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DEPARTMENTS

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Contemporary U.S. Tax Policy

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Contemporary U.S. Tax Policy, by C. Eugene Steuerle. Published by Urban Institute Press (Washington, 2004). Paper, 322 pages. Price: $24.00.

Even for seasoned observers of U.S. tax policy, it is difficult to find rhyme or reason in the endless stream of proposals (and what is worse, actual tax legislation) that comes out of Washington. For decades now, we have experienced what Daniel Shaviro once referred to as "perpetual income tax legislation,"[1] with major tax bills enacted every few years, all without any clear purpose or direction. Certainly, little has been achieved to improve the tax system, and a lot has been done to make it worse. Just look at current attempts to repeal the extraterritorial income provisions, which the World Trade Organization has (not unreasonably) held to be a prohibited export subsidy. Apparently, this basic task cannot be done without simultaneously loading up what otherwise should be a rather simple bill with dozens of special perks for corporate America, to say nothing of a $10 billion gift to the tobacco industry. Michael Moore makes movies about lesser evils.

Most of this kind of abuse of the tax system is nonpartisan, but the majority party bears special responsibility as it is in control of the tax policymaking process in Congress. This means the GOP leadership deserves a good deal of credit for what Congress has recently wrought. To be sure, there has been a distinctly Republican cast to our tax policy since 1980, with only a brief respite of Democratic tinkering during the Clinton years. At that time, in an ill-advised display of nostalgia for tax policy 1970s-style, Democrats sought to reverse what little was left of the Reagan Revolution and raise taxes on the wealthy constituents of the Republican Party. To their credit, in the 1990s Democrats also adopted rules that institutionalized a more stable budget process that produced some modest success in bringing tax revenues into balance with spending — at least, if you ignore the fiscal disaster with which Social Security threatens us. True, they did this by raising taxes, rather than cutting spending — but then, even the Gipper didn't have much success with the latter. In any event, efforts by Democrats to seize the moral and political high ground regarding fiscal responsibility came to a screeching halt in January 2001 when George W. Bush landed in the White House and the Republican Party firmed up its control of the House (where it has had a working majority since the 1994 midterm elections). The only setback for the GOP was the loss of its slim majority in the Senate, but that too proved a temporary stumbling block.

Notwithstanding these electoral successes of the Republican Party, President Bush surprised most of us by having his way so easily with congressional Democrats when it came to taxes. Bush shepherded three major tax reduction bills through Congress in his first three years in office, an impressive display of presidential leadership over the legislative process. Despite this, there has been remarkably little coherence to the Republican tax legislation enacted since 2000. Even long-time supporters of Republican tax policy have been heard lamenting the lack of ideological consistency and rationality behind the Bush tax policies enacted into law to date.[2] If a strong antitax Republican Party in control of both houses of Congress and the White House cannot enact ideologically coherent tax policy, then what does it take?

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There is little doubt that the Republican tax bills enacted in 2001, 2002, and 2003 all reflect the president's (and the GOP's) singular obsession with cutting taxes. (Didn't Paul O'Neill get fired for telling us this, as if we didn't already know?) Still, as a whole, Republican tax legislation is all over the place — cutting marginal rates a bit here (at least temporarily), reducing the tax burden on capital investment somewhat there, all without effectively implementing any coherent changes to the tax code anywhere. Despite a surprisingly strong and principled campaign by Bush's first chief economist (Glenn Hubbard) to take meaningful steps to integrate the corporate and individual income taxes, nothing came of his efforts except a reduced tax rate for dividends that distorts

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[1]Daniel Shaviro, "Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s," 139 *U. Pa. L. Rev.* 1 (1990): "Just as China in the 1960s has perpetual revolution, so the United States in the 1980s has perpetual income tax legislation."

