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# FAX TRANSMISSION

IRS TAX

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**To:** Goody Marshall
Ben Johnson
Rob Weiner

**Date:** October 27, 1997

**From:** Michael Froman

**Pages:** 7, including this cover sheet.

**Subject:** IRS hearing 10/28

COMMENTS: Attached is the testimony that Charles Fowler, newly appointed National Direcor of EEO and Diversity for IRS, will give tomorrow (10/28) before the Subcommittee on Civil Service of the Government Reform and Oversight Committee. Please note that this is the same testimony that was originally submitted in September.

**STATEMENT OF**
**INTERNAL REVENUE SERVICE**
**SUBMITTED FOR THE RECORD**

**for the**

**Subcommittee on Civil Service**
**Committee on Government Reform and Oversight**

**Employment Discrimination in the Federal Workplace**
**September 25, 1997**

The Internal Revenue Service (IRS) appreciates the opportunity to submit this statement for the record of the hearing on the topic of employment discrimination in the Federal workplace. Our statement discusses equal employment opportunity at the IRS.

Equal employment opportunity issues often are related to workforce composition. Currently, more than 67% of our workforce is female and more than 35% is from minority groups compared to 61% for females and 30% for minorities just 11 years ago. The percentage of female IRS executives has increased from 9.7% in 1988 to 23.6% in 1997. The percentage of executives from minority groups has risen from 10.4% to 13.1% over the same period. We have had similar changes in the composition of our workforce in the higher pay grades. The percentage of females in the GS/GM 13/14/15 positions was 22.9% in 1988 and 32.9% in 1997. For minorities, the numbers rose from 12.2% to 16.9%.

A number of factors have produced this changing workforce composition. The "baby boomers" who came to the Service in large numbers after 1970 began the change in the ethnic and gender mix of the IRS. Advances in civil rights and educational opportunities, as well as changing societal mores and economic necessity also provided the IRS labor force with increasing numbers of professionally skilled women and minorities. By the late 1980s, the IRS experienced significant changes, not only in its workforce, but also with respect to fulfilling its primary mission (to administer the tax laws), and as an employer. Changes in workforce diversity were important in the IRS planning process. They also were important as we sought to facilitate changes to our work environment and new business requirements by adopting a strategic approach to planning and management that focused on long- and short-term business objectives.

Our planning process focused on four strategic areas, one of which was "Enhancing Recruitment and Retention of Employees." In this area, the IRS undertook 1[illegible] initiatives and studies. One study reviewed the status of women and minorities in the IRS. That study (*A Design for Organizational Diversity: Report of Strategic Initiative ERR-16: Minorities and Women Within IRS* (December 1989)) (ERR-16) has been provided to this Subcommittee and probably is the most relevant study in connection with this Subcommittee's recent hearings. ERR-16 addressed a number of equal employment opportunity issues within the Service. For example, it addressed the underrepresentation of women and minorities in management and leadership positions, as compared to their numbers in the total workforce. It is clear from the study that the IRS was concerned that the concept of equal employment opportunity was clearly reflected in our recruitment efforts, but was reflected far less clearly in advancement. The study also addressed the IRS training and development programs and their adequacy and relevance to the Service's increasingly diverse workforce.

ERR-16 defined the strategic direction the IRS was taking in this area as follows:

> The Internal Revenue Service at all levels will be representative of the public it serves and committed to a leadership role that ensures racial, ethnic, and (sexual) gender equality. The IRS culture will be free of barriers which limit opportunity for minorities and women.

To elaborate on this strategic direction, we articulated strategies in five areas:

- Strengthening Management Accountability;
- Achieving Progress through Education;
- Improving the EEO Functional Support to Management;
- Ensuring Effective Recruitment, Retention, Development, and Advancement; and
- Developing Reliable Workforce Information Systems

ERR-16 called for the IRS to look beyond actions that only remedied existing representational imbalances and to pursue a comprehensive strategy to understand, and be strengthened by, the diversity of its human resources. ERR-16 challenged the IRS to become an organization in which equal employment opportunity was not considered a program for a few designated groups, but a way of doing business that would ensure that all employees were treated equitably and were not advantaged or disadvantaged by their racial or ethnic background or by their gender. It has never been the policy of the IRS to use quotas to achieve diversity. We wanted to remove barriers to advancement so that any IRS employee who was qualified for a position would be given a fair chance to attain it. This was our objective in the late 1980s, and we think it remains a good objective today.

The IRS acted in good faith to achieve this objective, and took many a tions to provide opportunities for all employees. We were not alone in our efforts to provide o pportunities for all employees. The concept of equal opportunity in federal employment had bee reaffirmed over the years by the executive and legislative branches of the federal government . nd in Supreme Court decisions. It was against this backdrop that the IRS and other federal d partments and agencies developed affirmative employment programs and policies. We belie e that our programs and policies have served us well. Recent court decisions in the *Ada and*[1] and *Byrd*[2] cases have caused us to review how we strategically approach or evaluate pro ress toward our objectives in the areas of equal employment opportunity for all employees.

In April 1997, a federal district court found, in an interlocutory decisi n, in *Byrd* that ERR-16 violated the Fifth Amendment equal protection clause. The plaintiff , four white male GS-12 revenue officers, alleged that they had been subjected to age, race, an gender discrimination in connection with specific personnel actions taken by the IRS The plaintiffs contended that ERR-16 encouraged institutional discrimination against white nale employees. because its objective was to increase representation of women and minorities n managerial and executive positions through employee development and advancement strateg es.

