Scott Hodge: Thank you for tuning in today. I'm Scott Hodge, president of the Tax Foundation.

Joining me for our weekly Tax Policy Podcast is *Wall Street Journal* columnist John Fund. John writes the weekly "On the Trail" column for OpinionJournal.com. He is the author of *Stealing Elections: How Voter Fraud Threatens Our Democracy*. Mr. Fund joined the *Wall Street Journal* in 1984 and has been one of the most prolific writers at the *Journal* ever since.

Thank you for joining me today, John.

John Fund: Pleasure, Scott.

Scott Hodge: Well, it's a new year. We have a new Congress and a very different agenda but before we look ahead I'd like to look backward, if you'd like.

You wrote a very interesting column in April of 2006 which was titled "Flirting with Disaster: Will 2006 be for Republicans what 1994 was for Democrats?" That was a pretty prescient column. What did you see then that made you ask the question and, I guess, what do we take away from the election?

John Fund: Well, the revolutionaries of 1994 lost steam right after the government shutdown the next year and they never really got their mojo back, so by the time the Republican control of Congress was in its 12th year this spring, I concluded that a lot of the Republican revolutionaries had come to Washington determined to drain the swamp and instead they decided the swamp made a great hot tub.

Scott Hodge: Well, certainly you've been following the earmarking spectacle over the last year and certainly Republicans got a lot of ridicule for things like the Bridge to Nowhere and so forth. And Democrats at least are indicating to some extent that they want to clean up this process, make it more transparent and maybe even call a truce on earmarking for awhile.

Is this possible? Can they do this in the face of their own appropriators and, I guess, ultimately is this enough to cure the problem?

John Fund: Well, you've identified the problem. There's a third party in Congress and it's more important than the other two parties. It's called the Appropriations Party. These are the members of the

Appropriations Committee. It's a bipartisan spending machine. I call it the "favor factory."

Scott, the real issue here is people like to talk about reform. The Republicans talked about earmark reform after the Jack Abramoff scandals and the Duke Cunningham scandals for months. They ended up not doing very much until the very end.

The Democrats talk a good game but the devil will be in the details. I am told the Democratic appropriators, including Robert Byrd, who supposedly wants this moratorium on earmarks, I'm told what they really want to do is go back to the old pre-earmark system where you send letters to the bureaucracy saying you know, it really would be helpful if you moved this money from Column A to Column B and, after all, we are the majority party and we do have control over your purse strings. That would be the implied message.

So I think if they start sending those letters out in lieu of earmarks, I think the administration's response should be immediately to have all of those letters go up on the Internet so they become public. That's the kind of transparency we need regardless of whether or not Congress moves for greater transparency on its own.

Scott Hodge: Wasn't the effort to create a web site a pretty good step in this direction?

John Fund: Yes. And Senator Coburn and Senator Obama deserve some credit for sponsoring that.

By the way, speaking of reform, I would like to note for your listeners something that you're well aware of. This is the 20th anniversary of tax reform, the 1986 tax reform that was pushed by Bob Packwood and Bill Bradley and President Reagan, of course, which closed a lot of loopholes, lowered rates, streamlined the tax code.

Well, since then, Scott, we've had 15,000 changes in the tax code. The tax code is even more bulky and out of control than ever and we had Senator Ron Wyden in from Oregon and interestingly enough he was at an event marking the 20th anniversary of tax reform the other day and Senator Bill Bradley showed up and literally passed the torch to him, saying the kind of tax reform we need is needed more than ever and we need to take this change of Congress and try to use it as some kind of vehicle to replicate what happened in 1986. And remember, Ronald Reagan's tax reform ended up being bipartisan because he had a Democratic House of Representatives to deal with.

Now, we probably can't go nearly as far as 1986 but I think there are going to be some Democrats who recognize that in the long run the real tension in their party is going to be between the people who want to just, you know, have a bidding war with K Street lobbyists for changes and favors in the tax code and those Democrats who recognize that the way to have economic growth, which means more money for social programs, is to streamline and simplify the tax code.

Scott Hodge: Well, Senator Wyden's enthusiasm is almost infectious to anyone who's heard him speak on the issue and he really does seem passionate. But in '86, wasn't there a lot more spadework that had been done on tax reform going back into, you know, Treasury I, Treasury II and all of those iterations? And we don't seem to have seen that at this point.

John Fund: Well that's a good point, Scott, but how much spadework do we need? We know that the current tax system is irredeemably broken. All you have to do is talk to any American.

The reason the tax code is as bad as it is, is we've got 35,000 lobbyists in Washington. Those lobbyists would be out of a job if we simplify the tax code in large part.

So I think what we need is political will more than we need intellectual spadework or another Treasury report. I think it's obvious what needs to be done. We need to lower the rates and we need to stop adding loopholes at the very least to the tax code.

Now I admit I don't think the Democrats are going to move on that in the next two years which is why I think the Republicans, who need to reform themselves and refurbish their revolutionary credentials, I think they need to take this to the people in 2008, whether it's the presidential candidate or running for Congress and say the time for tax reform is now, the Democrats haven't done anything with it and we need to move on it. At the very least, when we had control of Congress we lowered capital gains rates, lowered taxes on dividends and look at the economic growth and expansion we had.

I mean, you saw the latest numbers. Revenue up 12 percent the last year?

Scott Hodge: It's really remarkable how much the economy is boosting tax revenues but one of the Democrats' first orders of business according to them is to fix the alternative minimum tax, which is capturing more and more people, some 23 million in a few years if it continues on this pace.

