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DEATH BY A THOUSAND CUTS:

An Analysis of the Estate Tax's Demise

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P R O C E E D I N G S

MR. GALE: Good morning, everyone. I would like to welcome you to this Tax Policy Center event on the estate tax. As everyone in Washington knows, the estate tax has been the subject of enormous controversy over the last several years, and I think it needs little in the way of introduction. I would just note that while opponents call it the death tax, there are always two ways to look at every issue. It is springtime, so we often want to be more optimistic, so maybe you can think of the estate tax as a life subsidy instead of the death tax, as we talk about this.

Today's forum will center around a new book by Michael Graetz and Ian Shapiro. The book is entitled, "Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth." There is a leaflet or a flyer about the book outside. I highly recommend the book. It is a very insightful treatment of what happened the last several years and how we went from a situation where the estate tax was little known to a situation where the estate tax was not only a red-hot issue, but repeal of the estate tax became a dominant political view.

Our format this morning will be simple. We have asked the authors to speak for 20 minutes. Then, we have asked each of three discussants to comment on various aspects of the book, the estate tax, the political situation as they see fit, and then we will take questions from all of you.

There are short bios for each of the speakers outside. You may have picked them up. Let me just very briefly introduce the speakers, and I won't be hopping up in between each talk to introduce the next one. I will just do that now.

Michael Graetz is the Justus S. Hotchkiss, Professor of Law at Yale University. He is known to policy wonks and academics for a wide range of stellar research on all aspects of taxes and social insurance and is one of the few people in D.C. who I can consistently say I always learn something from when I listen to him. That is "when" I listen to him.

[Laughter.]

MR. GALE: Ian Shapiro is the William R. Kenan, Jr., Professor of Political Science, also at Yale. I know Ian much less well than I know Michael, but my interactions with him have all been extremely positive, and I look forward to hearing his comments as well.

The first discussant will be Tom Mann. Tom is the Avril Harriman fellow in Governance Studies here at Brookings.

Our second discussant will be Bill Frenzel. Bill has the humble title of guest scholar here, but he is so much more than that, and it is hard to convey the unique role that he plays both in the institution's life and in the policy world.

The last discussant will be Len Burman, who is a senior fellow at the Urban Institute and a Co-Director of the Tax Policy Center.

So let me turn the floor over to the authors and let's begin.

MR. GRAETZ: Thanks, Bill. So this book on the estate tax that Ian and I have just completed was prompted by a mystery. The mystery was how could a tax that applies only to the richest 2 percent of the American public become anathema to 70 percent of the population and be repealed by bipartisan votes in both the House and the Senate?

As we proceeded to try and explain that event, we came across a second mystery, and the second mystery was how could the Coalition for Repeal, about which I'll say a little more in a few minutes, stick together in the face of offers to raise the exemption to $5 million, $3- to $5 million were the offers that were on the table, to do so immediately and to lower the rates. The $3- to $5-million exemption, for example, would have taken care of a vast majority of the membership of the NFIB, which was one of the key--National Federation of

Independent Businesses--which was one of the key movers for repeal. It is easy to see why the billionaires would make a bet for repeal. A $5-million exemption is chump change if you've got billions, but for many of the small businesses, this was the whole enchilada. Yet the Coalition stuck together for repeal.

The answers to these questions, actually, interestingly enough, began outside the Beltway. The original movers for estate tax repeal were an odd group of quixotic folk: Harold Apolinsky, from Birmingham, Alabama, an estate planner; Frank Blethen, the publisher of the Seattle Times; and Pat Soldano, who runs a family office for a group of wealthy clients whom she always refuses to identify.

They began in 1992. Soldano, actually, hired the Patton Boggs law firm, legendary for its prowess in lobbying around Washington, and the joke from other Washington insiders were that they were giving the most expensive tours of the capital anybody had ever conceived of, that this was just a pipe dream.

This Coalition, which they formed, the Family Business Estate Tax Coalition, became actually a strong political force over the course of the '90s and then merged, in 2001, with the anti-tax wing of the Republican Party. Grover Norquist plays a big role in this book. One of the blurbs in the back of the book describes the book as "money ball for politics with the role of Billy Bean, the general manager of the Oakland team, which is the subject of money ball being played by Grover Norquist," and there is some truth to that description.

But Grover and other policy entrepreneurs in Washington sort of took over the movement, and it merged with the President's Tax Relief Coalition, which was a group that was headed by Dirk Van Dongen of the National Association of Wholesalers, involved the Chamber of Commerce of the United States, the National Association of Manufacturers, the NFIB, which had played an important role in the earlier coalition, and even the Business Round Table of large businesses, which had no horse in the estate tax fight and, essentially, no horse in the 2001 legislation. The unique thing about this Tax Relief Coalition was that they had agreed to promote the agenda of the Bush administration, whatever it was; that is, they were an administration coalition. So whatever the administration's position was on tax policy, that was the coalition's position on tax policy, and that has held at least through the 2003 legislation. The 2004 feeding frenzy over corporate relief split some of this group up a little bit.

Now, this is a case study. Ian and I don't want to overstate the events that we describe and their general applicability. But there is something of a play book here. We have chapters--we are not going to go through them--but we have chapters on think tanks--Ian is going to say more about that--and polling, the use of polling. The President was traveling in 2001 in much the way he's traveling today on Social Security. The use of language, Bill mentioned the "death tax" label, which was very important, Frank Luntz plays an important role in that. I noticed in Tuesday's New York Times that there is a headline, it is private versus personal in the debate over Social Security, with Luntz again trying to control the language of the debate--not as effectively as he did with the estate tax because of lots of reasons, but most important of which is that there is an opposition at this time.

There is, also, a headline in Saturday's Times, "GOP Courts Blacks and Hispanics on Social Security." The repeal movement was extremely effective in providing support among the African-American and Hispanic community for repeal of the estate tax.

There is a scene, which we describe in the book, from West Wing, which we have on good authority is the way it happened, actually--one of the consultants to West Wing, you may know, also, was a consultant to Mr. Clinton--in which the Clinton administration--I guess it is not the Clinton administration on West Wing--but the administration learns that a majority of the Black Caucus in the House is supporting repeal of the estate tax, and they are just shocked. Well, this was not something that happened overnight and is a tribute to the way the repealers did it.