After *Adarand*, government actions related to race or ethnicity that ar challenged under the Equal Protection clause are examined under what is called a "strict scruti y" standard. Under the strict scrutiny standard, the government prevails if it shows that its progra n or policy serves a

[1] *Adarand Constructors Inc. v. Pena*, 115 S.Ct. 2097 (1995).

[2] *John A. Byrd v. Robert E. Rubin*, Civ. Action No. 95-1280 (W.D. La. April 9, 1997).

compelling governmental interest and that it is narrowly tailored to serve that interest. In *Byrd*, the Court held that ERR-16 encouraged or authorized preferential treatment of minority and female employees, and that, accordingly, the strict scrutiny standard must be applied to the Service's initiative. The district court then concluded that diversification of the Service's workforce was not a compelling governmental interest sufficient to justify the agency's use of race and gender criteria in decision making.

*Byrd* is one of the first federal court decisions in which a federal affirmative action program was found unconstitutional. It was an interlocutory decision on a motion for partial summary judgment which could not be appealed until the trial on the merits had concluded. After that decision and before a final judgment on the merits, the case was settled by the parties under an agreement not to disclose the terms of the settlement.

The Acting Commissioner, in an August 19, 1997, Memorandum For All Executives and Managers, temporarily suspended portions of two standards in individual performance plans and two measures used in the Business Review (copy attached). The temporary suspension applies only to these performance measures -- not the affirmative action program. In consultation with the Justice Department and IRS Chief Counsel, we are working to redesign the elements and standards of the performance plans for executives and managers for FY 1998 The redesigned elements and standards will ensure that all managers and executives are evaluated on their efforts to develop and promote all employees in accordance with affirmative action plans that are consistent with current law and Administration policy.

In a September 22, 1997 memorandum, the National Director, Personnel Division, reiterated the changes to 1998 performance plans which had been described in the Acting Commissioner's memorandum. The memorandum also described new, Treasury-mandated EEO performance elements and standards for all supervisors and managers to be included in the Executive/Managerial Performance Plan for the FY 1998 performance appraisal period (copy attached.) The IRS has not terminated its affirmative action program and, indeed, remains committed to doing everything permitted under law to achieve a diverse work force.

In concluding, the IRS remains committed to providing equal opportunities for all employees and to maximizing the benefits of having a diverse workforce. The IRS is aware of its affirmative employment responsibilities under Management Directives promulgated by the Equal Employment Opportunity Commission, and will work with the Commission in maintaining a lawful affirmative employment program.

To Marc Schaweske 3P
FYI - Fiola Shortz
I have full study if you wish more detail

Cato Policy Analysis No. 289 December 8, 1997

# Policy Analysis

## The National Sales Tax
### *Who Bears the Burden?*

**by Gilbert E. Metcalf**

*Gilbert E. Metcalf is an associate professor of economics at Tufts University and an economist with the National Bureau of Economic Research.*

**Executive Summary**

A leading criticism of a national sales tax replacement for the income tax is that low-income households would be harmed by the regressivity of the tax. This study uses data from the Bureau of Labor Statistics' Consumer Expenditure Survey (CES) to measure the lifetime incidence of a shift from the current income tax to a national sales tax.

The incidence of the tax burden under this reform depends in important ways on the measure of household well-being. If annual income is used to rank households, the tax reform looks very regressive. If lifetime income is used to rank households, the tax reform continues to look regressive, though much less so than when the annual income approach is used. If a universal rebate tied to poverty thresholds is coupled with the national sales tax, as is the case in the Schaefer-Tauzin bill (H.R. 2001), the sales tax is about as progressive as the current income tax. Alternatively, if a payroll tax rebate is provided to low-income families, the new system is only slightly less progressive than the current income tax system.

There are two essential messages of this paper. First, how we rank people--by annual or lifetime income--makes a big difference when we measure the progressivity of a national sales tax. Second, a national sales tax replacement for the income tax is not inherently regressive; it is relatively easy to construct a sales tax that protects the poor from paying any tax and is roughly as progressive as the current income tax. The universal rebate option is a good example of how one could adopt a non-regressive national sales tax.

**Introduction**

Dissatisfaction with the current income tax continues to generate interest in broad-based tax reform. In particular, there is considerable interest in moving from our current income tax to a consumption tax. In the 104th Congress there were approximately a dozen proposals for substantive tax reform, falling into three broad categories: flat tax, consumer income tax, and retail sales tax. [1]

A major concern with any of the consumption tax proposals is that they are perceived to be highly regressive relative to the current income tax. Much of that perception follows from the idea that, because rich people do most of the saving, any move to a consumption tax will release a substantial share of income from taxation. Incidence studies using annual income support that view; distributional tables for a shift from an income to a consumption tax show that the reform would be highly regressive. [2] A major problem with annual incidence studies of consumption taxes, however, is that life-cycle income and savings patterns distort the measured incidence of a consumption tax in a pronouncedly regressive direction.

The goal of this study is to indicate the biases resulting from measuring the incidence of a consumption tax using an annual incidence approach and to show incidence results for a national sales tax using a lifetime income approach that I have used elsewhere. [3] In addition, I consider two of the leading proposals to make the national sales tax more progressive: 1) provide a family rebate equal to the poverty level times the sales tax rate; or 2) provide a $2,000 per worker refund on payroll taxes. If the sales tax includes a universal rebate tied to poverty thresholds, the sales tax looks nearly as progressive as the current income tax measured by the lifetime incidence approach. [4]

## How Should We Measure Tax Incidence?

An incidence analysis attempts to answer the question, Who bears the burden of a particular tax? Any attempt to evaluate the "fairness" of a tax (or a change in the tax system) requires knowing whose disposable income is changed and by how much in response to the tax. Economists often refer to taxes as "regressive" or "progressive," but the confusion over the terms' meanings requires careful definitions. The definitions that most economists use rely on the average tax rate, that is, the ratio of tax liabilities to income. [5] A tax is regressive if the average tax rate falls with an increase in income, proportional if the average tax rate is constant, and progressive if the average tax rate rises with income. Simply put, low-income people pay a higher fraction of their income in taxes than wealthier people if the tax is regressive and a lower fraction if the tax is progressive.

