HANDBOOK OF GOVERNMENT BUDGETING

ROY T. MEYERS

EDITOR

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Editor

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CONTENTS

List of Figures, Tables, and Exhibits xi

Preface xv

The Editor xxi

The Contributors xxiii

PART ONE: AN OVERVIEW OF GOVERNMENT BUDGETING 1

1 Features of the Budgetary Process 3
Jerry McCaffery

2 Understanding the Role of Conflict in Budgeting 30
Irene S. Rubin

3 Financial Management Reform in the Federal Government 53
L. R. Jones, Jerry McCaffery

4 Budgetary Management in the United States and in Australia, New Zealand, and the United Kingdom 82
A. Premchand

PART TWO: CREDIT MARKETS, THE ECONOMY, AND BUDGET BALANCING 117

5 Understanding and Using Government Financial Statements 119
John H. Engstrom

6 The Changing World of State and Local Debt Finance 157
Merl Hackbart, James R. Ramsey

7 State and Local Government Budgeting: Coping with the Business Cycle 178
Michael Wolkoff

8 The Federal Budget and Economic Management 197
Van Doorn Ooms, Ronald S. Boster, Robert L. Fleegler

9 The Rhetoric and Reality of Balancing Budgets 227
Naomi Caiden

PART THREE: TAXATION IN BUDGETING 253

10 The Major Tax Bases 255
Jane G. Gravelle

11 Addressing Tax Expenditures in the Budgetary Process 277
Bruce F. Davie

12 Practical Methods for Projecting Revenues 308
Stuart Bretschneider, Wilpen L. Gorr

13 The Politics of Taxation 332
Sheldon Pollack

PART FOUR: THE INFORMATIONAL FOUNDATIONS OF BUDGETING 355

14 The Bases of Accounting for Budgeting and Financial Reporting 357
James L. Chan

15 Cost Measurement and Analysis 381
Fred Thompson

16 Information Technology for Financial Management 412
Rowan Miranda

PART FIVE: BUDGETING BY INSTITUTIONS 439

17 Preparing Agency Budgets 441
Jacqueline H. Rogers, Marita B. Brown

18 Examining Budgets for Chief Executives 462
Barry White

19 Legislatures and Budgeting 485
Roy T. Meyers

20 Courts and Fiscal Decision Making 502
Phillip J. Cooper

PART SIX: POLITICS, MANAGEMENT, AND ANALYSIS IN BUDGETING 527

21 Cutback Budgeting 529
James D. Savage, Herman M. Schwartz

22 Strategies for Spending Advocates 548
Roy T. Meyers

23 Budget Implementation 568
Rebecca Hendrick, John P. Forrester

24 Performance-Based Budgeting 597
Philip G. Joyce

25 Analytical Techniques for Budgeting 620
Marvin B. Mandell

PART SEVEN: BUDGETING OVER TIME FOR LARGE AMOUNTS 651

26 Budgeting for Capital Improvements 653
Robert L. Bland, Wes Clarke

27 Budgeting for Entitlements 678
Joseph White

28 Budgeting for Contingent Losses 699
Marvin Phaup, David F. Torregrosa

CONCLUSION 721

29 The Future of Government Budgeting 723
Roy T. Meyers

Name Index 739

Subject Index 749

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CHAPTER THIRTEEN

The Politics of Taxation

Sheldon Pollack

Budgeting addresses one of the fundamental questions of politics: How shall the resources of the government be employed? A budget is a map or blueprint for what political scientists refer to as the authoritative allocation of resources by the state. But for the U.S. government, the budget is only one side of this allocation; public finance is the other. How the government raises the revenue that finances its various activities ultimately dictates who pays what, when, and how. The nature, structure, and incidence of a system of public finance all have an impact on how the various economic and social interests of civil society will share the burden of government, that is, who will pay for the appropriations authorized in the budget. The design of a system of public finance determines how the economic burden will be distributed and hence raises political issues of the utmost importance.