The biggest surprise to us, in all of this, was how little a role--this will be disappointing to Len and Bill, in particular--but how little a role economic arguments played in the effort to repeal the estate tax. There was economic work done on both sides. Bill, himself, edited an important volume on the estate tax. The other think tanks--Heritage and Cato and others--had produced countervailing economic information. But the argument essentially was not economic, it was a moral argument. What won the day for the forces for repeal was a moral argument based in the great U.S. tradition of hard work and thrift and an argument that taxing transfers of wealth at death was an imposition on the American dream, and the faces that were put on repeal were not the billionaires, with the exception of Robert Johnson, who we talked about, but were, in fact, small business owners.

My favorite character--there are a number of these in the book. We talk about them at some length because it is very revealing--my favorite character was Chester Thigpen, who was an African-American tree farmer from Mississippi, who testified in favor of repeal before the House Ways and Means Committee. It turned out, and Chester talked about the--he got the land from a former slave owner, and he was Tree Farmer of the Year for his environmental work and a wonderfully attractive and great guy who became the face for repeal. At one point, Jim Martin said we should call it the Chester Thigpen Relief Act instead of Estate Tax Repeal or Death Tax Repeal. But it turns out that Chester, his estate was too small, even with a million-dollar exemption, to be affected by the estate tax, but that was just a detail in this story.

[Laughter.]

MR. GRAETZ: And so what you have is you have a moral argument, exemplified by people who everyone likes, with coalitions that were extremely effective in rallying forces, and small business owners, particularly, and also some farmers, what we call the "grass-tops" constituents. These are people from outside of the city, outside of the Beltway, from around the country, all of whom have some relationship with the Congressmen in their district and the like, an extremely effective, well-organized effort to contact members of Congress and so forth, and there was no moral argument on the other side; that is, the arguments of Teddy Roosevelt and Andrew Carnegie that led to the tax, which had to, in Roosevelt's case, with concerns about aristocracy and concentrations of inherited wealth, were really not made, and the Carnegie concern, which was, the way Carnegie put it was, if you leave a million dollars to a child, you'll ruin the child, was really never made.

So we say in the book that one of the things that the opposition should have done was focus on the children who receive the money, rather than the parent who built up the estate. Our favorite characters in this regard--or one you will know--Paris Hilton would have been Exhibit No. 1 for us. We would have called it the Paris Hilton Benefit Act. But there is also a fellow named Luke Wyle, who we talked about in the book as well. You'll have to read the book in order to know more about him.

Let me turn it over to Ian.

MR. SHAPIRO: Let me just add a few things to what Michael said about some of the things we really learned by doing this book. I am going to really focus on three areas; one having to do with the lack of opposition, which was stunning. The degree to which the pro-repeal forces found themselves pushing against an open door surprised us, and it surprised them. I will say a little bit about that. That will lead me to make a couple of remarks about the use of think tanks, since, given where we are, it seems appropriate to say something about that. Then, finally, I will make some comments about public opinion and the contours of public opinion and how they were used to achieve the result.

So where was the opposition, we found ourselves asking. When we were working on this project, people said, where was the opposition, and where was organized labor, for example. But the more you dig into where was organized labor, the more obvious it becomes that they would play no real really important role in this. If you interview people on the Hill, they will tell you you can't get organized labor out on any issues having to do with the tax side of the budget, only the expenditure side and issues of regulation.

When you interview the lobbyists from organized labor, the AFL-CIO has six lobbyists on the Hill, one of whom spends 25 percent of his time on all tax issues. When I interviewed him, he could recall opposing the Bush bill. He couldn't even remember what the components of it were. When you dig further into this, you discover that organized labor is so far back on its heels, trying to cope with the implications of its collapse in membership over the last decades, that they are shifting money and organizational resources from lobbying to membership building, and it makes perfect sense, really, given where they are, that they are not going to spend much time lobbying about tax issues, things that matter to them much more--NLRB-type issues, trade issues, a host of things that are going to come before the estate tax. So asking where was organized labor is a bit like asking why somebody, in need of a blood transfusion, isn't standing in line to give blood. It is just a complete nonstarter.

Nonetheless, the sort of standard political scientist's story that here you have concentrated benefits and diffused costs is still not right because there were concentrated costs. There were concentrated costs potentially among charities, and there were concentrated costs in the insurance industry, but both of them found themselves behind the eight ball in important ways. The insurance industry, first of all, is split because a lot of the retail insurance salesmen are, in fact, on the other side of this issue because they are small businesses, they are NFIB members. So they didn't speak with one voice.

Secondly, as one insurance lobbyist put it in an interview, we are a very Republican industry, and it's almost impossible for us to fight the administration on any tax cut no matter what it is. Then, of course, the insurance industry didn't really have a good argument to make because how do you stand there making the argument that you want to keep the estate tax so that people will have to buy estate-planning life insurance.

It is not an easy nut to crack, which isn't to say that they couldn't, before the headlights were turned up on it, they couldn't have funded research on the other side below the radar, when it could have still have been done below the radar. But here they were really as taken by surprise as anyone and didn't really think this was going to happen and thought, in one interview with a lobbyist, I said, "Why weren't they funding research on the other side," and the answer that came back was, "Well, we knew President Clinton would veto it."

I questioned, "Well, what about after 2000?"

"Well, we thought Gore would win the election."

I said, "And you sell insurance?"

[Laughter.]

MR. SHAPIRO: The irony was completely lost.

What about the charities? The charities were also behind the eight ball in many ways because they didn't want to annoy their donors. Many of the people sitting on the boards of rich charities are themselves extremely wealthy. So it would be very difficult for Ivy League university presidents to stand up and start talking about our position, getting rid of the estate tax.

They, too, ultimately didn't have good arguments on the merits either because whatever the purposes of the estate tax, they are not to create charitable giving. So, at best, maybe it's not quite as bad as the life insurance problem, but at best they have the problem of sort of analogous to trying to defend the space program because it produced Velcro and nonstick frying pans. So they found themselves in a difficult spot and mainly kept their heads down, although they were quite torn up about it and had--the Council on Foundations had one of its most contentious retreats on this whole subject. They weren't players.

So there was astonishingly little opposition, in sharp contrast to the presence of the AARP now in the Social Security debate. It may mean that, although the Republicans are very much playing from the same play book that we worked our way through in the estate tax, that things will have a different dynamic with Social Security.