[2]For example, Bruce Bartlett, a supporter and respected tax adviser within the Republican party, recently complained of the lack of ideological coherence of Bush tax policy: "Bush . . . cites no particular ideology or theory of economics to defend his tax policies. His speeches and statements on the subject consist of disparate arguments, seemingly assembled in an ad-hoc fashion." Bruce Bartlett, "Explaining the Bush Tax Cuts," *Commentary* magazine (June 2004), p. 23.

investment decisions and adds unnecessary complexity to the tax code as much as it solves the problem of the double taxation of corporate income. On the other front in the Republican war on federal taxes, the much-despised estate tax was phased out. But lo and behold, it abruptly phases back in after the year 2010 — much to the chagrin of tax professionals, who in the meantime must advise their clients on how to cope with the inconstant wealth transfer tax. (Maybe one day Mel Gibson will make a movie called *The Passion of the Estate Tax*, recounting the tortured existence, demise, and resurrection of the ''death tax.'')

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True, there is some evidence of Reagan era supply-side principles lurking behind the Bush tax legislation, but in the official justifications for the economic stimulation provisions included in the 2002 and 2003 acts, there also was a whole lot of lip service paid to the kind of pro-investment theories once espoused by the Jack Kemp wing of the GOP (and now advanced by Steve Moore of Cato and his Club for Growth). There also was a good deal of Keynesian thinking behind the stimulus package in the Jobs and Growth Tax Relief Reconciliation Act of 2003. The overall result was a mishmash of Republican tax policies thrown together into one big stew and dished out three times in the past three years — mercifully, with the last year off for the coming election. I guess that none of this should come as a surprise. The process for making public policy is distinctly a *political* process, and as such, it will seldom produce theoretically coherent or ideologically pure policy. This is true of all federal public policymaking — whether in health, education, environmental, or any other area of public policy. Tax policy is certainly no exception, especially when it takes its direction from politicos inside the White House, and even worse, political hacks outside the government altogether. (Does the name Grover Norquist ring a bell?) Alas, the day when nonpartisan professionals in Treasury made tax policy is long gone. For better or worse, the tax code is a *political instrument* made by politicians and used for political purposes.

This fundamental reality of U.S. tax policymaking bothers some — particularly economists, who have a low tolerance for unprincipled departures from a theoretically pure tax system. I sense that many young economists (as well as neophyte tax lawyers) get frustrated when they first realize that Washington policymaking has a logic all of its own when it comes to the tax code. They lament that it is *politicians* (not professional economists) who make our tax laws. They look with scorn at the political process that produces the theoretically flawed tax laws — laws that ''we'' (meaning Republicans, Democrats, labor, industry, and other assorted constituents) demand of our politicians. If some economists despair of the political nature of our tax system, Gene Steuerle is a notable exception.

Gene Steuerle is familiar to the readers of *Tax Notes* (wherein his column on tax policy regularly appears), as well as economists, tax professionals, and scholars of the income tax. He is a senior fellow at the Urban Institute in Washington, where he has been a fixture for years, and also is codirector of the Tax Policy Center (a joint venture of the Urban Institute and the Brookings Institution). Before entering the world of Washington think tanks, Steuerle was intimately involved in the political process that produces tax legislation, having served as Deputy Assistant Secretary for Tax Analysis in the Treasury Department during the second Reagan administration. Before that, he was involved in collecting and organizing the various reform proposals generated within Treasury into a single coherent proposal (commonly referred to as ''Treasury I''), which served as the starting point for the bill that was subsequently enacted as the Tax Reform Act of 1986. Of course, before that happened, Treasury's reform proposal (drafted by tax professionals) was tweaked by the politicos in the White House, to say nothing of those political fellows over in Congress. Perhaps because of his personal experience with the ''tweaking'' process, Steuerle is comfortable with and quite capable of grasping the subtle intricacies of the political process that generates our tax legislation. Most importantly, he takes as fact that tax policy is molded by the political process, and he looks to the political world for explanations of how and why tax policy has gone astray and, for that matter, how and why it has succeeded on occasion. In other words, he seeks to identify those ''principles'' that will guide us through the political quagmire toward an improved, albeit imperfect, tax policy. We may never get to the promised land, but at least we should know the right direction.

