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Panel One Discussion Transcript

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PANEL I: DISCUSSION TRANSCRIPT

VICTOR ZONANA: Let's open it up for comments.

GARY HUFBAUER: What I want to do is somewhat sharpen the latest disagreement between Jack Mintz and Vito Tanzi. Jack is from Canada and Canadians are very polite people, so he was quite polite in his emphasizing the differences, but I will be less polite. The only problem with Vito's paper is the title. He used the word "termite." I think he should use the word with a question mark. Is it termites or worker bees that work in the system?

When I listened to Vito and Jack, there is a lot of worker bees going on here because at the end, both of them said that the corporate tax is probably going to dwindle. I think that is just great. This is a very useful thing that is coming out of globalization and also, one sees the erosion of income taxes as well—especially taxes on capital income, and I would say another worker bee at play here and all these forces.

The view really depends on how you think both structures ought to go, and I disagree with my old friend, Stan Ross, on how revenues and expenditure interact. I think there is some pressure the other way. I see more cause for celebration than Vito sees in this and less cause for regret. Having said that, yes, I would say there are both termites and worker bees, and there are some termites, and where are they?

The multi-national corporation issue, as I would regard, is pure worker bee and David Bradford talks about this later. There is a pretty straightforward solution and that is not a problem. Hedge funds, I think are also not a problem. I looked at the literature and came up with a much smaller number, but that is not the question. I think hedge funds, as tax evaders, are not big tax evaders.

I think the termite issue is one which was in Vito's points four and six; and that is tax savings which facilitate portfolio investment of one kind or another and various kinds of financial transactions so that I think he had a very large number like $6 or $7 trillion, on which income is slightly taxed. That is the termite issue in my view. If one could just concentrate on that one and actually applaud some of the others, that is how I would like to see the debate go.

Two other quick points, the IMF really ought to play this role of defending some of its lesser countries. If you look at the world today—who is really paying off? The Bay area, Silicon Valley, all of these areas with a greater conglomeration of facts. What can some of these poor countries, such as Peru, Malaysia, and so forth, do? Here we are going to have some kind of concerted effort to beat up on them in some of these so-called termite areas. There is a lot of equity at stake and I think OECD is obviously not going to defend the Malaysias of this world, or the Egyptians, or what have you. That is where the IMF comes into place.

Finally, I thought one of Vito's dramatic suggestions was for the World Tax Organization, because if you take the initials of that and you think about it, it would take a lot of rhetorical pressure off the World Trade Organization.

DIANE RING: I was really struck by the termite ending. I have never thought of myself as part of the exterminator group, but apparently we are a little bit in that business. One of the issues that arises a little bit in this paper and comes up more in the later sessions is the question or idea of cooperative efforts and where that might go and some of the questions related to that.

Obviously, there are varieties and impediments, and we will be talking about that more, but in connecting that to the termite image, one of the things that comes to mind—I imagine sort of a building. It has lots of shops, and some of the shopkeepers would like a new building. Some of them are happy and there are a lot of termites, so the ones that are happy with the building aren't focused, but maybe the ones that are not too happy are eager to see those termites break it down. There is not enough of a group effort to deal with the structure and the building collapses; and the termites who wanted a new one are happy to work toward a new structure at that point. It may be the new structure is partially a good idea, but I think one of the points that came up in two of the papers is that if we allow the termites to work as they go without stopping and aggressively thinking about it, it really is not going to be the worker bees. It will be the termites, and we might end up at a final stage that is not the result that those hoped for in terms of a new regime. We may be happy to see the pressure points. We may be happy to see a lot of the pressure points show. If we are not really focused on that, we may end up with various interim kinds of taxes or revenue directions that were not what we had in mind.

MICHAEL GRAETZ: One point that Vito is probably not aware of is the great tax history of termites. They were studied for years by the IRS in an effort to determine whether they qualify, whether the termite damage qualifies as a casualty loss under the Internal Revenue Code and whether it was sudden and unexpected enough, once the building collapsed, to be a casualty loss. The IRS ruled that termite damage did not qualify as sudden and unexpected so, therefore, no casualty loss was allowed. I disagree with Gary. You stick with the termite and you get the right tax image.

I want to make three quick points. One is that there is an important overlap between the real events that Vito is concentrating on and the others that have been talked about as well, and the legal categories that exist. It is important to recognize that the legal categories were developed in the 1920s and they have been maintained since the 1920s. Here, it is not just arm-length pricing which everyone has talked about, but it is permanent establishment which about everybody has talked about. I list some of these in my paper but I will not cover them in my remarks.