Think tanks. I think think tanks are, also, ultimately part of the story of the lack of opposition. If you go back--and we have a chapter on think tanks--if you go back and look at the history of the politicization of think tanks, and you dig into what the AEI got into trouble for during the Goldwater campaign and almost lost its nonprofit status or at least there was the threat of it, it is child's play compared to the way some think tanks have become politicized in a contemporary environment. The way in which the conservative think tanks, founded in the 1970s or greatly expanded in the 1970s, have come to operate, they are really an animal of a different order.

When you see how Heritage works, it has more the structure of an infantry battalion. It is a top-down. There is a strategic quality to what they do. They focus on an issue. They have a 5-step process where they produce a foundation paper. In the case of the estate tax, it was by a very able guy, probably well-known in this room, called Bill Beach, who put together, very early on, when nobody on the other side was even remotely taking the estate tax issue seriously, the Foundation paper, and then they produced short two- and three-page papers.

They go with lobbyists to the Hill. The congressional liaisons from Heritage will go with the lobbyists to meet with the Congressmen, and the intellectual analysis will be given by the liaison from Heritage. Then, the lobbyist will say, "So that is why you should vote for our bill, Congressman or Senator." So they don't strictly lobby, but they operate, for all intents and purposes, so close to that line. They have so pushed that envelope of what counts as acceptable conduct that it really creates a lopsided situation because the traditional think tanks, while they may sometimes be left of center, and has certainly been perceived to be left of center by conservatives, such as Brookings or the UI, they don't do that. So, really, apa biggest thing. Bob McIntyre is really a one-man show, very able, but it's Pop's grocery store next to Stop-N-Shop when you really look at the difference. So I think the politicization of think tank activity is important in its own right and feeds into the lack of effective opposition.

Let me just spend a couple of minutes on public opinion because I think that the story about public opinion is just fascinating in its own right, but it's also very important for the play book on other issues because the most important factor about public opinion is not what people believe, but how people use what people believe. They are what we call in the book, the title chapter, "The Running Room of Public Opinion." How do people exploit the running room of public opinion for their own purposes?

Well, first, you have to understand the contours of public opinion. Although the public opinion about the estate tax was not well understood in the very early '90s because most people just thought it was not an issue worth anybody's attention, once it got on the radar screen in 1992, as a result of an attempt by some Democrats to lower the threshold, then some polling was done. People on all sides quickly learned some basic facts about public opinion and the estate tax that are not really controversial.

One is that there's low intensity of preference about all tax issues, to begin with. Everybody knows that. Everybody knows that if you poll the estate tax as a stand-alone issue, is the estate tax an unfair tax and should it be abolished, you can get very high percentages will say, yes, in the high 60s. If you call it the death tax, it goes up even higher, into around 70 percent.

The point about the death tax language, it is not that important for public opinion, mass public opinion. It is hugely important for activist opinion because it plays into the moral mission of the activists, which we describe in the book. But the mass opinion, you call it the death tax, it moves it up a very small amount. If you explain to people the probability that they will actually play the tax, the support goes down from the high 60s to about 50, 51, 52 percent--still very high, given who actually pays it.

Everybody knows all of that. Everybody knows, also, that if you put repeal of the estate tax into a comparative list with other possible tax cuts, it drops right to the bottom instantly. Everybody knows that if you start pairing it with particular spending cuts, the support for getting rid of the estate tax evaporates.

So those are the contours of public opinion about the estate tax from the mid '90s on. They are well known. They have widely polled, at least widely enough polled that most people don't doubt that those are the facts of the matter who are doing the polling.

But what do people do with this knowledge? Well, the Democrats did nothing with this knowledge. They assumed estate taxes are not very important to people. They are not going to be important in Democratic races at the margin, so they did nothing. What the pro-repeal forces did with this knowledge was to publish dozens and dozens polls of the estate tax as a stand-alone issue and get the media to report the results. Because nothing was being done on the other side the mantra that got endlessly repeated was the American people think the estate tax is immoral and should be repealed. They were so effective at completely occupying the running room of public opinion that even the independent polling organizations like Zogby started polling it the same way. We tracked down, of all the published polls, I think we could only find four polls that polled it in any way comparatively and in any way that would get the intensity of preference exhibited.

Of course, the point of publishing the polls is not to move public opinion, but to move opinion on the Hill and give lobbyists weapons to take and talk to politicians with. So that was the story about the political use of public opinion, which was tremendously effective, as was virtually everything else the Coalition did.

I will stop there and turn it over to our discussants.

MR. MANN: Thank you, Bill.

Michael and Ian have written a wonderful book, I'm here to tell you. I have read it. It is a marvelous read. Frankly, it is hard to believe that it was written by two academics. It is light, it's lively, engaging, wise, sophisticated, and in my humble view, I believe they basically got the story right. I am convinced this book will be widely read and that it will enter the pantheon of case studies that all of us use in teaching courses on Congress, the policy process, American politics, right up there with, "The Dance of Legislation," Eric Redman's book and "Showdown at Gucci Gulch."

Now, having said that--there is always a "but"--I want to suggest that careful students of Congress and the policy process will enjoy this book, but rather than feel seriously challenged by it, I think they will find the argument and interpretation a familiar and comforting one, rather than a challenging one.

Let me suggest that, in picking up on some of the comments both Michael and Ian made, for example, it turns out the old James Q. Wilson concentrated benefits, diffuse cost argument is largely valid. What, in fact, we do is look at those two instances where there are concentrated costs on the life insurance industry and on the nonprofits.

Our authors come up with a plausible explanation as to why their opposition was diminished or neutralized. Their executives had an interest apart from their company's interest, in the case of life insurance, and with the nonprofits they had to be attentive to their patrons. In a broader sense, cutting taxes, as ala George Bush, is a positive sum gain. The costs are down the road. The benefits are here and now, and that made possible an extraordinarily ambitious achievement not just on the estate tax, but on tax cuts more generally. In fact, they argue in the book that the low intensity of public opinion on taxes made possible several things; one, an ability to shape public opinion, with a focus on morality and the creative and dedicated organizational entrepreneurial efforts. So I see those two things as sort of reinforcing things we know, with particular nuance in this particular case.