But they've also promised to enforce the pay-as-you-go rules. Have they boxed themselves in on this? Is there any way that they can fix really the biggest tax affecting their constituents in blue states because they've got to pay for it?

John Fund: It's almost a prisoner's dilemma. They can't have it both ways. I think the question will be for reformers what price, what reform can be leveraged in exchange for adjusting the alternative minimum tax because as you know, the alternative minimum tax largely affects people in blue states, Democratic states. New Jersey, Connecticut, Illinois, California. These are the states which have very high income earners who are increasingly being captured by the alternative minimum tax and really socked.

So Democrats are going to need votes to pass the alternative minimum tax. What reforms can we attach to that as a price for frankly bailing them out of their constituents' anger?

Scott Hodge: And what are some of those provisions that could be attached to that as a compromise?

John Fund: Well, we've already seen that the economy has grown most dramatically when we have lifted the taxes on savings and investment. We have made it easier to create jobs, to accumulate capital. We need to expand that.

Increasingly, I realize that we're not going to have an overall, comprehensive reform in which we replace the current income tax system with a consumption tax or something like that. But we can do more and go further down the road of reducing the taxes on savings and investment. We can expand individual retirement accounts. Maybe we can't have some of the payroll taxes that people pay into Social Security transferred into their own private account but at the very least we can expand IRAs so that increasingly, if you earn money and you save it, you pay no tax on it. And if you do spend it, then you are going to pay some taxes on it.

So I think whether it's health savings accounts, we liberalized the laws, as you know, last month when Congress left town. Now health savings accounts are easier to set up and easier to put money into. We should do that with retirement accounts.

Increasingly, even if we can't have comprehensive tax reform, Scott, I believe that we can continue to chip away and reduce taxes on savings and investment that helps people plan for their future. It doesn't make them as dependent on these uncertain government programs that are actuarially unsound and at the same time it boosts economic growth and output and enables us to afford much more.

Scott Hodge: Well, the president has indicated that he'd like to take on Social Security reform again or entitlement reform more broadly and has actually at least made the sounds that he's willing to put taxes on the table.

What do they really mean by that at the White House and what sort of a compromise could be made in this political climate?

John Fund: Well, I fear that the compromise would be adjusting perhaps the benefit formulas so that you tie them to different indices and you bend down the curve of – bend down the angle of the rate of growth on the entitlement programs like Social Security in exchange for lifting the cap on the payroll tax. I think now it's about $92,000 a year.

I think that would be a terrible mistake. I think perhaps the president may not be able to pull that through Congress. That's why I fear we may see another commission. Remember the Greenspan Commission in 1983 which very gradually raised the retirement age and also increased the payroll tax? I think we may be going down that route again.

I think it would a mistake for the president. If he wants to leave a legacy, I think he should leave a legacy of sticking by his guns, sticking by his principles. For the last six years, Scott, his principle has been lower taxes, holding the line on taxes, not raising taxes is the way to go. It's the only way we can create the revenue growth to pay for the expanding government programs in the entitlement area.

If he breaks with that, I don't think any entitlement reform he's likely to get is going to be worth the tax increases and the precedent that that sets for even more tax increases in other areas.

Scott Hodge: I want to wrap up with one last question, shifting gears just a little bit, and ask you to talk about a story that you wrote from Hong Kong in which you saw firsthand how the Sarbanes-Oxley law is impacting the U.S.' status as sort of the magnet for capital around the world.

What did you find and what lessons can we take from it?

John Fund: Well Hong Kong, even though it's a part of China, operates under a completely different system of economics. It's rated the most free economic place in the world by both the Heritage Foundation and the Cato Institute, and I believe Hong Kong is about to become one of the two world capital centers for raising money and having initial public offerings for companies. And the reason is because New York is abdicating its role.

Sarbanes-Oxley has such arbitrary restrictions, such burdensome requirements, such high costs in setting up companies and doing business here that the business is shifting to London and Hong Kong.

In fact, the financial secretary of Hong Kong, Henry Tang, actually told me – this was just before Treasury Secretary Paulson was coming for a visit. He said I'll have a message for Treasury Secretary Paulson. We are doing great. We are about to become the number one city in the world for initial public offerings. Thank you, Mr. Sarbanes and thank you, Mr. Oxley, because you're the ones who helped us achieve that position.

Scott Hodge: And what are the chances that Congress can reform Sarbanes-Oxley to make it at least less punitive?

John Fund: Well, the Securities and Exchange Commission has belatedly issued some regulations which ease some of the burdens on small public companies. I think Congress is going to wait to see how that sorts out.

Unfortunately, I think Sarbanes-Oxley reform is not a big priority with this Democratic Congress and unfortunately the Republican Congress was always loathe to touch it, Scott, as you know, because they would be accused of currying favor with big business and being in league with people who wanted to created the next Enron or WorldCom.

So I think in the short term we're not going to see Sarbanes-Oxley reform but as it becomes clear that the Securities and Exchange

Commission regs aren't going to lift the burden enough, I think we'll return to it, probably in the election year when, shall we say, the attentions of the legislators will be most focused on it and also their need for campaign contributions.

Scott Hodge: Well John, this has been very, very interesting and fascinating. I appreciate you taking time out of your busy schedule to join me.

John Fund: Well, keep up the good work with the Tax Foundation. I have to tell you, it's one of the best sources of data we have at the *Journal* and we quote from it all the time.

Scott Hodge: Well, thank you very much.

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