Corporate residence is one that is not mentioned at all in your paper, which I emphasize. I think this is a fiction that cannot be sustained in a modern economy for lots of reasons, which I will not go into now but it is extremely important because it determines both residence-based taxation and source-based taxation in many instances. I do not know what the category of archaic—I call them outdated concepts in my paper—but the category of archaic legal concepts matching on to this set of real transactions that you are describing is a major set of problems that people are talking about all the time, but they have not really begun to be tackled.

The second point that I want to make is my wariness, my on-going wariness about the ratio of taxes to GDP as a measurement of the size of government. As a reminder, not only the targeted tax cuts that Jack mentioned, but the ability to mandate and privatize, and all sorts of other techniques for doing things badly through government may come up. There is sort of optimism and pessimism going on here. The optimism, it seems to me, is the imagination of taxes that no one has and the assumption that they are going to be much better and free of all the problems. This is my on-going, I think, 25-year problem with yield exemption consumption taxes which I have never been able to convince David on, although I think it was 1974 that we first started having this conversation. I never will convince him, I am sure.

I do think there is a problem of imagining a tax as being a good tax and forgetting about how Congress, as the worker bee community, will make it not work the way it has been imagined, and this is just a warning that we may have very bad taxes. I do think that this idea—you talk about healthcare expenses—if you look at healthcare expenses as a ratio of GDP, the U.S. is much worse than anybody. Because of the way we have done it through income tax and payroll tax exemptions or providing wages in the form of health insurance, we are also worse on coverage than anyone. On the other hand, we look good if you look at taxes to GDP ratios in terms of how government is doing. I think this is a very big problem in terms of thinking about the solutions and I want to emphasize Stan's point that the one thing that governments are really pretty good at is the pure transfer of cash, which is the Social Security system and the retirement security, at least in the social insurance package that Stan is talking about, we ought to be wary of giving up the idea of just taxing and transferring if that is the goal.

VICTOR ZONANA: Do you have a third point?

MICHAEL GRAETZ: That was my third point. I don't count them the same way everyone else does.

JOHN STEINES: I have a question more than a comment. We are going to spend a lot of time, I would guess, in the next day and a half talking about the corporate income tax base. Jack, you offered the view that you think it is going to dwindle significantly, and subject with what Mike just said about the wariness of using tax to GDP figures. Basically what I heard was that, despite fairly significant drops in corporate tax rates, corporate tax as a percentage of output has remained stable, which would suggest on a very simplistic level that the base is broadening quite a bit. Some of the termites that have been talked about are not new. They have been around for a while and if they have been eating away at the system, I think it is not just in the last year or two. I wonder why you think the corporate tax base is going to become so insignificant.

JACK MINTZ: Because of this highly mobile base, which is a reported profit without having to move physical inputs, that is where I think the real significant competition or undercutting tax breaks are occurring, and it is occurring through the general rates. Governments have been able to shore up corporate income tax revenues by base broadening, but if you start looking at the reforms, and my paper goes into a lot more detail. If you compare the 1980s and the 1990s experience, the thing that I am seeing now that is happening across the world. I am saying this generally as opposed to any one country's experience, is that in the 1980s, there was a lot of base broadening in attempts to cut rates and broaden bases and that would pave the way of keeping up the corporate tax revenues, and it succeeded.

What is happening in the 1990s now is that there is still desire to keep cutting rates, and the ability to just broaden tax bases is not easy anymore because many countries have gotten rid of a lot of incentives that were existing in the system that they had before the vested tax cuts and balances and tax holdings. There are still a lot of countries that have the stuff, but I am just saying that it is harder to broaden the base because you end up getting some more of the politically powerful parts of the industrial sector. My favorite example is mining and oil and gas industry. Here you have an asset that is sitting in the ground and if anything, is the one you want to tax because it is not mobile and yet, if you look at tax regimes around the world, that tends to be where your lowest effective tax rates are, and the biggest incentives. I know in our experience in Canada, that is really where you start hitting those powerful lobby groups in a country. It gets harder to get some of those things that are there and what countries have been doing is shifting to other taxes on businesses, away from the corporate income tax.

That is my point, and we are still seeing falling rates around the world. I think that is going to continue and I think the idea of having 10, 15 percent corporate income tax rates within 10 years, I don't think it is going to be that unusual, and Hong Kong is not going to equate the tax haven anymore. I do not think it even looks like a tax haven anymore. As a result, I am saying in 20 years, I think this extreme form of competition is going to occur. People are going to say, maybe we have to move the system away from the corporate income tax entirely and do something else.