Steuerle's latest study of contemporary tax policy is an indispensable guide to anyone who wishes to understand the nature of the beast. *Contemporary U.S. Tax Policy* is really an updated, revised, and expanded version of his prior study, *The Tax Decade* (1992) — the classic study of tax policymaking in the 1980s. We now benefit from a revised and improved account of the Reagan years from the vantage point of over a decade of hindsight, which distance sharpens Steuerle's analysis and assessment. Most importantly, Steuerle provides new chapters covering the turbulent 1990s and the tax policies of the administrations of George H.W. Bush, Bill Clinton, and George W. Bush, as well as an overall appraisal of the major trends discernable in federal tax policy over the last half-century.

If there is an overarching theme in *Contemporary U.S. Tax Policy*, it is the lack of principle guiding contemporary tax policy. Steuerle also stresses the long-term budgetary problems that now set the framework for all policymaking. By the former, Steuerle mostly means the principles that guide professional economists and tax law academics in evaluating tax policy (efficiency, horizontal equity, vertical equity, and so forth). In the past, I have been critical of those who reify these terms as if they were neutral, scientific principles of taxation, rather than just loaded vocabulary masking a wide range of policy choices. (For example, tax academics state the principle of vertical equity — a graduated rate structure that imposes a proportionately higher effective tax rate on those with higher incomes — as if it is dictated by nonpartisan principles of economics, rather than merely the reflection of a preconceived and largely unexamined political preference as to who shall bear the burden or cost of government programs.) On the other hand, even if these academic principles reflect a distinctly ''liberal'' political ideology with which not everyone will agree, it still is nice to actually have *some* unifying principles behind our tax legislation. Otherwise, what you get is a nonpartisan, incoherent, unprincipled hodge-podge of overly complicated tax provisions — which, come to think of it, is exactly what the political system has dished up for decades now. It is not enough to have thoughtful tax professionals such as Gene Steuerle in the Treasury Department, on the staff of the Joint Committee on Taxation, and serving on the Hill at the Congressional Budget Office and the Congressional Research Service — and fortunately, we have such people willing to serve. It also is necessary for policymakers to listen to what they have to say. It also helps to have someone with some understanding of what makes for good tax policy in control of the tax legislative process — someone like Wilbur Mills, who for all his faults, still had a strong sense of the need to preserve the integrity of the tax policymaking process.[3]

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Pondering his own account of tax policymaking over the last 50 years, Steuerle draws insightful conclusions and offers instructive advice on how to improve the process so as to add principle and a bit of coherence to tax policy. By reviewing our past successes and failures, Steuerle believes that we can actually learn how to do things better. ''No matter how much badly designed tax policies stand as evidence that getting it 'right' is difficult, when good policies are enacted and revisions well timed, they remind us that political honesty, tenacity, and integrity can help create a better, more efficient, and equitable system.''[4] Personally, I am more pessimistic about our chances of learning from the past, but I have to admit that Gene Steuerle's optimism is refreshing. By way of reform proposals, he suggests ''strengthening the governmental processes and institutions'' within which tax policy is made. His list of perfectly sensible proposals includes strengthening the tracking, accountability, and enforcement capabilities of the IRS, pursuing nonpartisan Treasury appointments and a nonpartisan use of the staffs of the Senate Finance and House Ways and Means Committees, and enhancing the role of the Office of Management and Budget (OMB) in the budgetary process.[5]

Of course, who would disagree with these suggestions? Probably no one, other than the politicians who actually control the tax policymaking process and like it just the way it is. Indeed, they are the ones who made it what it is precisely because it suits their purposes and satisfies their interests and needs as dictated by the political institutions and electoral processes within which they operate. For non-political-scientists in the audience, that means they use the tax code to help get themselves reelected. That's why the House bill to repeal the Extraterritorial Income provisions includes a $10 billion subsidy for tobacco. The really tough problem is designing an alternative institutional framework and processes which will yield an improved mode of tax policymaking. At the same time, thinking about improving the tax policymaking process inevitably leads us to ask: What happened to make things worse? Why did Congress once adequately fund and support the IRS, but then turn on its own tax bureaucracy? Why did the chief executive once solicit and actually follow nonpartisan advice from Treasury professionals, rather than the pollsters and politicos? And why did Ways and Means formerly function as a gatekeeper to exclude special interest provisions, but today let everything get through?