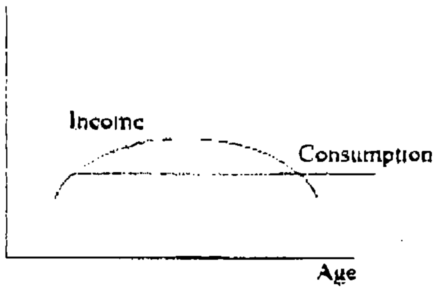
Early tax incidence studies used economic models to inform judgments about relevant incidence results from tax changes. In effect, economists used existing research results to generate plausible assumptions about the incidence of specific taxes. The late Joseph Pechman of the Brookings Institution is a classic example of that type of economist. [6] Using a one-year time frame for analysis, Pechman assumes that consumption taxes are passed forward and borne by consumers in proportion to their expenditures, finding that consumption taxes are quite regressive. [7] A recent study by Brookings Institution economists Gale, Houser, and Scholz confirms this view. [8] In an analysis of a shift from the current income tax to a flat tax, they find that the lowest-income group would see their average tax rate increase by 2.2 percentage points (81 percent increase) while the highest-income group would see their average tax rate decrease by 7.1 percentage points (17 percent decrease). [9] Similarly, economists from MIT and the National Bureau of Economic Research find that there would be a substantial shift in the tax burden to the poor occasioned by changing from the income tax to a retail sales tax. [10]

An alternative approach uses estimates of lifetime income as a measure of the taxpayer's economic well-being. Economists, taking into account both Milton Friedman's permanent income hypothesis and life-cycle considerations, have long recognized that annual income may not be a very good measure of an individual's potential to consume. [11] For purposes of measuring tax incidence, individuals should be grouped by income according to the present discounted value of earnings plus any gifts received.

The lifetime income theory makes the difficulties with the annual incidence approach readily apparent. People tend to earn the highest incomes in their lives around middle age and the lowest incomes in their youth and old age. Consequently, in a cross-section annual analysis, lower-income groups are likely to include some young and elderly people (and some people with volatile incomes) who are not poor in a lifetime sense. Similarly, higher-annual-income groups are likely to contain some people at the peak of their age-earnings profile for whom peak earnings are a poor measure of annual ability to consume.

To see why a lifetime approach makes a difference, imagine a world with identical people who have identical skills and identical earning patterns over their lifetimes. Figure 1 illustrates the lifetime income and consumption paths of a typical person in this imaginary society. Income, initially low and rising to a peak in the middle years, falls as this worker gradually cuts back on work and enjoys more retirement leisure. Consumption, however, is constant over the lifetime. In early years individuals borrow against future income to finance consumption that exceeds income. Savings occurs in the middle years, first to repay borrowing from the early years and then to finance consumption in the retirement years. In this stylized example, I assume that all savings are consumed so that at death there are no assets remaining.

**Figure 1. Annual Income versus Annual Consumption over Lifetime of a Typical Worker**




Next, assume that there is one person of each age in this identical society. Figure 1 now has an additional interpretation. In addition to indicating consumption and income patterns over an individual's lifetime, it also shows income and consumption patterns for our society of individuals at any given point. Now consider an annual incidence analysis of a national sales tax. Since consumption is constant across all individuals, tax payments will also be constant. But since income varies over a lifetime, the average tax rate (taxes as a fraction of annual income) will fall as income rises, and the tax will look very regressive. But this is clearly wrong. Individuals are exactly the same in this hypothetical society and over their lifetimes will earn exactly the same amount of income and pay exactly the same amount of taxes. A lifetime incidence analysis will correctly conclude that this tax is proportional.

## Measuring Lifetime Income

Lifetime income is more difficult to measure than annual income. National Bureau of Economic Research economist James Poterba has proposed using consumption as a proxy for lifetime income, arguing that since household consumption tends to fluctuate less from year to year than income, total annual consumption is likely to be a better measure of household well-being than total annual income. [12] Using data on total expenditures from the CES, Poterba finds that excise taxes on alcohol, tobacco, and gasoline are much less regressive than they appear when viewed in an annual income framework. Following this approach, I find that the system of state and local taxes is less regressive when consumption is used as a proxy for lifetime income. [13] Feenberg, Mitrusi, and Poterba also use the consumption proxy for lifetime income in a detailed analysis of a shift from the current income tax system to a national sales tax. [14] This comprehensive work considers personal income tax, corporate income tax, and estate tax. Using consumption as a proxy for lifetime income, the authors find that the regressivity of the shift measured using annual income is substantially reduced and that the shift can in fact be made progressive through straightforward measures (e.g., lump sum grants or making certain categories of spending exempt from the tax base).

TAX

CAPITAL GAINS

# YADDA YADDA TAX REFORM

## Congress stumps for simplification. But who just passed that new, mind-bending law?

BY JANE BRYANT QUINN

LET'S SEE, NOW. THIS SUMMER, A BOASTFUL CONGRESS passed 824 new income-tax changes, most of them cuts. They'll require thousands of regulations, a couple of dozen new lines on your tax return and Cliffs Notes for tracking the weird eligibility rules.