VICTOR ZONANA: I have on the list Phil West, Victor Thuronyi, Dan Shaviro, and then Hugh Ault.

PHIL WEST: I want to make a series of brief points, some more narrow, some more broader. First of all, on the taxes of percentage of GDP, I do not think anyone mentioned what I find to be a relevant statistic, which is in the U.S. we are at the low end of all OECD countries and the amount of revenue we collect is a percentage of GDP, whether it is relevant as an absolute matter. I do not know, but relatively speaking, I find that relevant.

I think it is necessary, since Vito mentioned that I have another idea for a termite, that I say what it is. It is what I see to be the increasing use of what I call across border arbitration and it is a function of a number of things: increased financial engineering, increased tax planning . . . and it is facilitated by a couple of the termites that were identified by Vito. Tax havens and lack of coordination among countries, because the more there are discontinuities and disparities among systems, the easier it is to arbitrate systems.

A point of clarification—both Hugh and I kind of winced in our seats when Vito started talking about tax havens that, say, why should we have to impose income taxes? Just for the record, no jurisdiction needs to impose an income tax to get off the list of tax havens. That is an important point. You can still have zero taxes, no income taxes, and not be classified as a tax haven. It is not a necessary prerequisite.

I want to support Stan's point on what drives. I am not a budget expert, but it seems to me in my experience that the expenditure side is what is going to drive the revenue side more than vice-versa. A related point is whether we should be in the business of shaping or calibrating the size of our government based on what we are no longer able to raise in revenue.

Should we let this happen through the back door. In other words, the fact that we are losing our ability to tax capital income . . . should that be what drives our decisions about the size of our government? Or should we be making conscious decisions about the size of our government in raising the necessary revenue to fund that? I think Diane made a point related to this. Do you want to let the building fall down just to rebuild it or not? I am reminded of Ralph Nader's strategy—let's gut the system. Let's see how conservative we can get and then we can move the liberals into power that way.

Two final points, it seems to me that low rates in a broad base can be consistent with international coordination. I am not sure if Jack intended his list of what governments can do to be mutually exclusive, but it seems to me that international coordination is not necessarily a bad thing because it can lead to—whatever your perspective whether it would be Gary's or another—lower rates and a broader base. In fact, when I was in the government, that is what we liked to think we were trying to do with the OECD project.

The final point is Stan's point about the importance of employment taxes. We can sit here and talk about the desire and ability of capital taxes, or the extent to which we are going to lose our ability to tax capital, but it seems to me as a political matter if we do lose our ability to tax capital and the base does shift to labor, I think that it is going to be unattainable as a political matter. I think we ought to keep that in mind and there is a fairness issue there in addition to a political issue and those are related and Michael's paper goes into the importance of the fairness issues. Not only is it unattainable, but I think it is undesirable also.

VICTOR THURONYI: I cannot resist the termite metaphor and I think it is a good one. Part of what I wanted to talk about was the extermination part—that it is a characteristic of termites that to exterminate, it does not make a lot of sense to start going after individual termites. Of course, the tendency of administrators or legislators is to try to enact specific rules to attack individual problems. I think this metaphor shows us that these rules will tend not to work and what we need is to work on underlying principles, which we are going to talk about later today and tomorrow; and on process, which I will talk about tomorrow afternoon, and which Mr. Tanzi has talked about in terms of some kind of international organization or forum for dealing with problems.

On the process issue, it is both a matter of trying to get this structure right and continuing review. That is another aspect of termites: you have to keep inspecting and taking stock of the situation. That is, I think, the appropriateness of the termites.

DAN SHAVIRO: I think we want to be more careful of what we mean, or what happens when there is no corporate income tax. Suppose the corporate income tax is going to disappear, we have to figure out exactly what that means, what is really happening. Why don't we like the corporate income tax? I would say the two reasons why we don't like the corporate income tax would be that it is an income tax—so it is a deferred consumption—and the other reason might be that the classical test is that they were double-taxing. We are obviously penalizing corporate investment in many settings because you tax it once and, with the distribution to the shareholders, you tax it again.

It is not clear to what extent those are the problems that are addressed if "the corporate income tax" is wiped out. If you have good advice and there is only one level of tax, and for that matter if you have consumption tax accounting and expensing in the like, then it starts to look very different. You can essentially be a proxy tax on the owners.

