generate more revenues. We need to accomplish such reform soon and before the United States faces its own debt crisis. Realistically, achieving comprehensive tax reform and achieving a "Grand Bargain" is not likely to occur before 2013.

The Tax Reform Act of 1986 hurt growth. It is no model.

STEPHEN J. ENTIN
President and Executive Director, Institute for Research on the Economics of Taxation, and former Deputy Assistant Secretary for Economic Policy during the Reagan Administration

Tax reform can encourage growth and lower the deficit if done right, but not if the usual approaches are followed. Taxes affect the economy by altering incentives to work, save, and invest, not by handing out money to spend or taking it away. Keynesian multipliers and spending stimulus demand are a mirage.

The tax code misallocates capital among competing uses, but merely fixing the income tax via mindless base broadening is not the answer. We need a different tax base.

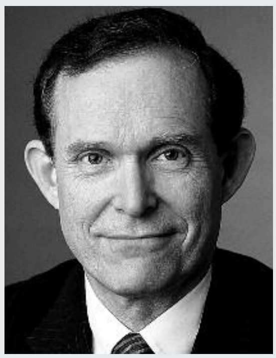
Income taxes discriminate against saving and investment relative to consumption. Income taxes hit saving repeatedly: after-tax income that is saved is taxed again on its earnings; corporate income is taxed a second time at the shareholder level; estate and gift taxes can be a fourth layer of tax. Furthermore, business income is overstated by depreciating instead of immediately expensing capital outlays. These biases against capital formation do far more damage than distortions between one use of capital and another.

True tax reform would end these biases by adopting a saving-consumption neutral tax, such as a cash flow tax, consumed-income tax, or Bradford X tax. Features of the current tax system—accelerated depreciation, temporary expensing of equipment spending, pensions and IRAs, reduced tax rates on capital gains and dividends, and the domestic production credit—move in that direction. They are not "loopholes" to be eliminated. They are the right neutral treatment and should be expanded to cover all saving, all businesses, and all types of capital. Expensing, lower corporate tax rates, capital gains and dividend relief, and ending the estate tax would all raise GDP and cost the government nothing over time.

The Tax Reform Act of 1986 hurt growth and is no model for new reforms. TRA86 disallowed deductions for legitimate costs of production. It lengthened asset lives, ended the investment tax credit (an alternative to expensing), curbed pensions and IRAs, and ended the capital gains differential. The broader tax base raised taxes on capital income even with the drop in individual and corporate tax rates. The result was a 1 percent drop in potential output and lower wages. The burden of the higher taxes on capital formation fell largely on labor.

The Bowles-Simpson Commission plan and the Wyden-Coats bill enlarge on the TRA86 approach of perfecting the income tax. They dramatically lengthen asset lives and raise tax rates on capital gains and dividends. They do not cut corporate and individual tax rates enough to offset these anti-investment steps. Wyden-Coats would depress GDP by about 4.3 percent, much worse than TRA86. It would replicate the economic disaster in Japan after Japan's TRA-style reforms in 1988–90. By contrast, China has a tax system much closer to the neutral tax plans listed above, and is booming.

The traditional tax community is obsessed with the income tax and TRA86. If that is the best we can do, it would be better to keep the current tax system and fix the deficit by cutting spending.



Yes, and tax reform should be an urgent national priority.

ROGER B. PORTER
IBM Professor of Business and Government, Harvard University, and former Assistant to the President for Economic and Domestic Policy

There are three compelling reasons—two economic and one political—for making fundamental tax reform an urgent national priority.

The first is the contribution tax reform can make to the imperative of increased economic growth. The tax code now is riddled with incentives to encourage or discourage certain kinds of behavior or activity and distorts the efficient allocation of resources.

The last major tax reform in 1986 was based on a powerful principle—broadening the tax base while lowering marginal rates. This positive shift produced an increase in taxable income by rewarding additional risk-taking and effort as well as encouraging entrepreneurial activity. Moreover, it discouraged the growth of compensation in the form of fringe and other non-taxable benefits. This more efficient tax system contributed to greater economic growth and employment.

Today, fully 90 percent of individual taxpayers pay for professional tax preparation or tax software to prepare their tax returns. The IRS estimates that over the past decade, the burden for the typical taxpayer has grown by about 20 percent.