Yet hardly were the photo ops over when that very same Congress denounced "the government" for the tax code's deranged complexity. Shaking their fists, they're swearing to pull the entire system out by its roots. Sounds like the classic cry from the murderer: "Stop me before I kill again."

I'd love to, believe me. But the history of this sort of thing isn't promising. Back in 1986, the tax-reform crowd pushed through a bill that simplified tax returns for the average person. It wiped out some popular deductions (like those for credit-card interest) and used the savings to reduce personal income-tax rates. Had we continued along those lines, fewer mouths would be frothing now.

But tax breaks are America's addiction of choice. Every interest group in the country—business, labor, farm, consumer, nonprofit—hires lobbyists to try to tweak the tax code its way. The most tweakable legislators harvest dollars and votes. No surprise, then, that new deductions and credits crept back in.

Today's tax-reform crowd isn't interested in gradualism. Having wrecked the old code almost beyond saving, they want us to trust them to build one from scratch. There are two main camps. One says, "Quit taxing incomes; pass a national sales tax instead." The other says, "Tax only earnings, at a simple flat rate." Neither camp would tax personal interest, dividends, capital gains or inheritances. Roughly speaking, here's what they want:

**The sales tax:** The bill on the table comes from Republican representatives Dan Schaefer of Colorado and W. J. (Billy) Tauzin of Louisiana. You'd be taxed on most goods and services bought at retail—food, clothing, insurance, cars, doctor bills, homes, rent, banking and brokerage (although college tuition would be exempt). In theory, you could afford the extra cost, because you're not paying income taxes any more. The price of goods might even fall. In real life, however, some of us would pay more and others less.

How high is the tax? You have no idea how long it took me to get a straight answer. The press release says 15 percent, but that's based on a weird calculation you don't want to know about. At the cash register, the actual markup comes to 17.6 percent. State taxes are extra. The Feds may count them as part of the item's price, which would increase their dollar take even more. Some other issues:

■ *Collectibility.* Schaefer and Tauzin crow that their plan eliminates the IRS. Retailers and service providers would capture the tax, keep half a percent of it for themselves and remit the rest to the states. The states would keep 1 percent of the tax and give Washington the rest. But why should a state work its butt off to collect for the Feds? Conceivably, it could net more money (and leave its citizens richer) by raising its own tax and shrugging off federal tax evasion.

■ *Tax evasion.* Tauzin says that sales taxes are a cinch to collect, even without tax reporting and automatic withholding. But the International Monetary Fund's Vito Tanzi begs to differ. An IMF study of high sales taxes in countries that used them found serious tax-dodging once the rate topped 10 percent.

■ *Federal revenues.* The Schaefer-Tauzin sales tax is supposed to raise the same amount of money that the income tax does. But with so radical a change, who can be sure? David Burton of the Argus Group, a Washington law and lobbying firm, thinks the planned tax rate is high enough. Not so, if you believe a study by Daniel Feenberg of the National Bureau of Economic Research in Cambridge, Mass.

Feenberg thinks a 17 percent rate would work only if cheating gets no worse, all retail transactions are taxed (no exemptions for college or basics such as clothing and food) and no exceptions are made for the poor. Schaefer-Tauzin, however, gives every worker a tax credit—regardless of income—to cover as much as a poverty-level income could buy. To cover this revenue loss, Feenberg says, the sales tax would have to rise at least to 22 percent. Burton disagrees. I can't referee this, but the country runs a big risk of red ink if Burton et al. are wrong.

■ *Winners and losers.* High-income folks would save a fortune in total tax—something I haven't noticed the public clamoring for. In the middle brackets, gains and losses are mixed, says economist William Gale of the Brookings Institution. The working poor would be—to put it technically—screwed. Their incomes would drop, because the earned-income rebate would be snatched away.

Growth might accelerate, although by how much is just a guess. There are unknown transition costs. Older people spending after-tax savings would be taxed a second time. But if you have years to tax-defer money, you'll do fine. Fewer employees would get health insurance, because companies couldn't write off the cost.

**The flat tax:** Pushed by Rep. Dick Armey of Texas, the flat tax comes closer to tax reform's traditional shape. All current deductions and credits would vanish—gifts to charity, mortgage interest, state tax deductions, child-care credits. There's a tax-free allowance, depending on family size. On everything else, you'd owe 20 percent the first two years, then only 17 percent. The working poor lose their income-tax rebate. The biggest winners are those who already have money income to spare.

As proposed, the flat tax raises less revenue than the income tax does today. That's political gaming; Armey needs that low rate to cut taxes for the middle class. To balance the budget, this bill requires deep program reductions—well beyond those passed so far.

As much as anyone, I'd like to see the tax code cleaned up, but separately from the bloody battle over reducing government spending. Maybe an Armey-type tax with a couple of brackets (to raise enough revenue) and a promise not to throw the working poor to the sharks. The 1986 disappointment convinced me that tinkering won't work. But neither will a riverboat gamble that wrecks the fiscal discipline that we've worked so hard to win.

*Reporter:* TEMMA EHRENFELD

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Toy

## Washington Outlook

**EDITED BY OWEN ULLMANN**

File - Tax Reform
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- Dick - White House [illegible] to [illegible]

# TAX REFORM: GET READY FOR A CLASSIC CLINTON TURNABOUT

If there was one thing Bill Clinton was sure of, it was this: He held the high ground in the tax-reform debate. By casting Republicans as defenders of the rich—and trumpeting his tax breaks for the middle class—the President thought he could keep all those crazy flat-taxers and income-tax bashers in their cages.