The two things that we might not like about the corporate income tax, again, is that it is an income tax. I have not had time to work through this. It struck me that some of the problems that Vito and Jack discuss are possibly particular to income taxation or the current technology of income tax collection. Others might be more general. Obviously, things like the tourism problem or the problem of the unobserved Vito was talking about, the creation of joint barter clubs if you have e-cash, and that sort of thing. Obviously that is going to be a problem for either system if it emerges a serious one.

Suppose we had consumption tax accounting, expensing or the like, it is useful to track through which of these problems disappear and which of them do not. Most of them do not have, necessarily, the timing conventions of income tax so much as the technologies of how it is set up and when the tax is collected and so forth.

The second thing, I think it is quite easy to agree it is sort of silly to have a classical corporate tax where you tax at the corporate level and at the shareholder level. The tax at the shareholder level is something that is often avoided to a fair extent and in some cases what is happening is that the corporate tax is the tax you get, and you risk having the corporation be a tax shelter where there is never any distribution. If you could observe the distributions and tax them, you would in effect have a cash flow consumption tax. If you could observe all the distributions, do you take the money out of the corporation that is in effect, like spending it out of your qualified account? That is not necessarily what we are talking about here. It is very possible, to some extent, that the corporate taxes we have around the world are, in effect, proxy taxes on the owners where you are not going to really get the second level and if you cannot tax those things, then what you basically have is a tax on being unable to earn your income through a corporation for tax purposes. Like in the United States, of course, it is well-known from an allotted tax law, a basketball player cannot say, I am now a corporation that is hiring myself out to the Knicks and if the U.S. could disregard the corporate elements. To some extent, if you have the corporate tax disappearing, what it could mean is that we are taxing being an employee, not being able to do the same things, but have your different incentive structure and legal relationships where you are not called an employee. That would not be a very desirable state of affairs. We do have to think about exactly what it means for the corporate income tax, who is really paying tax, what are the conditions and what you can avoid, and the like.

I agree with Gary about the undesirable features of the current system that are being whittled away. We have to think about what is actually being whittled away relates to those bad features rather than something else.

A final brief point on capital versus labor. I think David and others have done good work. It is not necessarily a good way of thinking, to think of the tax on Microsoft as the tax on capital and the tax on me is the tax on labor. We are not talking about yield exempt. We are talking, for example, consumption tax accounting and the like. Bill Gates, in effect, pays a lot of tax, or Microsoft does, because they earned marginal returns. There is certainly a political problem of being perceived as capital versus labor. Whether we tax the return to waiting and so forth is probably a better way to think of things rather than capital versus labor as these categories. The people who make money through a corporation are paying the corporate income tax. It is sort of labor in a way, especially for the fact that they only use income tax appreciation.

HUGH AULT: I think it is inevitable that, given the interconnected nature of all of these issues that we would sort of get them all out on the table at the same time and if we talk about all of them this morning, we would not have anything to do this afternoon or tomorrow. I will not talk about international cooperation or the mechanisms for international cooperation that we might think about. I would also like to resist the termite metaphor or any other metaphor. Metaphors sometimes can be helpful, but also sometimes they can be more confusing than clarifying.

I would like to put on the table what seems to me the conversation we have been having. It seems to me that there are people who think that the income tax is the appropriate way to approach the funding of governmental expenditures. Some people do not believe it. It seems to me it is one exercise to do a mind experiment. It will be more difficult for some people than others, but do a mind experiment: that you wanted to have a good functioning income tax and you went through Vito's paper and you identified the number of problems which seemed to jeopardize getting to that policy goal. Then you would have to think at each problem; transfer pricing is difficult. It has gotten better. We have the guidelines. We have the procedure developments of APA on the one end of the procedure and possibly arbitration on the other end of the procedures as some of those difficulties are being modified. Then we could think about whether some sort of formula approach might be a better fix to that problem. We could say that capital flight into tax savings is a problem and, therefore, maybe there should be some sort of effort to try to convince the tax havens that it would be in all of our interests that we cooperate or something like that, which is more or less what we are doing.

Unfortunately, the argumentation, which was very much Gary's argumentation, that comes out in a lot of the publications, is we do not want an income tax; we have a different goal and therefore, we either applaud or object to efforts taken to deal with problems in the income tax. Gary draws the line at tax evasion and tax havens that undercut the income tax. There are obviously other people out there, if you have read any of the literature that has been coming out on this, that do not take that position.