In the twentieth century, the income tax has been the principal source of revenue of the U.S. government. The great revenue brought in by this tax financed two worldwide military campaigns and made possible (along with payroll taxes) the establishment of a social welfare state in the 1930s. The post–New Deal U.S. state has been funded largely through the income tax. Because of the centrality of income taxation to public finance, the politics of the income tax is

Note: The author wishes to thank David Beam for his many useful comments and suggestions on this chapter.

the politics of revenue in the United States. The particular structure of the income tax is thus a constant concern of federal policymakers as well as of an army of Washington lobbyists representing special interests who are jockeying for political favors bestowed through the tax code. The many exemptions, deductions, credits, and social policies written into the tax laws express political decisions and bargains—just as appropriations in the federal budget express political decisions and bargains over the funding of particular public policies and programs. As such, the federal income tax is a *political instrument* that effects an authoritative allocation of resources.

Although the tax laws (like the budget) allocate resources among various economic, social, and regional interests, the politics of taxation is quite distinct from the politics that prevails over the budgetary process in the appropriations and budget committees. Tax policy is expressed in its own distinct language—the arcane language and technical jargon of tax law. Likewise, the politics of taxation takes place in its own distinct political arena—the House Ways and Means Committee and the Senate Finance Committee. Although tax policy proposals commonly originate in the White House, and although congressional leadership and committee staff (that is, the staffs of the Joint Committee on Taxation, the Ways and Means Committee, and the Finance Committee) have considerable influence over the course and success of tax policy initiatives, the tax laws are mostly the product of the agreements and bargains struck by and among the most powerful members of the tax committees. The chairs of the tax committees play a dominant role in shaping tax bills through their markup of legislative proposals. Presidents may set the agenda for tax policy by initiating legislative proposals, but tax bills are largely the handicraft of the tax committees.

Because tax policy is made by elected politicians, decisions inevitably reflect compromise, consensus, and coalition building as well as partisan politics. Elected politicians must carefully cultivate support for their revenue policies (especially those that increase taxes) because they are ultimately accountable to the electorate. Furthermore, tax policy is highly susceptible to the pressures and influence of powerful, organized interest groups in the districts of congressional policymakers. This was recognized by T. S. Adams in his 1927 presidential address to the annual meeting of the American Economic Association: "Modern taxation or tax making in its most characteristic aspect is a group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. It is, first of all, a hard game in which he who trusts wholly to economics, reason, and justice, will in the end retire beaten and disillusioned" (Adams, 1928, p. 1).

It is this politics of taxation—the "hard game" played by presidents, committee chairmen, congressional leadership, and powerful organized interests—that is the subject of this chapter. What, then, are the motives, goals, and interests of the politicians who formulate U.S. tax policy?

POLITICS AND REVENUE

The revenue policy of any state inevitably reflects a complicated calculus of decision making. Policymakers take into account numerous interests and goals dictated by the overall constitutional structure of the regime. As political scientist Sven Steinmo (1993, p. 10) has put it: "Politicians want to be reelected, bureaucrats want to manage a stable and efficient tax policy, and interest groups want to promote the well-being of their constituents. But how these general desires get translated into specific policy preferences and specific political strategies depends upon the rules of the game; and the rules of the game are written by the institutions through which the game is played." Thus, to make sense of the politics of taxation in the United States, it is first necessary to understand the rules of the game—namely, the political processes and institutions through which the tax laws are made.

The political institutions and procedures for legislation established under the U.S. Constitution are important but do not alone define the rules of tax policymaking. The extraconstitutional party system that evolved in the early nineteenth century has also had an important impact on the legislative process. The officials who write the tax laws are politicians who must periodically seek reelection. Their very claim to office is dependent upon winning election in their local district or home state. Elections link congressional policymakers to their constituents. Much has been written by political scientists about how this "electoral connection" influences the behavior of members of Congress, who introduce legislation and seek credit for the introduction of favorable legislation, and about how the actual distribution of government benefits constituents in their home districts (Mayhew, 1974; Fiorina, 1977). It is because of the electoral connection that the tax legislative process is so susceptible to the pressures and entreaties of interest groups located in the local districts or states of the most important members of Congress.

Although this side of the politics of taxation is important, tax policy is much more than the product of interest group politics. The politicians who are in control of the tax legislative process pursue other political interests and goals as well through the tax laws. Because U.S. tax policy is made within the context of a competitive party system, it is highly partisan. The same elected politicians who represent local districts must also operate within Congress as members of their political party. Although members of Congress do not always vote with their party, party affiliation remains the single most important factor in predicting voting behavior (Schneider, 1979). In the 1980s and 1990s, voting on major tax legislation has pretty much followed strict party lines as Democrats and Republicans have used the tax code to implement much of their respec-

tive partisan agendas and have consistently voted against each other's partisan proposals.