There are no easy answers to these questions, and even if we could identify the institutional mechanisms that would recreate these prior modes of tax policymaking, there is no guarantee that we could ever muster the political willpower necessary to do so. The 535 members of Congress would have something to say about that. Indeed, I suspect that Washington politicians are now getting a tax policymaking process that, having been refined and perfected over decades, is wholly suited to their political needs and interests as elected officials, which explains why tax reform á la TRA 1986 is just not happening anymore.

Regarding the budgetary problems that inform tax policymaking, Steuerle has a lot to say — all of it interesting and useful to policymakers, if only they will listen.

Regarding the budgetary problems that inform tax policymaking, Steuerle also has a lot to say — all of it interesting and useful to policymakers, if only they will listen. First, he underscores the important change that set in when perennial deficits altered the framework for tax policymaking. In retrospect, we can see that the deficits experienced during the early Reagan years following the 1981 tax act were a harbinger of things to come, although

[3]The best analysis of Wilbur Mills and his masterful chairmanship of the House Ways and Means Committee is Julian E. Zeilzer's, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (New York: Cambridge University Press, 1998).

[4]Steuerle, *Contemporary U.S. Tax Policy* at 257.

[5]*Id.* at 253.

those deficits were produced by a combination of reduced revenue attributable to the tax cut, an economy heading into recession, and increased spending on the military by the Reagan administration. Likewise, in retrospect we can see that the indexing of tax rates in 1981 was a turning point in the history of contemporary tax policy, as it marked the end of an era of ''easy financing'' (in Steuerle's memorable phrase) and the beginning of perennial budget shortfalls. With pragmatic tax increases enacted in 1982 and 1984, as well as the subsequent turnaround in the economy, deficits as a percentage of GDP declined during the second Reagan administration. However, that was temporary, and by 1990 it was clear that there was an endemic and institutionalized imbalance between revenue and spending. The budgetary rules enacted in 1990 pursuant to an agreement between the Bush administration and the Democratic Congress (for example, ''pay-go'' budgeting and caps on discretionary spending) improved the budgetary process and had a real effect on the problem of uncontrolled deficits. Steuerle properly praises those budget rules. A long-term price will surely be paid for the shortsightedness of the Republican leadership in Congress that allowed them to expire.

The other big factor in creating the constricted budgetary framework for policymaking is the rise and seemingly uncontrolled expansion of the so-called entitlement programs — most prominently Social Security. Beyond his expertise in income taxation, Steuerle is also an authority on Social Security, having coauthored an excellent book on how to reform that flawed program.[6] Talking about tax policy without mentioning the fiscal imbalance and impending collapse of Social Security (as well as Medicare) is like ignoring the 600-pound gorilla sitting on your couch. Steuerle understands the program and offers sobering advice for those willing to confront the gorilla — a retirement system out of actuarial balance that threatens the long-term fiscal stability of the federal government.

[6]C. Eugene Steuerle and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform* (Urban Institute Press, 1994).

Looking back with nostalgia on the bipartisan coalition that produced TRA in 1986, Steuerle proposes a comparable approach to the current mess. He calls for a ''grand budget compromise'' to resolve the problems of the tax system and the retirement program, a compromise between ''those who would allow retirement and health programs to continue to grow without bound and those who would continually prescribe tax cuts into the future.''[7] Normally, I would be pessimistic as to the likelihood that ''tax and spend'' Democrats and antitax Republicans will ever come to their senses, join hands across the table, sing ''Kumbaya,'' and reach a ''grand compromise.'' But perhaps fiscal reality will eventually set in and bring politicians from both sides of the aisle to the bargaining table, despite the inherent shortsightedness of a political process that leads politicians to postpone addressing problems until they loom much closer on the horizon. By nature, our political process focuses on today's crises, ignoring the crisis that is coming down the road — even if it's a 600-pound gorilla. Still, we can always hope that statesmen will emerge who will take a long-term view and lead Congress and the White House in the right direction before it's too late. Alas, Pat Moynihan, that great giant in Washington politics, is gone, and surely no one will ever fill his shoes. If we are lucky, Gene Steuerle's excellent new book, *Contemporary U.S. Tax Policy*, will help those of shorter stature see the way.

[7]Steuerle, *Contemporary U.S. Tax Policy* at 255.

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