I think it is very important to distinguish the framework of the conversation. Are we talking about an income tax? Do we want to keep an income tax, or are we talking about a consumption tax and what a consumption tax may look like?

DAVID BRADFORD: A couple of points, I think there is less of a difference between proper income taxes and consumption taxes than most of this community seems to believe. I do not think it is that big of a difference.

I also want to mention to Hugh that Alan and I are back, and I think we have designed the right way to do a real income tax. We really worked at it. I do not think you will like it, but we think we have designed the only way to do it. I was not quite sure how relevant this was. The discussion of the size of the government is an interesting one, and another kick of mine has been that we do not have very good ways of describing governments and saying what we are doing. That I call it our budgetary languages is poor.

One of my favorite examples that I use to illustrate this is the debate that arose at the beginning of the first Clinton term when he came in. He had a big deal about how he was going to attack the budget deficit problem. He was going to have one part tax increase and one part a spending cut. It turned out to be very hard to do, of course, but the package that he finally came up with involved increasing the taxation of Social Security retirement benefits and we enacted it. The question was whether that extra revenue was a result of a spending cut or a tax increase. The administration wanted to say it was a spending cut because they had to get more spending cuts because of its promise they made to match spending cuts and tax increases. Of course, the opponents, the Republicans, said that that is a tax increase. An economist thinking about it would say it doesn't make the slightest bit of difference what you label it. The real impact is the same. It makes no difference whatsoever, but, of course, politically it does seem to. The fuss died down when it turned out that Reagan had done exactly the same thing and called it a spending cut in one of his budgets, so they stopped fussing about it. The Republicans stopped attacking Clinton on the point.

I think there is a major lesson in it, which is you really cannot tell from these labels what something is, whether it is spending or taxation. If you were to ask "what is the ratio of taxes to anything," you would have to answer that question and it is clear there is no meaningful way to do that. There are real economic effects going on here that you can describe, but our language is very poor at it.

I think another interesting example of that which is relevant, again not to substance but psychologically thinking about these things, is the discussion of employment tax that Stan had. I understand what he means and am not saying that it's wrong, but most people would say that a value-added tax, particularly value-added tax of the consumption type, is equivalent to a wage tax and earnings tax.

All of those countries where you gave me the total for their employment tax, I bet you did not put the value-added tax. From a functional point of view they are the same and, for some, certainly thinking about the economic impact of those things. You would want to put those things together. We are being quite badly misled by the language in that regard.

One last thing: right now many of us, because of the tax incentives, would like to put more away into our retirement plans, than we are allowed to. If we were to re-label those contributions to our retirement system as taxes, we would not change the economic thing at all, but we would radically change the description of what our governments are doing. We have this very heavy employment tax, whereas functionally, what that particular system is doing is the opposite of what you think employment tax would do. You think it discourages work, etc., whereas that particular part of our system encourages work, so you can raise the amount you are allowed to put aside into these systems.

Again, many of these European systems, and it's true to an extent in our own Social Security system, those payroll taxes really are just functional in terms of an employee's life cycle, just like contributions to retirement plans and the set of incentives that are created by those things are very different from the set of incentives we would think about if you were using a payroll tax to pay for national defense. It is a totally different set of incentives you get as a result because of the life cycle phenomenon of the so-called "spending," which is really negative tax and benefits in the old age in that case are going to exactly offset the impact of the things that are called taxes in the earlier part of the life cycle.

PETER MERRIL: What was striking, I think, from Vito's talk, is those two things from a tax administration standpoint that are viewed as really big problems and it is a little odd and discordant because from an economic perspective, we think of technological development and competition as the really wonderful things. I had the sense that we are being a little bit too gloomy. Maybe this termite destruction is really part of what Chuck called creative destruction; that perhaps competition in technological change, while they are obviously having major beneficial impacts on the private economy and are responsible for the productivity growth that has generated huge budget surpluses that we have, that they also may be opportunities for tax administration. The technology area is certainly the higher productivity that can be gained from the use of information technology and should be able to free up folks that are currently spending their time doing very menial tasks in tax administration to doing much higher work and auditing the larger taxpayers. It strikes me that there must be opportunity for enormous productivity enhancement in government administration. I think the technology change is leading to a fair amount of concentration. I think 80 percent of e-commerce was done by 50 companies which, in some ways, should make the job easier for tax auditors if there is a huge concentration in the activity. I think the opposite is happening from what many people thought could happen with technology.