Then, there is the matter of framing the debate. I think they are absolutely right about the importance of narratives, of the critical role that morality plays versus immediate self-interest and the importance of rhetoric. I just think they are dead right, but I think a lot of political scientists, I certainly have long believed that framing the debate is critically important in achieving policy outcomes. What has happened, as they point out quite correctly, is that Republicans and conservatives have been way ahead of the game in this regard.

I think you will be interested, if you haven't read it already, the newest of the new issues of New Republic has a cover story by Robert Reich called, "How Democrats can Relearn the Art of Political Narrative." The particular American stories that he engages are, one, the triumphant individual, the benevolent community, the mob at the gates and the rot at the top.

My own view is that this book really reinforces the importance of morality and narrative, and Democrats in the last year or two have begun seriously to pick up on this. So I think it is absolutely an important point, accurate, but it is not contrary to what we believe and think.

Now, I do have to take exception to two points related here. One, any time a book puts "Frank Luntz" and "profound" in the same sentence gives me pause.

[Laughter.]

MR. MANN: Michael and Ian really fell head over heels to a number of activists and consultants on the conservative side, from Grover Norquist to Frank Luntz. I found the portrayals vivid and very compelling, except for Frank Luntz. I think they got sold a bill of goods on Frank, but that is a subject for another story.

The other point is the role of money in politics. I think they caricature people involved in campaign finance reform who believe that the only role money plays is in campaign contributions. They conclude, at the end of one chapter, "Controlling campaign finance will not stop money from working its way in Washington. Water flows around a rock." Amen. None of us would disagree. I often pointed out ten times as much money goes into lobbying as campaign contributions. And if you look at the broader infrastructure, it is even more the case.

Two last points. One is sort of think tanks, the market and the place for policy analysis and economic reality. There is no question that the modern era has spawned alternatives to think tanks. They are called advocacy tanks. They begin with a world view, they deduce their positions on issues and then they go and sell them. We don't do that here. We try to do as fairly as we can real analysis, and we think, at some point along the way, that will make a difference. Obviously, in the short term, in this case it didn't, but the role is for political players and entrepreneurs to pick up the evidence and work with it. As they acknowledge, there are now beginning to be sort of counter-organizations, including the Center for American Progress, working on these matters.

But there is something to be said for economic reality. I predict that if not this administration, the next administration will raise taxes, and it will happen because of the great disparity between outlays and revenues and because of the discipline of the financial markets; that is, there will come a time in which this will happen in spite of the cleverest of efforts to push an alternative agenda.

A final point, what is the broader application here? Both Michael and Ian speculated about how it may or may not apply in the case of Social Security reform, now the right to die, the very visible case we're in, and the broader issue of tax reform.

What I want to suggest is that the whole area of tax cuts and estate cuts are very different, in many respects, from those of Social Security, right to die, and the broader tax reform issues. I want to suggest the same kind of campaign for privatization of Social Security has been underway in the conservative infrastructure for decades, and yet it is running up against a sort of reality. People are directly touched by Social Security in a way they are not by estate taxes or other kind of tax cuts, and there are compelling alternative narratives to be told. So it may well be that this particular case will not extend to the broader case.

The same is true, by the way, in right to die and tax reform. When people's lives are directly affected in a way that is sort of contrary to what they see as their interest and their conception of what's right and the morality, then the opposition is much more easy to mobilize.

Thanks very much.

MR. FRENZEL: Thank you. I am Bill Frenzel, guest scholar at Brookings.

I concur with about the first third of Tom's statement, and it is a great book. It's an easy one to read. It's fun, and it is a wonderful case study now of congressional process. I make the point now because I want to elaborate on that a little bit later.

It poses the questions that you have heard here: How did they get away with it? How did they get the whole loaf instead of a few crumbs when there were the elements of a deal? Is not always legislation, especially tax legislation, effective at the margins in the form of compromise? Why were the defenders of the inheritance tax, why were their efforts so feeble? I guess the last question is my own. Did they really do it or is the compromise still out there somewhere, perhaps closer than we think?

Well, my thoughts on some of these questions are, and what impressed me about the book was that the old ways don't work any more. This isn't your father's Congress any more. The watch word today is shoot the wounded, take no prisoners, accept no compromise. To phrase it another way, if you were a Greek at the gates of Troy, you would say, "Don't give us back Helen. We don't want your money. We just want to raze your city and sow your fields with salt."

[Laughter.]

MR. FRENZEL: What is driving both parties today are their close-in constituency. So you find the Republicans in a very strong position with respect to taxes, while the Democrats will say never mind who is he or what he is, if he's a Republican appointee as a judge, he isn't going to pass muster. That's the way the place works now. People who watch the process have to understand these kinds of things are going on.

Another thought I had is that it is hard to fight any strong repeal or anti-tax movement when you don't have any ammunition. Obviously, there was no money, there was little organization, and the argumentation was fairly feeble. Class warfare can be effective, often. It surely wasn't in this case. The pro-repeal slogan is far more effective--and argumentation--far more effective than the anti-repeal. In fact, you could say that the only reason you were given to oppose repeal was that somebody else whom you don't know, and none of your relatives know, and none of your friends or neighbors know who live in a gated community in the Caribbean are going to pay this tax.

Well, that is not a hell of a good argument if you don't think the tax is a very good tax in the first place. In fact, it is roughly comparable to you don't care about Social Security reform because you are over 55. Well, folks over 55 have got a little different impression about that, and you've got to be careful.

I remember Chairman Rostenkowski had a little problem on catastrophic Medicare at one point, where the people who weren't going to pay the extra assessment were the ones who actually blew it out because they thought it was messing with their own program. So I guess I think we need a new set of shibboleths for a new day in the Congress.

Remember that Americans still basically hate taxes. We have not progressed very far from the Boston days of throwing tea in the harbor and that if we are given any kind of an excuse to vote against taxes, we are probably going to take that.

I guess the last item that sits with me is that any time you change the tax code in a major way, you will see a period of erosion, both in terms of tax practitioners picking new holes in the system and of various forms of repeal or modification or the Congress itself, as it has since 1986, inflicting 10,000 larger loopholes in the system.

So I guess one of the things the book says to me is it's again time for a big change, and that is an ad for tax reform.

MR. BURMAN: I, also, liked the book, although it caused some nasty flashbacks for me. I was working in the Clinton administration in the late 1990s, and that West Wing episode I couldn't watch because it was exactly what happened. "The Congressional Black Caucus is favoring estate tax repeal? Maybe this could happen."