But congressional hearings into Internal Revenue Service abuses made electrifying political theater, catching Clinton off guard and forcing him to accept Republican proposals to reform the IRS. And if that wasn't enough, tax issues helped the GOP sweep key elections on Nov. 4.

That's why Administration complacency has been replaced by near panic. Despite Treasury Secretary Robert E. Rubin's reluctance, Clinton may do an about-face. Rather than opposing change, he is now looking to promote his own version of reform, perhaps as soon as in his State of the Union Address in January.

**"WE'VE GOT TO RESPOND."** Just by getting in the game, Clinton vastly increases the odds of a tax restructuring before he leaves the Oval Office in 2001. Without the President's backing, tax reform would be a hot issue in 1998 and 2000 campaigns—but it would go nowhere. "Fundamental reform has to be bipartisan," says Barry K. Rogstad, president of the American Business Conference, a group of midsize companies. "You need a chief executive to take this to the American people."

What's behind Clinton's abrupt change? Al Gore, for starters. The Vice-President's potential rivals for the 2000 Presidential nomination, eager to counter the GOP clamor for a new tax code, already are pushing their own plans. And congressional Democrats, worried about their '98 races, are eager to stake out a position.

"After the IRS debate, there was a fierce determination not to get stuck with the short end of the stick," says a senior White House official. "We've got to respond to the tax debate." So a team of Clinton advisers—led by Deputy Treasury Secretary Lawrence H. Summers and National Economic Council Director Gene Sperling—is working up options. "We're marching through every reform idea," says Sperling.

While New Democrats and Republicans agree on many economic issues, Clinton's version of reform could be very different from the GOP alternatives. He's likely to focus on making the tax code simpler while preserving progressivity.

That puts the President at odds with two leading GOP proposals—a 17% flat tax championed by House Majority Leader Dick Armey (R-Tex.) and a national sales tax embraced by House Ways & Means Committee Chairman Bill Archer (R-Tex.). Republicans say their plans would simplify taxes and spur economic growth, but Clintonites insist both plans favor the rich.

Clinton could lift key elements from plans offered by Senate Budget Committee Chairman Pete V. Domenici (R-N.M.) and House Minority Leader Richard A. Gephardt (D-Mo.), considered Gore's chief rival in 2000. Domenici backs a consumption tax, and Gephardt's proposal would set a 10% rate for families earning $60,000 or less.

Afraid that he'll find himself alone among candidates defending the status quo, Gore has been a major catalyst for the White House's new-found interest in tax reform. By the time the Veep hits the primary trail, he needs to have a plan of his own. "It's close to an imperative," says one Gore insider.

**SHIFTING SANDS.** But first the Vice-President and other tax-reform advocates will have to win over in-house skeptics. Some White House politicos still hope a bitterly divided GOP will fail to reach consensus on a reform proposal, allowing Clinton to duck his own tough choices. "Maybe we'll all agree to just debate this in the abstract until 2000," says one strategist.

Clinton no longer wants to take that chance, however. And with marching orders coming directly from the Oval Office, even the Treasury Secretary is going along. "He is not wildly for reform," says a White House aide. "But he has agreed to see what they can come up with." For now, Rubin says, "Whether the President will have anything to say in the State of the Union is very much unresolved." But down the road, he could live with a plan like the Tax Reform Act of 1986, which cut rates and dumped loopholes but preserved the income-tax framework.

For now, the best bet is that the President will reprise the strategy that worked so well for him in the balanced-budget debate. Once he senses public support for reform, Clinton will try to get ahead of the GOP with a middle-of-the-road plan of his own while painting the Republican alternatives as "radical." To set the stage for such a step, he could use his State of the Union address to issue a call for a tax code based on the principles of progressivity and simplicity—with details to come later. By just embracing the concept, Clinton will go a long way toward turning tax reform talk into reality.

*By Howard Gleckman, with Mike McNamee*

T04

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DATE: December 1st, 1997

TO: Maria Echaveste + Charles Kamasaki

OF: The White House + NCLR

FAX #:

FROM: Rick Swartz

RE:

Immediate Response Requested: Yes No

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Wall St. Journal 11/25/97
File Tax

# REVIEW & OUTLOOK

## Max Tax Choice

Taxes clearly are going to be on the political agenda next year, and if there's anything resembling a consensus on this issue right now it's that somehow there has to be a better way. For instance, tax specialists have come to regard the vaunted Taxpayer Relief Act of 1997 as a particularly egregious exercise in inefficiency. Mainly, it looks the a Tax *Preparers* Relief Act.

Now along comes an idea with the potential to point us toward dawn. It is known as the Max Tax, or Alternative Minimum Tax. First described by Stephen Moore of the Cato Institute on these pages last spring, the Max Tax plan is a simple one. Come tax time, the IRS would mail two forms to each household: the traditional 1040 and a Max Tax postcard. Taxpayers could then decide for themselves what form to use. They could claim all their beloved deductions, exemptions and exceptions. Or they could skip all that, fill out the postcard and a pay a flat rate of 25% on gross income. Mr. Moore's plan should prove attractive to lower earners, even those whose current statutory rate is below 25%. That is because it allows them a credit against their Social Security (12.3%) and Medicare (2.9%) taxes, creating, de facto, a 10% rate.

Not every tax geek or lawmaker is going to like this idea. For one thing it hasn't been "scored" for revenue "losses"—a virtue, to our mind, but a negative in the eyes of Washington. Then there is the matter of its flat rate format. House Ways and Means Chairman Bill Archer, for example, now seems to favor doing away with the IRS altogether and installing a national sales tax. House Majority Leader Dick Armey wants a flat tax, but one with a lower rate of 17% and without the Moore payroll tax credit. Dick Gephardt wants a multi-rate flat tax, whatever that is. Still, the Max Tax has found support from Congressmen and Senators: GOP Rep. Vince Snowbarger of Kansas has introduced a Max Tax bill in the House. In the Senate, Orrin Hatch has said he likes it; Michigan's Spence Abraham will sponsor legislation called "the Alternative Flat Tax."