In the competition area, it certainly seems to me, from an economist's view, that the tax competition has many good aspects to it. Also, I think the OECD tax competition project recognizes there is a taboo aspect that the economists talk about the tax competition of greater matching of the benefits provided by government with tax revenues, and the competition keeps those things in line. I definitely think there is a distinction between the good tax competition—which is the process of making sure the benefits and revenues are in line with each other, and responses to what we believe—and bad competition, which I would view as a haven for tax evasion: basically not cooperating in exchange of information and essentially abetting tax evasion from developed countries.

I think it is a very different kind of competition and really should be distinguished. I think there is actually a positive side to the technology and competition in the fiscal area, not just the termites and negative aspect of it.

VICTOR ZONANA: Any more comments? I want to give both Vito and Jack a chance to reply.

MICHAEL GRAETZ: There has been a lot of talk about the corporate taxes not declining. The other fact, which has not been mentioned, is that we assume that we are not taxing income from capital. If you look at the statistics of income data over the last year in which income was reported—which I think is 97 returns—there was $425 billion of capital income reported on individual returns. We are managing tax, a lot of capital income and individuals as well. If you think the size of the government is not going to shrink commensurate with the disappearance of these taxes, then you are going to have to have higher taxes on something else. The question is, what are the rates? As you lose instruments of taxation, you lose the ability to have low rates on multiple instruments. I think that is an important point that seems to me to have gotten overlooked in this conversation so far.

I also want to say that I agree with David's last comments, because it is so rare for us to have that opportunity.

DIANE RING: I wanted to add something to what Hugh said, which is to the extent that part of the reason for the lack of underlying support for action against the termites is, in fact, a disagreement about the sustenance direction we should be taking with the income tax that really is part of what is going on. What we may be saying is if you do not like the income tax, go at it directly, but do not wait for it to collapse before you really enter the area in a constructive way. One add-on to that is to the extent that you see the environment—and that partially comes out of this morning's papers—the environment is a changing one in terms of the realities for the tax system. It may be that the very difficulties that we are seeing will, in fact, shape our views about what is the proper tax system. David would be very happy about that, but I think they are both connected and quite separate, and we need to be clear about, as Hugh said, whether we are talking about trying to figure out how to improve an income tax if you do not want to do it anymore, maybe because of the very problems we see, and then you need to be very explicit about that in going forward.

GARY HUFBAUER: A brief comment on what Dan Shaviro and Michael Graetz said. If one is as skeptical as I am about the corporate income tax, that should never be equated to being skeptical about taxes on capital. There are a lot of ways you can tax capital that you do with the corporate income tax and the emphasis I would put on taxing at the personal level, all these wonderful receipts which are floating around in either.

VICTOR ZONANA: Any other comments from the audience or panelists? We are going to give the floor to Jack and then to Vito and then we will have a couple of closing comments and adjourn for lunch.

JACK MINTZ: I am not going to try to respond to all the comments that were made, but I would like to take three of them that I think are quite relevant to the discussion.

The first point really goes to the comment that Stan had, and others, about whether more mobile tax bases and globalization makes some taxes more difficult might have implications to the size of government. The reason I made my comments is first of all, when you think of the size of government, whether it is through political economy process or just thinking in terms of efficiency, the size of government is going to be dictated by the marginal benefits that one gets from additional government expenditure and whether that is sufficient in terms of the cost of raising revenue to finances and expenditures.

My main point really is nothing different than what they are seeing in terms of implication. What I am trying to imply is, as a result of globalization, there are going to be some taxes that are going to be harder to raise. And because the marginal cost of raising those taxes—the economic cost of raising those taxes—are going to go up a lot or significantly, then governments, in order to raise just the same revenue, will have to rely on other taxes. But then they start raising rates, and this goes to Michael Graetz's comment at the end: that when they start raising rates, of course the marginal cost of raising those taxes are going to go up. So the total cost of raising taxation or tax revenues will rise as a result of having the inability to, or the difficulty of, imposing some taxes on certain bases. So I would argue that, yes, we will go to more employment-based, employment taxes. In Canada and the United States there's probably room to move in that direction. But I think it's also important to distinguish between two types of taxes in that regard—one of them being a general payroll tax that some countries have had. In fact, my own has some of the provinces and Canada have that already. Then another type is a user pay-related tax, payroll tax, which is a payment for certain benefits. My argument is that we will see more of these user pay-related taxes, including employment benefit taxes. But again, there's only so far you can go.