Since then, government policy has relentlessly used the tax code to encourage specific forms of activity. The Congressional Joint Committee on Taxation has determined that in the last thirty years, the number of tax expenditures in the tax code grew from less than 100 to almost 250. The Augean stables need another cleaning.

A second economic imperative is to simplify the code, which has become burdensome for both individuals and companies. The Internal Revenue Service has identified three thousand legislative changes to the tax code since the year 2000. A more simple and stable tax code facilitates planning for individuals and corporations, reduces overlapping and confusing requirements, and increases the likelihood of compliance. Complexity also creates opportunities to game the system.

Today, fully 90 percent of individual taxpayers pay for professional tax preparation or tax software to prepare their tax returns. The IRS estimates that over the past decade, the burden for the typical taxpayer has grown by about 20 percent. Today, individual taxpayers and businesses spend more than seven billion hours annually preparing and filing their tax returns.

In addition to the economic benefits of tax reform, there is also a political windfall. The level of trust between ordinary citizens and their government has declined in recent years. Many individuals today are deeply skeptical about government and question the fairness of our tax system. They believe not merely that the tax system is complicated and inefficient, but that it favors those interests who are able to secure special benefits. By eliminating these special benefits, fundamental tax reform can help rebuild much-needed trust in government.

Some claim that while fundamental tax reform is economically desirable, it is politically "almost impossible." A quarter of a century ago, Ronald Reagan acted with determined, persistent leadership. He relentlessly educated the public as well as elected officials on the merits of fundamental tax reform and negotiated with skill by finding common ground. His efforts contributed to producing bipartisan landmark legislation. A similar effort with the promise of similar results is needed.

The best tax systems have a broad base and low rates.

DONALD B. MARRON
Director, Urban-Brookings Tax Policy Center

America's tax system is a mess. It's needlessly complicated, economically harmful, and often unfair. And it doesn't raise enough money to pay our bills.

That's why almost everyone agrees that tax reform should be a top priority. Democrats, Republicans, and independents. Accountants, lawyers, and economists. Elected officials and ordinary citizens. All know our tax system is deeply flawed.

Unfortunately, they don't agree on how to fix it. Some want revenue-neutral tax reform, while others want higher revenues to cut deficits and pay for rising entitlement spending. Some want to fix the income tax, while others want to tax consumption. Some want to cut tax rates across the board, while others would lift rates for high earners.

Public discourse, meanwhile, is hung up on the idea of attacking "loopholes" when the real action is in tax breaks that benefit millions of taxpayers. Tax reform isn't just about corporate jets or carried interest. It's about the mortgage interest deduction, the tax exemption for employer-provided health insurance, and generous tax incentives for debt-financed corporate investment. Those policies have major flaws, but they are not loopholes. They reflect fundamental economic and social choices, and they benefit well-defined constituencies.

Tax reform will thus involve a prolonged political struggle, as reformers seek some compromise that can attract enough support to overcome the inevitable inertia against change. That won't be easy, but given our skyrocketing debt, weak recovery, and flawed tax system, it's clearly worth the effort.

Even as they seek a reasonable compromise, reformers should continue to articulate their visions of an ideal tax system. Mine would reflect five principles. First, the government should raise enough money to pay its bills. That likely means higher revenues, relative to GDP, than we've had historically. Second, it's better to tax bads rather than goods. That means greater reliance on energy and environmental taxes. Third, it's better to tax consumption than income; policymakers should thus limit how much they tax saving and investment. Fourth, the tax burden should be shared equitably both across income levels and among people of similar means who make different choices (for example, renting versus owning a home).

Finally, the best tax systems have a broad base and low rates. Policymakers should thus emphasize cutting tax breaks rather than raising tax rates. Indeed, some rates, like the 35 percent rate on corporate profits, should come down. To afford such cuts, policymakers should go after the dozens of deductions, credits, exclusions, and exemptions that complicate the code and narrow the tax base, often with little economic or social gain. Many of these provisions have been sold as tax cuts, but are really spending in disguise. They should get the same scrutiny that policymakers devote to traditional spending programs. ◆