What these fellows grasp is that the attraction of the Max Tax is the choice it permits between paying through the current tax system or the Max Tax alternative. Most taxpayers, one senses, will be interested enough to run the numbers under both arrangements. When they do they'll likely discover they are better off under the Max Tax even though it dispenses with such heretofore untouchables as the mortgage-interest deduction.

One of the great attractions of this proposal is that it has the potential to depopulate Gucci Gulch, source of so many upscale Beltway incomes. If homeowners stop claiming the mortgage-interest deduction voluntarily, suddenly the Realtors, mortgage bankers, homebuilders and the like will find they have no constituents to subsidize their lobbying. When fewer seniors claim the credit for the elderly and disabled, the AARP will find it more difficult to practice the scare tactics we saw in the 1996 elections. Without high tax rates to make their muni exemptions so desirable, the municipal bond entrepreneurs will no longer be able to maunder on about helping little old ladies. There would be a lot fewer tax attorneys grumbling about "transition." Next thing you know, the nation would be a whole lot closer to something recognizable as tax reform.

We'd of course expect President Clinton to instinctively veto anything with choice in it, as he did with vouchers for the District's academically drowned school children. But we find the Max Tax philosophically attractive for another reason. It's our conviction that people almost always make the right decision when they get their hands on enough pertinent information. In the 1980s, new information technologies helped political dissidents from East Berlin to Alma-Ata to China communicate with one another and the West. That knowledge of alternatives made them confident enough to force change on their cloth-eared regimes.

We've noted something similar going on in the way Americans use computers to study pocketbook reforms, such as those for Social Security and now the tax code. These days hundreds of thousands of citizens use online calculators at Websites of organizations such as Americans for Tax Reform ("ATR.org") or the Tax Foundation ("TaxFoundation.Org") to calculate what their tax liability would be under various different tax and Social Security arrangements. Dick Armey's staff reports that his flat tax site, "Flattax.gov," has received up to 200,000 hits a month. Mr. Moore's Cato Institute offers a Social Security calculator of its own; shortly its Max Tax calculator ("Cato.org") will be up and running. Tax reform from the top has faltered often in the past. Don't be surprised if support this time for ideas such as the Max Tax emerges from thousands of linked taxpayers.

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**FAX**

DATE: December 1st, 1997

TO: Maria Echaveste + Gustavo Mohar

OF:

FAX #:

FROM: Rick Swartz

RE: Prospects for legal immigration debate in 98 → 99

Immediate Response Requested: Yes No

TOTAL NUMBER OF PAGES, INCLUDING THIS COVER PAGE: 9

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MESSAGE:

Subj: High-tech pushes for more guestworkers
Date: 97-11-25 10:56:05 EST

Re prospects for legal immigration debate in 98→99

**Visa cap limits high-tech workforce**
**Industry to press for more skilled workers**

San Jose Mercury News, Friday, November 21, 1997

Fax to Echaveste Gustavo Mohar

BY MIRANDA EWELL
Mercury News Staff Writer

At the end of August, a promising Stanford Ph.D. from Asia with expertise in compound semiconductors was forced to leave the payroll at Hewlett-Packard Co.'s optoelectronics division in San Jose because the national visa allotment for skilled foreign workers had run out.

Aside from the personal suffering the engineer had to bear, her company also suffered: Because she was the only member of her team with the particular skills for transferring a new technology from R&D to manufacturing, the project she was working on went into limbo, the company says.
Similar situations throughout Silicon Valley raised a red flag this fall for the high-tech industry, which is struggling with a critical shortage of technology workers in all categories. The U.S. government issues 65,000 work visas for skilled foreign workers each year -- a total that for the first time this year was filled by the end of summer. Industry associations say they intend to push for new legislation that will increase the yearly visa allotment or eliminate visa caps altogether.

"We have made this our No. 1 priority," said Susan Marshall, vice president of information technology services for Information Technology Association of America, an association of IT companies.

The Immigration and Naturalization Service stopped issuing H-1B visas in late August, when the allotment for the year ran out. Nationwide hires of foreign workers came to a sudden halt -- with urgent consequences for industry.

Designed to allow U.S. companies to hire foreign workers with special expertise, the H-1B visas are used heavily by the high-tech industry to hire highly specialized engineers, often graduates of U.S. universities with advanced degrees. The 65,000 limit was placed on H-1B visas in the 1990 immigration reform bill.

The INS started issuing H-1B visas again this month, the start of the new visa year. Pent-up demand for visas meant 3,500 applications had already been processed and were ready to go at the start of the month. That has led to expectations that the cap next year will be reached even earlier -- possibly as early as May.

"There's a real concern next year that everyone will anticipate the cap and every company that can hire early will do that and it will become a self-fulfilling prophecy," said Mary Dee Beall, government affairs manager for HP.

High-tech companies say the foreigners they bring in on H-1B visas are often key technical engineers who develop new technologies that, in turn, spawn more jobs for U.S. workers.

At Intel Corp., a senior technical marketing engineer, a legal immigrant, was part of a two-member team that developed Intel's desktop video-conferencing system, an advance that created 500 new jobs, Intel attorney Coeta Chambers told a forum in Palo Alto this week. The forum, conducted by U.S. Sen. Spencer Abraham, R-Mich., chairman of the Senate Commerce subcommittee on manufacturing and competitiveness, was organized by Technology Network -- a coalition of Silicon Valley companies.
"High-tech companies like Intel competing in the global economy need a global workforce," Chambers said.