You did leave out some important things that we did, though. There was a really good veto letter from the President that scared people a lot, and we spent weeks on an op-ed by Larry Summers that swayed opinions of tens of people around the country.

[Laughter.]

MR. BURMAN: The book mentions that this is--and Tom hinted at this--that this is really just the beginning of a whole series of legislative acts. I didn't realize what the scope was until a few days ago when I realized Congress wasn't satisfied with eliminating the death tax, that they really wanted to eliminate death, and they've actually legislated that, apparently. It's scary.

[Laughter.]

MR. : And taxes are next.

MR. BURMAN: And presumably people will keep on getting Social Security forever once death is eliminated, which will create other problems.

One of the messages from the book that is a little bit depressing that, at least in this case, facts in evidence lose out to stories and demagoguery. I guess you didn't point out that when the estate tax was being voted on, the Tax Policy Center did not exist, and it does now. So we have got a lot better facts than we used to have before.

There is, sitting outside, the pre-production version of a new policy brief on options to reform the estate tax, probably something that would have been more useful in 1997, but better late than never. There are a number of options and a lot of data on who is affected by the estate tax and who would be affected under different options.

One of the substantive points that I think is important to bring into the debate is that one of the moral issues that estate tax opponents raise is the unfairness of double taxation. Certainly, there is an element of double taxation in the estate tax, but one of the key points for people who think the estate tax is an important component of the tax system is that a lot of income isn't even taxed once, and a lot of the income that is taxable is taxed at very low rates because capital gains are taxed now at a 15-percent rate, when the top rate on ordinary income is 35 percent. So small businesses and large businesses that are owned by families actually make wonderful tax shelters.

If you didn't have an estate tax, and the Joint Committee on Taxation's estimates bear this out, that you wouldn't just lose the estate tax revenue that we're planning on collecting now, but you also lose a whole lot of income tax revenue. Estate tax repeal, as it's in place now only for one year, in 2010, would establish this new thing called carryover basis, which means that capital gains on assets that are held at death, that are bequeathed to heirs, subject to huge exclusions, be eventually taxable when those heirs sold the assets. Currently, the rule is that when you inherit an appreciated asset, it is as if you bought it at the date of death from the decedent. Therefore, the capital gains are entirely forgiven.

This carryover basis provision has no chance at all of working. First of all, there is a huge exclusion to make sure the people who were not taxed under the old estate tax wouldn't be taxed under the new carryover basis provision. There is a $3-million exclusion on gains transferred from one spouse to another and I think a $1.3-million exclusion for assets that are given to people other than spouses. So, for a couple, you can exclude up to $5.6 million of gain.

You can imagine a situation where the IRS, 50 years from now, is trying to figure out whether the gain on an asset that was inherited from someone 50 years earlier was part of the excluded capital gains or part of the gains that were supposed to be taxed sometime down the road.

There is a nice article by Jay Soled and others about taxation of capital gains now, where they argue that people misreport bases, even under the current rules, which are relatively simple. Under the new rules, basically, and I think the JCT estimates assume this, capital gains will be forgiven from tax forever, as long as they are bequeathed.

Just some background on what the situation was before the repeals put in place. In 2001, the estate tax was the most progressive component of the overall tax system. Sixty-four percent, almost two-thirds, of the tax was collected in 2001 from the top 1 percent, by income, of households, and 91 percent of the tax came from the top 5 percent. By comparison, under the income tax, a third of the income tax is paid by the top 1 percent and a little bit over half by the top 5 percent.

There is an issue about farms and small businesses played heavily in the debate. Even before the estate tax phase-out was put into place, there were only a thousand small farms that were subject to the estate tax in 2001, according to our estimates. If you included all farms and small businesses, including the Seattle Times, which is not small by any measure, but is owned by a family, the Mars Company, there are only 1,200 estate tax returns that had those assets on them.

Under current law, where the exclusion is $1.5 million, the tax has been even more focused on the top. Eighty-three percent of the tax in 2004 will be paid by the top 1 percent of households. The number of small farms and family-owned businesses is down to about 300 small farms and family-owned businesses are currently subject to a tax. So this isn't something that is rampant all through the farm community.

There is this great story in David K. Johnson's book, where he went around in Iowa and asked the farm lobbying group to introduce him to one of these farm families that had lost their farm because of the estate tax, and they said, "Oh, yeah, we'll do that right away." They actually never found anybody. Somewhere there is such a farm, but it's hard to find.

So we look at a number of different reform options. We look at raising the exemption level to $2 million right now and holding it at that level permanently; raising it to $3.5, $5 million or $10 million. You can see that the cost of these options goes up, and none of them is expensive in the long run as permanent repeal.

One thing that our analysis shows us, and this is because there are so few farms and businesses subject to the tax now, but before you account for behavioral responses, you can exempt farms and businesses up to $5 million or $10 million at almost no budget cost. Our estimate is that a $10-million farm and small business exclusion would cost $3 million.

The authors of this book point out that this farm and small business exclusion, called QFOBI, was extremely unpopular. But my guess is that part of the reason it was unpopular was, first of all, you had to keep the farm and business actually going as a farm and business, so it actually was directly targeted at the complaint about the estate tax, but, also, it wasn't worth all that much when it was in place. It was only the difference between the $675,000 exclusion in 2001 and this $1.3-million special exclusion for farms and businesses. My guess is that a $5-million QFOBI level, there would be a lot more farms and businesses that would be interested.

They talked about ethical and moral issues. One of the issues with the estate tax is that the cost of this estate tax repeal swells just as baby boomers are starting to retire. The estate tax repeal only takes effect in 2010. If it were made permanent, by 2015, the static costs of repealing the estate tax would be about $50 billion. After accounting for all the income tax losses because of all of the additional tax evasion and avoidance that would take place, the costs would probably be something like $80 billion.

There is a box in our brief about things that we shouldn't do in the context of estate tax repeal. One thing is called unlimited QFOBI, allowing farms and businesses an unlimited exclusion. So the Mars Company and Cargill would be able to pass on their estates completely tax free, as well as small farms of any size. Well, the problem with that is the behavioral response. There would be a huge incentive for very wealthy people to convert their assets when they get close to death into farms and businesses. My guess is that this wouldn't even work for farmers because, eventually, Bill Gates, Jr., would own Iowa, and presumably he wouldn't be that good a farmer.