I was just in Belgium, and they were talking about some of the reforms that they're undertaking. They have no fiscal surpluses, and they're cutting taxes. Where are they cutting it first? They're actually cutting it as employment taxes because there is a real resistance now to having such high taxes on labor income in Belgium. They have very high personal income tax rates, and they also have very high payroll taxes; and that is a very significant issue. So when you start looking at some of the other countries, there's only so far you can go on certain taxes.

The second point I wanted to make goes to Phil West's comment about my strategies: are they going to be mutually exclusive? I think my comment would be that from a political economy point of view, I think we're going to see all of them being done. We're going to see some protectionism in certain countries. There may be edges that one will see. I think we will see changes in tax structures as a result of the changes that are going on worldwide.

I think we will see some constraints on how, especially in the countries with very large government sectors that I think that you'll see some reduction in that. By the way, we can go into the issue about budgeting and tax and incentive versus expenditures and things like that. To me that's not relevant. To me it's just the overall intervention of the size of government. Often, when you're talking about governments that are 50 percent of the economy, they're large; and they're doing a lot of regulation. And they're doing lots of tax incentives because . . . that's what happens. They end up actually talking to countries with very high taxes that use tax incentives a lot, because it takes the burdens away from the things on which the fiscal burden might be a real problem.

So these I would suggest are pretty complimentary. So I think the size of government relative to the size of the economy is a pretty good indicator about how much intervention governments have in the economy. But I think all those strategies are going to be done and including cooperation at the international level. That gets to my political economy thing.

Even though I personally like the idea of moving towards consumption taxes, I think that's a hard thing for governments to swallow. I think the idea of taking taxes off the rich is going to be politically a difficult thing to sell in their countries. We also know that wealth taxes are not simple to put on. I mean you end up exempting the farmers and the small businessmen, and everybody else. So you know that politically, people are going to be looking for ways to tax the rich no matter what happens. Governments will try to shore up the income tax in some way, and they'll be looking at cooperatives efforts at the corporate level. If they don't cooperate, and if they fail over the next number of years, then I think they're going to end up looking at other taxes on the rich.

The same thing with businesses. The corporate income tax in my view will fall, and will continually decline relative to other taxes on businesses. But I really think that the political economy is that people will want to maintain taxes on business in some form. If it isn't the corporate income tax, it will be something else; and that's what's been happening . . . I know that's been happening in Canada. I wish we could have a real detailed historical study of many countries on the relationship between profit and profit insensitive taxes to see whether there has been this shift of profit insensitive taxes over time.

The only series I've seen, or at least for one year, was in Vito's book. But I think we need a careful historical study that would be done. So that's a good project for the OECD to do.

VICTOR ZONANA: You have your marching orders Hugh. Vito, you have the near to last word.

VITO TANZI: Thank you very much. I will take three, four points that were made by several speakers. But the first one, the fiscal termite maybe . . . I tried but not to give a connotation. I tried to be neutral about. I thought I was simply describing what would happen if we allow the process to go forward. Now whether they're fiscal termite when you would change to worker bees, then you begin to bring value judgment into that. The assumption here is that it well may be time to get rid of all the bad taxes. You know, the termite will do its work and then will produce very nice taxes.

This reminds me a little bit of a discussion that took place about maybe 30 years ago during inflation. When, inflation was distorted; distorting income taxes and especially the income from capital; and there was a big discussion which was very similar to the one today. I remember Professor Felner. I don't know, many of you may not know him. Economists would know who he is. He was a very prominent economist that died ten years ago. Making the analogy, he said "when I hear this discussion, I find myself in the situation of a plastic surgeon that has been called to a hospital, or somebody in a horrible accident, the whole face was disfigured; and now he's given a picture of this guy and he has to work on this. It's obvious that this guy is very ugly. Now what do I do? I restore the way it was or do I improve the look?" Well this essentially is the discussion we are having here.

And there is some sort of implication that somehow if we get rid of it, bad taxes, corporate taxes . . . this is a marvelous idea of David's, and others will come in. This is now what will happen. I mean the reality that you will have what Europe and the OECD call "tax degradation." You will have bad taxes coming forward. I mentioned that what is happening like in America with the financial transaction taxes, that's more likely to happen. So maybe we should be guarded about cheering this process. This was the first point.