If the cap on visas forces skilled engineers to remain outside the United States, Chambers warned, companies will follow. "I don't want to make it sound like a threat but we do need that talent," she said.
The H-1B visa issue comes against a backdrop of acute labor shortages in the technology industry. Conservative estimates peg current vacancies nationwide in IT positions at 190,000, according to an ITAA study. At the workforce forum, Tony Vickers, director of Computer People Inc., cited Bureau of Labor statistics that IT employment now stands at three times that of the auto industry and 10 times that of the steel industry.

"In the knowledge revolution, skilled people are our basic raw material, just as iron ore was for the industrial revolution," Vickers said. "This problem . . . impacts the entire U.S. economy."

The senator suggested that the next step would be to hold a formal hearing in Washington, D.C., to educate legislators on the issue. But he warned listeners that sentiment on Capitol Hill, if anything, was to "restrict legal immigration further."

"There's very little support for expanding any category," Abraham said.
Industry spokesmen acknowledge it will be hard to convince legislators to overturn the visa cap. But companies believe they can be persuasive if they present the issue as one of U.S. competitiveness.

"What we're interested in is being able to compete in a global economy and the immigration laws hinder our ability to do that," said Brian Raymond, manager of domestic programs for the American Electronics Association. "This is one part of the competitive puzzle that needs to be fixed."
The AEA board, which met in September in San Jose, also voted to make the H-1B visa one of its top priorities for the coming year, Raymond said.
When the INS began issuing visas again in November, the HP worker in optoelectronics finally was able to return to work. But her absence forced a delay in the transfer of the technology her team had worked on and tied up R&D funds.

''In fact, even now we are still trying to recover from problems that could have been resolved sooner,'' said Jeff Rogers, the team's process engineering manager.

**Legislators put focus on fences, not jobs**

The San Diego Union Tribune, Monday, November 3, 1997

Marcus Stern
Copley News Service

WASHINGTON -- Last year, Congress quietly made a crucial choice in its battle to stem illegal immigration. It decided to hire more border guards and build more fences, rather than try to keep undocumented immigrants from getting jobs once they're in the United States.

The choice was precisely the opposite of what immigration commissions have been recommending for decades. But it allowed the lawmakers to appear responsive to voter concerns about illegal immigration without upsetting powerful special-interest groups.

The reluctance of Congress -- and successive presidents -- to seriously tackle the jobs magnet is rooted in one of the grim realities of electoral politics: Politicians are afraid to defy business lobbyists and influential blocs of voters.

"The people who take advantage of the weakness in the law want to maintain that weakness," said former Sen. Paul Simon, D-Ill., a longtime member of the Senate's immigration subcommittee.

"You have some within the immigrant community who basically don't really want to slow down illegal immigration. While they would not admit it, clearly they don't want to see anything that stems the tide of Hispanics or Poles or Irish coming into the country.

"And you have employer groups who are making money off of these illegal immigrants, and they don't want to see any kind of real sanction there. The combination is enough to make it difficult to pass legislation."

But since 1951, one immigration commission after another has told Congress that jobs fuel illegal immigration.

"Reducing the employment magnet is the linchpin of a comprehensive strategy to reduce illegal immigration," the U.S. Commission on Immigration Reform concluded in a September 1994 report.

More specifically, it said, "A computer registry to verify that a Social Security number is valid and has been issued to someone authorized to work in the U.S. is the most promising option for eliminating fraud and reducing discrimination while protecting individual privacy."

The commission said, in essence, "It's the jobs magnet, stupid." But Congress and President Clinton largely spurned the advice.

Immigration-law showdown

The first real showdown over last year's immigration law came in September 1995 when the House Judiciary Committee approved pilot projects to test whether something as simple as a phone call to the federal government could sharply cut illegal immigration.

Employers would make the toll-free call to verify the Social Security number of every new employee, making it harder for unauthorized workers to get jobs. It was a key to curbing the flow, supporters said.

But later, behind closed doors, House Majority Leader Dick Armey gave other key House Republicans a warning.

The immigration bill would die, the Texas Republican said, unless it was endorsed by small business. And that wouldn't happen if even one employer was required to take part in an employment verification pilot project. Small businesses are the principal employers of illegal workers.
Rep. Lamar Smith, R-Texas, the bill's main architect, began secret negotiations with the National Federation of Independent Business (NFIB), which represents small businesses. Just before the bill went to the floor, Smith announced that it had been altered to make the pilot projects entirely voluntary for employers. Then the House passed the bill.

Smith had never disclosed Armey's threat or the NFIB's virtual veto-control over the immigration bill.

"So many of the Republican freshmen were elected on planks of being vociferous supporters of small business that when they heard that the National Federation of Independent Business would not be amenable to mandatory verification, they knew they had to do something," said a Republican congressional staffer.