[Laughter.]

MR. BURMAN: So what's the effect on small businesses of raising the exempt level? We looked at several different options. As I mentioned, under current law, there are about 340 small farms and businesses subject to the estate tax. If you raise the exemption level to $3.5 million, the number subject to a tax would be about 30. If you raised it to $5 million, it would be 10 subject to the tax.

So you can eliminate small farms and businesses with relatively modest changes in the exemption level and still collect a significant share of the estate tax revenue. Also, by raising the exemption to $3.5 million, the tax that was already extremely progressive, would virtually all fall on the top 1 percent. Ninety-seven percent of the tax would be paid by the highest-income 1 percent of taxpayers.

The Congressional Budget Office did some research that we summarized in this paper on the effect of repealing the tax on charitable contributions. This is discussed a fair amount in the book and, as mentioned by the authors, is probably not the main purpose of the tax, to induce people to give to charity, but it is a great side benefit.

According to our estimates, based on the CBO analysis, if you eliminated the estate tax, you would lose about $17 billion a year in charitable contributions--$14 billion in contributions during life and another $4 billion or so actually at the time of death.

With that, I think I'd like to throw it open to discussion.

MR. GALE: Thank you. Thank you all, discussants and especially authors.

I am tempted to use my chair's prerogative to ask a question, but I will hold off unless there is not interest from the crowd.

First, there is a microphone coming. Please use the mike, please state your name and affiliation, please keep it short and please be sure you have a question.

[Laughter.]

QUESTIONER: My name is David Falk, at the School of Public Policy, University of Maryland. I don't suppose I would have to ask this question if I had read the book, but could you comment, briefly, on the role of Bill Gates, Sr., and his group and the campaign they conducted.

MR. GRAETZ: We have a chapter entitled, "A Billionaire's Battle," which begins with Bill Gate, Sr.'s, effort to come in and save the day on this. The other billionaire in that chapter is Bob Johnson, who was the first African-American billionaire, followed shortly by Oprah, who was the second. But Bob Johnson founded BET television and then sold it to Viacom and made a lot of money.

One effect, which I think was probably the major effect of Bill Gates, Sr., was that he made Bob Johnson mad, and Bob Johnson bought a countervailing ad in the USA Today, the Washington Post and the New York Times, signed by 150 African American--

[Tape change.]

MR. GRAETZ: Bob Johnson is a very engaging guy. He was originally a table salesman and is wonderful to spend time with. But this ad explained, and Johnson feels quite sincerely about this, explained that the build-up of African-American wealth is very recent, and there's not a lot of generational wealth in the African-American community and that he would have been happy with an exemption for African Americans, sort of a small business story written differently.

But Johnson's ad was actually picked up immediately by Jack Kemp, spread around. The President referred to the problem of African Americans, and so the question is whether, if Bill Gates hadn't made Bob Johnson mad, would it have made any difference? I think Gates, Sr., was not terribly effective. He didn't have a lot of help, and the arguments weren't well formed.

There are lots of things that happened since then, the Tax Policy organization being one, which I think is responsive, in some ways, to the events of 2001. Gates and Chuck Collins wrote a book, "Wealth and our Common Wealth," in which they have developed their arguments in a different way. Collins, who actually sent us an e-mail after we wrote the book, says that they are about to come up with a different form of campaign, using soldiers and the like. I will let you wait and see it. But he just wasn't very effective, but we do talk about it.

MR. GALE: Peter?

QUESTIONER: On a similar theme--

MR. GALE: You have to say who you are and where you're from.

QUESTIONER: Peter Orszag, from the Brookings Institution.

On a similar theme, and I guess this is probably for Ian, the question is whether your analysis of think tanks is going to be as wrong as the proponents of retaining the estate tax were wrong about the movement in the mid to late 1990s; that there is energy building that you don't give a lot of weight to.

So since the time of that, the Tax Policy Center was created, Brookings has put in a television study. I haven't checked the data, but I'm sure that the number of Brookings scholars appearing on television has gone way up because we can just walk downstairs. The

Center for American Progress has been created. There appears to be a lot more energy, in recognition of the failures that have occurred, both for think tanks and advocacy tanks, to sort of combat the imbalance. I am not sure that in the book you actually give that much weight to what the world will look like over the next 10 or 20 years, as opposed to the past decade, and I would be interested in your comments.

MR. SHAPIRO: Well, I would say a couple of things in response to that. One is that our book really tells the story of the 2001 act, and so what's happened since then, I don't think we would dissent from what you say. However, I would add some qualifications to it.

Although I see the Center for American Progress and these other groups being formed, it still seems to me that the amount of denial in leadership circles in the Democratic Party is stunning, to me. I think the Democratic Party is pretty much where the Republicans were in the early 1970s, when the Nixon administration was falling apart, and when Heritage and these other groups were really formed to try and think up a strategy for the medium term.

It seems to me that, if precondition for the different kind of politics that Bill Frenzel talks about is having a movement that is certain of its goals and its strategic decisions, that then makes tactical choices, if and when needed, in order to pursue those goals. It seems to me that the Democrats are deeply devoid of well-formulated goals. They don't know what they believe. We do a little bit of this in the book, but the symptom of it is the triangulation that they got from Bill Clinton, with the help of Dick Morris and others, that certainly permeates the tax discussion.

When you think about it, George Bush came into office in January 2001 with less legitimacy than any President in American history, and this is before 9/11, yet he got the biggest tax cut in American history through in record time, months faster than any large tax cut had ever been achieved by any administration. Daschle's opening move was to say that the

Democrat's would regard it as a victory if they kept the tax bill to under a trillion, which they didn't do.

All of this goes back to the notion, the triangulation notion, of oppose two-thirds of the other side's or half of what the other side is proposing, and you'll win enough votes at the margin to win. But the difficulty with it is it runs up the flag pole the notion that all the other side has to do is keep moving the goal post, and you'll be scrambling after them. Secondly, you can't mobilize your own supporters if they sense that you're opportunistic all the way down.

So I don't think it's just a matter of getting some counterweights on the other side and getting some advocacy think tanks on the other side. I think there are deep philosophical and moral questions the Democrats have to face about what they're in favor of, which might get incubated in these think tanks, but they are the beginning of this process not at the end of it.