The second point: there's been a little bit of discussion with the taxes driving government spending or government spending drives taxes and how high should the government spending be. Also, the question that whether the taxes to GNP ratio is a good measure of the size of government. I wrote a paper recently called "Globalization: The Future of Social Protection," in which I argue that the role of government works through two different channels mainly. One is spending and tax expenditure, and the other one is regulation. Many regulations are really substitutes for taxing and spending. All the European countries—Sweden and so forth—are famous because they have very high taxes. But there are most on tax expenditure, and they don't have an economic regulation. I mean really the regulation that took place is tax and spending. They have a regulation for social and various other things. So, in some way, their tax to GNP ratio distorts the size of the government compared to the US.

Well there were some many other very interesting points. Stan made several points about combining the tax administration and the collection agencies for social security. Of course, as you know, this works in some countries and doesn't in other countries. The fact that administration is very bad, and you add to them the task of collecting social security taxes, maybe it will make them a little bit worse. So you have to always take with a grain of salt.

On the corporate income tax, one interesting question is what do we do about this tax? I remember there was a German economist who worked in the U.S. in the 1950s. Garrett Kolb wrote a book on the corporate income tax in which he talked about the cynical law of taxation. He said that government essentially will collect the taxes which are easiest to collect. He saw no justification for having a corporate income tax, but he assumed that this income tax will continue.

My preference for the corporate income tax has always been a Milton Friedman idea. Now that's . . . I don't know whether there's been much discussion of it. That essentially we should have no tax on corporations, but all the profits of the corporation should be distributed forcefully every year to the shareholders. And you tax the shareholder, period. Thank you.

VICTOR ZONANA: Wonderful ideas coming out here. Stan?

STANFORD ROSS: Yes, I want to pick up on one of David Bradford's points and maybe . . . it's the difference in perspective between economist and lawyer. The language isn't very good, but the language has consequence and drives people. I'll use your same example to show that.

When income taxation was first imposed on social security retirement benefits, to get it through they had to provide the debt which ought to be general revenues, obviously, gets recycled back into the trust funds to pay benefits; and so, in a way, it's going to go out as an expenditure at some time. This is what it took.

Then when the Clinton Reform went in, Medicare Trust Fund was having a terrible problem. So the logic of the recycling so there will be, you know, we know we're doing a bad thing imposing income taxation on retirement benefits that, you know, people didn't expect. We'll put it in the Medicare Trust Fund cause it needs the money. So now it's being used to pay health benefits.

When the recent proposals came from the Republicans that they wanted to reverse this as a campaign thing, the Democrats accused them of trying to undermine Medicare. They're taking money out of the Medicare Trust Fund, which ought to be a lockbox. So here is the shell game—general revenues to the OASDI Trust Fund, to the Medicare Trust Fund, and you try to explain this to anybody on The Hill, you know, they don't get it, which gets to Vito's point which is this language that is used *does* have consequences.

I guarantee you, social security taxes are good and value added taxes are bad in most people's minds, even if there is some equivalent. The degradation factor is very important because of the short-term nature of what people will do. If they get in a hole like they were with Medicare in the 1980s, they'll just go find that money anywhere they can because of the pressures of needing to continue to pay those benefits. That's one thing Vito and I were talking about at a sidebar earlier, which I think I'll just end with; and that is that governments get extremely short-sighted when they're under pressures, and they usually make very bad policy judgments because they do follow the line of least resistance.

By the way just to show you I've got a memory, I recall when we taught Tax I, there was once an argument that when termites ate fast enough, it was a casualty, and you could get a deduction. It was a question of how fast they ate.

VICTOR ZONANA: That silly case is in the Eighth Circuit. Well thank you. This has been a very good session. I think we've had some wonderful talks identifying for us some of the problems that we're facing going forward. Through the discussion what has also emerged is that we're asking a number of important questions that have been asked over and over having to do with what are we going to do with the income tax? Do we want an income tax or something different? What should we do about the corporate income tax? Some people would like to get rid of it. Others think otherwise.

We basically accomplished exactly what I hoped we would in this session: to lay the groundwork for the next three sessions in terms of talking about what are we going to do on the international tax side with a few of the papers, assuming that we have an income tax, and then others moving into David's [Bradford] world of something somewhat different.

The one thing that has not emerged in this discussion so far, and that I hope will as we go forward because we have kept this at a fairly general and theoretical level, is what is going on out there in the real world? Mike [Graetz] made some allusions to it, but you have to think in terms of what it is that the tax practitioners are doing, and how are they applying all of these wonderful rules? What do they mean to them? We have focused the government concerns. I think in the continuing discussions we'll focus on what is happening to the taxpayers and how they're advised, what these rules are doing in terms of the kind of advice that they're getting, and the products they're getting into.

With that, I think we will close this session, thank our panelists, and thank everybody.