"The leadership lives in mortal fear that something will be done against the interests of small business and it will show up in the form of negative
(NFIB) ratings of Republican members at the end of the year." Armey's little-known election-year threat to scuttle the entire immigration
bill because business groups, including the National Restaurant Association, opposed the verification provision was telling. Even though members of Congress frequently use forceful rhetoric in declaring their intention to curb illegal immigration, there are limits to what they're willing to do. Alienating business groups isn't one.
"He's always been opposed to anything that might lead to a national data base," Armey spokeswoman Michelle Davis said in explaining the majority leader's opposition to verification.
But Smith's proposal relied only on existing immigration and Social Security databases.
Verification debate
On the other side of the Capitol grounds, the Senate Judiciary Committee conducted its verification debate in March 1996. Sen. Patrick Leahy used the occasion to describe a brush he'd had with the U.S. Border Patrol. As the Vermont Democrat told it, he was driving about 60 miles from the Canadian border a few years ago when he was stopped at an immigration highway checkpoint. A patrol agent stepped up and asked him to prove he was

in the country legally.
Leahy erupted.
"I've never had to prove my citizenship in my own country to anybody and I have no intention of proving it to you," he thundered.
When the agent's superior noticed the senator's VIP license plates, the incident ended. But Leahy's anger endures.
"I'll be damned if I want to have to go out and have to prove to anybody that I'm an American," he said during the verification debate. As it turned out, Leahy was preaching to the choir.
By the time the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 became law, Congress had gutted the verification proposal. It had agreed to pilot projects, but they would be carefully limited and voluntary for employers.
For those who have followed the nation's long-running debate over illegal immigration for some time, it was a moment of deja vu. Congress had authorized voluntary pilot projects 10 years earlier -- without much result.
"What a pale shadow the new pilot system is of what we recommended," said Larry Fuchs of Brandeis University and the Commission on Immigration Reform. Congress created the commission to provide advice on immigration policy. "You could call it a gutting of it."
Nor did Congress seriously tackle the problem of document fraud. Lawmakers rejected requirements for tamper-resistant birth certificates and driver's licenses. And they opposed significant increases in the number of labor and immigration work-site inspectors.
Congress did, however, add more Border Patrol agents.
For desperate immigrants, getting in would be tougher. But they would still be lured by the continuing temptation of jobs and eager employers. "There's a lot of hypocrisy on this issue," Fuchs said.
Jobs draw millions
Jobs continue to draw millions of desperately poor people to the United States. They travel in buses up Mexico's west coast from starting points in the country's impoverished interior, or from farther away in the jungles of Central America. Some land in Baja California Norte crammed into the hulls of rusting trawlers sailing from mainland China. Others fly from Eastern Europe to Mexico City as "tourists" and trek north.
Those who arrive in Tijuana today stare across a 10-foot-high steel fence at a row of Border Patrol vehicles. Beyond the agents, the sprawling U.S. job market beckons like a giant thirsty sponge eager to soak them up. Because security has been beefed up on the border in San Diego, the crossers have shifted eastward to the rugged outlying mountains and deserts. Already this year, dozens have died in this forbidding landscape,
including a young woman whose husband carried her body out in his arms. For the migrants, the costs of doing business in the United States have always been high. But, with jobs waiting, the flow continues. The employers aren't altruists.
"We get nothing but absolutely glowing reports from the companies about these Hispanics working for them," said Mike McAltin of the Mississippi Poultry Association. "They come

in with a great work ethic. They have a real tenacity about working. It's the law that we hire only legal people.
And we try to enforce that. But it can be tough."
"They're an employer's dream," said a San Diego employer. Enforcement difficulty
Lawmakers took their first stab at shrinking the job market for illegal immigrants in 1986 by making it illegal to intentionally hire them. But fraudulent birth certificates, driver's licenses and immigration documents
made enforcement impossible because the government couldn't prove employers knew they were hiring illegal workers.
Employers were given no way to check if a Social Security number, driver's license or birth certificate is valid.
"It's easy to pass a law and say, 'OK, all your workers must be legal,' "
said William T. Roenigk of the National Broiler Council, a trade group representing chicken plants. "And then someone else says, 'Well, yes, but
you can't ask this question, you can't ask that question. And you can't examine the documents beyond whatever or it leads to discrimination.' " With so much ambiguity, enforcement of the law quickly waned. "The '86 law is dysfunctional because we didn't want it to work," said Sidney Weintraub of the Center for Strategic and International Studies. "We
passed legislation (in 1986) that we knew was unworkable because we aren't willing to take the steps of identifying who is an illegal. The (members of Congress) knew that when they did it."
When Congress took up the issue again last year, lawmakers put out a blizzard of press releases proclaiming the bold steps they were taking during an election year. But their releases invariably failed to note Congress' retreat from any kind of verification proposal or document reform.
Sen. Dianne Feinstein implored her colleagues on the Judiciary Committee to approve some sort of system to ensure that birth certificates, driver's licenses and immigration documents are real.
"Gentlemen," the California Democrat said, "as sure as I'm sitting here now, the result of continuation of a non-system, the ostrich-like head-in-the-sand attitude, the constant rejection of any efforts to solve
this problem, will produce an Armageddon in the American population in those states where there is a big problem."
Opponents said a worker-eligibility system would infringe on civil liberties and would conflict with America's abhorrence of big government.
It would be bad for business and wouldn't work, they said. "Using a national verification system to stop illegal immigration is to me
like trying to fix a wristwatch with a pickax and a sledgehammer," said Sen. Russell D. Feingold, D-Wis.
Feinstein and former Sen. Simon said political pressures sometimes compel lawmakers to pass feel-good legislation. That way, they're able to placate the public without upsetting special interests.
For example, Congress doubled the size of the INS budget over the past five years and hired additional Border Patrol agents. But little has been done to devise a workable verification system and secure documents. The public doesn't

understand the nuances of the complex issue, but the special interests do, said Simon. And they know how to work Congress, build broad coalitions and use the media to assist in their campaigns. "You face this dilemma from time to time when you're a member of the House or the Senate," he said. "Do you serve the public good when the public at large doesn't really understand the issue? Or do you serve a very small constituency that understands the issue and is going to respond?"