MR. GALE: Gene Sterling.

QUESTIONER: I apologize, Mike. The copy you lent me or gave me, I've only read about a third of it, so maybe you answered this later in the book.

I wonder if there is not another part of the story that at least I haven't heard so far, which is that when Congress or the President or whoever is sort of on the "giveaway" side of the budget, when they're giving things away, it's often people who have built up the most sort of power to feed at the trough who get there, and I don't know whether it's the estate tax bill or a Medicare bill or even this last tax bill, which both right and left will say was horrendous because it was totally designed by the lobbyists.

I wonder if part of it is not so much that the death tax cutters were all that powerful had we been not on the giveaway side, but once we start giving things away, we don't do it in a very principled manner.

Along with this, going to the future--this gets a little bit to what Bill Frenzel has--it seems to me, historically, whether we are on the giveaway side of the budget or trying to make recognition of we have to pay for what we do, there used to be some notion that we had some analysis, and we often lost it, the Treasury Department or somebody would put forward some analysis, some base on which we would proceed, and we just don't seem to do that any more. Now, the Treasury would lose 80 percent of the time, but at least it got that 20 percent or sometimes 50 percent of decent things in a bill.

Now, it seems to me, that pretty much the people who are lobbying, on whatever side of the budget, whether it is the demagogues or the special interests, are so much in charge I worry that, regardless of whether the Democrats win or the Republicans win, that we don't get that solid base of analysis for where we're going.

MR. GRAETZ: Two things. One is that even on the giveaway side of the street, the idea that you repeal this tax is an extraordinary thing. I said this earlier, before you got here, but in the 1990s, when Pat Soldano and this handful of Don Quixote characters were arguing for repeal, everybody in Washington laughed at them. The thought was, as I said earlier, that Patton Boggs was taking her around to meet people, and they were just charging her a huge amount of money for tours of Washington.

So this is an extraordinary event that you would repeal a tax that's been in the--you know it's the most progressive tax, as Len said, has been the most progressive tax for a very long period of time, and it's been in existence for almost a century. So, yes, on the giveaway side of the budget, all sorts of things happen, but I don't think that is--I think there is more to this story than that.

The other point about factual analysis is that both the role of the Treasury and the role of the Joint Committee on Taxation, which were the arbiters, have really changed dramatically. It's what Bill said about not being your father's Congress any more. Until 1977, when Larry Woodworth went to be Assistant Secretary of the Treasury, from being Chief of Staff of the Joint Committee on Taxation, there had been three Chiefs of Staff of the Joint Committee on Taxation. In the last five years, there have been three. There have been ten I think since. I would have to count them.

But you don't have the institutional weight within either the Joint Committee, and the Treasury has become both more politicized and less vocal than it was in your day or even in mine, which was later, and so you--

MR.   : And, therefore, Mike is younger.

[Laughter.]

MR. GRAETZ: I'm not sure that's right. But you, also, have these counterweights in the form of factual disputes. So that you get an analysis of the CBO that says it is going to not do much to the economy to repeal the estate tax or that says, well, you know, the double-taxation argument is interesting, but there's double taxation all over. When you get your wages, you're taxed--George Harrison made this point the best in his song--but you're taxed when you get your wages, under the income tax, and you're taxed when you spend the money, and there's triple taxation here and there.

But there are counter forces to this, and so there is now I think more of a stalemate on the factual analysis. I think this does come out later in the book more explicitly, but that factual analysis just does not, and will not in my view, play the same role that it has in the past. It is important, but it is not dispositive.

MR. SHAPIRO: Could I just add a note to that? It seems to me this is really important, and it affects all of us and what we do.

The market for policy analysis in recent times has been weak, I think it is fair to say, and particularly weak within this administration. It seems to me it is driven partly by longer-term forces in our politics, the parity between the parties and their ideological polarization, which makes it difficult for a Bill Frenzel on Ways and Means to ask for, receive and use disinterested information on tax policy because there is a position already, and you can't do anything about it.

But the President plays an extremely important role in this. What we have had in testimony from Paul O'Neill to John Dilulio is that there just isn't a market for that kind of information, that positions exist ahead of time and the object is to find loyal supporters and supportive briefs that make the case for it.

It wasn't so long ago that the first President Bush and President Clinton, partly on the basis of policy analysis, embraced and supported positions that were quite unpopular, were very hard to get through, and that were followed by really promising and successful developments in the broader economy and the distribution of the benefits of that economic growth. We, then, had big surpluses and the opportunity for a different President to sort of set aside the policy analysis and propose these moves that are chronicled, in part, in this terrific book.]

The question now becomes whether economic realities will, over time, lead more disinterested policy analysis back into play, and my guess is the answer is yes.

MR. GRAETZ: Can I say one more thing just before we leave this because I agree this is an important point. That point is I always tell my students, if you're in a court of law, you have to either argue the law or, if you don't have the law, argue the facts or, if you don't have either, you have to sew confusion.

[Laughter.]

MR. GRAETZ: But in Congress, I always say to them, you've got to come to Congress with a good story. You have to make something alive. I think one of the points--we make this at the end of the book--but one of the points is that what really sells, and it couldn't be more evident than the front pages of the newspapers today, is the story about the person who is going to be affected.

Once you have lost the institutional force--I think Gene's point is important--once you have lost the institutional force of a Treasury in a certain position, the Joint Committee staff in a certain position, that will keep things from happening and also fashion things so that good things can happen.

The narratives are key. The narratives are key, and so I think the policy analysis--and this goes back, I guess, to Peter's question--is, well, on the emerging think tanks on the other side is that they have to find a way to produce the narrative. Bill Beach did the economic analyses--he's a very good analyst--he did the economic analysis on the other side--his best production was something called, "Death Tax Horror Stories: Tales from the Crypt," in which he has 14 anecdotes which were picked up and recycled within Congress over, and over, and over again. And the thought that other think tanks are operating this way, maybe they will be soon, and we were looking backwards not forwards, but there is a big gap here.

MR. GALE: I don't think they offered that course when I got my Ph.D.

[Laughter.]

MR. GALE: Way in the back.

QUESTIONER: So I would ask the authors, will it be repealed after 2010?

MR. GALE: You have to identify yourself.

QUESTIONER: I am Bennett Minton [ph]. I am lobbyist.

MR. GRAETZ: Who are you lobbying for?

[Laughter.]

MR. SHAPIRO: What was the question?

MR. GALE: Will it be repealed?

MR. GRAETZ: Will it be repealed? I will say this. Before we started this exercise, I was with all the smart money in the '90s that repeal would never happen, even the kind of repeal we had. Obviously, the ability to repeal the tax in 2001 was dramatically improved by the then-story that we had a huge surplus going forward as far as the eye could see, and Alan Greenspan's testimony and fear that we would run out of debt--

[Laughter.]

MR. GRAETZ: It didn't seem to turn out that way, Alan. But this created an opportunity, and the biggest difference, when Congress votes this year or next year or in the next few years, is that we now are in a situation where there is no fear of running out of debt, and we have got large deficits. So giving up this much revenue, the revenue is about what Len said it was, giving up $50 billion a year is tough. A small business exemption, even unlimited, which it only applies as long as you keep the business in the family--obviously, if Bill Gates can put it in Iowa and then sell Iowa back to the market, there will be a problem--but if you exempt it as long as you keep it in the family and, yes, Mars and Gallo are going to win.

The context has changed. What you are now battling is repeal for everyone. It's not just Mars and Gallo. It is also people with huge amounts of liquid portfolio wealth.

I would not bet against repeal. If you look at the new Senate, putting aside the deficit, which is like saying, sex aside, the castrato is the best role in the opera.

[Laughter.]

MR. GRAETZ: Putting aside the deficit, you, clearly, have 60 votes for repeal now which you did not have before this Congress. But I think you've got huge deficit issues, and that makes some of the people who voted for it in the past less likely to vote for it going forward. But I am not a betting man. You folks are in Washington, but I am not betting against these forces. They are very good.

MR. SHAPIRO: I would just add something in connection with that, which also speaks to one of the points Tom Mann made, and that is that if you talk to a lot of the people in the tax-cutting coalition, from Grover Norquist to people in the administration, to folks at AEI, supply side economists, one of the consistent answers we got back was there wasn't that much enthusiasm among this crowd for getting rid of the estate tax. The opportunity costs of getting rid of it are high. So, in the 2001 act, it's only 10 percent. It's $138 billion out of $1.35 trillion, but that's largely because of the phase-ins of the rate reductions and the phase-out of the tax. If you put another decade's worth after that, the tax, plus the demographic changes that are coming, the tax seems to be over $700 billion. So the opportunity costs of this, in terms of making other tax cuts permanent are huge.

But the interesting story that we learned in the research for this book is that the appetite for cutting estate taxes among the tax-cutting crowd isn't great. In terms of supply-side theory, you don't get much bang for the buck. You'd be much better off cutting the rates, getting corporate tax cuts in there. There is not that big of a constituency for it precisely because so few people pay it. But over, and over, and over again people said, but we have to go with this issue because it was populist. It was supported. The moral arguments had worked.

So it is not obvious to me that, even though there might be very powerful forces who would prefer to make other tax cuts permanent, they are not going to have to keep this on the table for these reasons.

Just a side point to Tom Mann is that this is another area where you see the standard story of diffused costs and concentrated benefits doesn't really capture what happened because there were these concentrated costs among people who would rather have had other cuts take a bigger chunk of the bill, and who are still there, but they had to give way because of moral arguments and things having nothing to do with the standard diffused cost concentrated benefit story in giving the estate tax repeal so much prominence in the Bush bill.

MR. : There was a Republican who told me once that he thought there was no hurry for making estate tax repeal permanent because it was a huge engine for campaign contributions as long as the tax was set to expire after or returned after 2010.

MR. GRAETZ: One other quick point. The other quick point is that the moral argument that this is an unfair, inappropriate double tax does not lend itself easily to compromise on that side. Once you've made that case, you can't say, well, it's immoral up to $5 million, but after that it becomes moral. So the whole way in which the arguments have been framed makes compromise difficult on the repealers' side of this.

MR. : There are 49 or 50 votes in the Senate now for return to a genuine PAYGO rule which would subject--

MR. GRAETZ: That will change things.

MR. : --a permanent estate tax repeal to offsetting tax increases or entitlement cuts. I think that puts in a new factor in all of this.

MR. GRAETZ: A PAYGO rule--I was at Andrews Air Force Base when one was negotiated in 1990, I have to admit--a PAYGO rule on the tax side would change dramatically, given CBO's scoring, not only the permanency of estate tax repeal, but the permanency of all of the other 2001 and 2003 tax cuts. So there is no question about that, and that is one of the reasons that it is being resisted as strongly as it is, until those issues are solved. I think once you get past the permanency question, a PAYGO rule would go through much quicker.

MR. GALE: But, of course, it is too late at that point.

[Laughter.]

MR. GALE: One last question. Right here.

QUESTIONER: I'm Paul Glenn, from American University.

One of the recurring themes that a number of you have talked about is that the arguments made in favor of repealing estate tax were moral in character and the arguments against it were not. I am curious if you think there is a connection between that and the facts that there seem to be more conservative organizations, think tanks and groups like Liberty Fund and the Olin Foundation that are funding people to actually work on moral and political philosophical research. That doesn't seem to be as true on the other side.

Are they doing a better job of building the moral and philosophical foundation?

MR. SHAPIRO: Well, I would say, yes, I think they are doing a better job of it. The argument that was made on the other side was you won't pay it, you won't pay it. That was the constant refrain. Look at the numbers, look at the math.

Luntz told his people, when you talk about taxes, never mention any numbers ever, only make moral arguments and give vivid descriptions or narratives of the people whose lives are affected. I think it is sort of, to the degree that the estate tax story is representative, it is clear that they are just doing a much worse job.

MR. GRAETZ: I would like to make one last comment, and that is I really want to thank Brookings for doing this. I want to thank our three commentators. I am taking to heart Tom's first third of his comments.

[Laughter.]

MR. GRAETZ: And the idea that we would have to teach him something about politics to be successful was beyond our ken when we started. So the fact that he knew a lot about this before is not shocking to us.

I will just simply conclude by saying that the book is available on Amazon.com at $19.97.

[Laughter.]

MR. SHAPIRO: A bargain too.

MR. GALE: Before we all rush to our computers to log onto Amazon, let's take a second to thank the authors and the discussants for an excellent presentation.

[Applause.]

[Whereupon, the proceedings were adjourned.]