The U.S. political culture is also important in defining the environment for the tax legislative process. Endemic to this political culture is a strong, native strain of antitax politics that surfaces from time to time. Individual politicians or entire political parties express this antitax rhetoric periodically. In the twentieth century, the Republican party has generally carried the antitax banner; Democrats too, however, have found this a useful campaign theme. Occasionally the antitax message prevails and is translated into public policy—as in the major tax bill of 1981 and to a lesser extent the tax legislation enacted in 1997.

Finally, Congress is charged under the Constitution with the great responsibility and burden of raising the enormous revenue required to pay for the activities of the federal government. A good deal of the time of members of the tax committees is spent scrambling to find the revenue to fund the proposals authorized in the budget. This is especially the case in light of the requirement for "revenue neutrality" imposed on the tax and budget committees under the so-called pay-as-you-go (or PAYGO) rule in the Congressional Budget Act of 1974, as amended by the Budget Enforcement Act of 1990 [2 U.S.C.A., secs. 633(c), (f), and 902]. Every bill that gives away revenue through some new, special tax preference must be accompanied by offsetting savings. This requires the tax committees to come up with new revenue or to cut entitlement spending, most of which is Social Security and Medicare. Accordingly, a constant and unrelenting search for revenue is behind much of the politics of taxation. Political and electoral constraints make raising revenue a very difficult feat for politicians. Policymakers must carefully build support for any tax increase, putting together broad coalitions and cultivating acceptance among the electorate.

To summarize, tax policy is made within the confines of political institutions (Congress and its committees) and strongly influenced by the electoral connection (elections and party competition). Policymakers act within a complex environment, motivated by competing goals and interests defined by the constitutional structure and influenced by the antitax tradition of the U.S. regime. Within this context, members of Congress and the tax committees use the tax code as an instrument to further what are, in essence, three main functions—raising revenue, serving constituents, and implementing partisan policies. Tax policy is often at odds with itself because congressional policymakers use the tax laws for these disparate and often conflicting purposes. (These functions are explored further in coming sections of this chapter.)

Elsewhere I have argued that because the tax laws are used in this manner, contemporary U.S. tax policy has become increasingly unstable and unpredictable, highly partisan, and exceedingly complex (Pollack, 1996), which has

had undesirable consequences for U.S. tax policy. The highly erratic pattern of tax policymaking and the explosion in the volume and complexity of tax legislation and regulations enacted in the 1980s and 1990s bear witness to this. Conversely, it must be acknowledged that the income tax remains remarkably successful in satisfying so many of the political interests of policymakers at once, while at the same time raising the enormous revenue that it does—an amazing $919 billion in 1997.

REVENUE AND PREDATION

Officials of any state face a common concern: raising revenue to fund the various activities of the state, ranging from military campaigns to social welfare programs. The particular method employed varies from regime to regime, but one way or another officials must extract revenue from civil society to support the state. In authoritarian regimes, raising revenue may take the guise of outright seizure—the state plundering civil society. Elsewhere, where civil society is better organized to resist state predation, state officials must negotiate for revenue with the major social and economic interests. This requires state officials to offer a tacit *quid pro quo*—protection, order, and public goods in exchange for revenue. In such cases, revenue is generally raised through regular, institutionalized methods of extraction.

Modern states use a variety of such methods, such as custom duties, user fees, and tariffs. In some cases, state-owned economic business enterprises generate revenue for the government. Taxation, however, is the primary method used by modern states to finance their activities; all the other methods of public finance merely supplement the revenue raised by taxation in its various forms. Everywhere the underlying relationship between taxation and the modern state is the same: "Taxes are the source of life for the bureaucracy, the army, the priests and the court, in short, for the whole apparatus of the executive power" (Marx, [1852] 1977, p. 320).

That the state must raise revenue to survive is obvious, but some theorists carry this observation one step further. They argue that state officials seek to *maximize* state revenue as predatory rulers. For example, economists Geoffrey Brennan and James Buchanan (1980) portray the state as an unrelenting Leviathan constantly seeking to maximize its own revenue. They base their analysis on the single premise that the state behaves like a monopolist seeking to maximize its own profit. The state as monopolist imposes taxation so as to maximize its revenue, ignoring the excess burden (or deadweight social loss) imposed on society and the private economy. From this perspective, the goal of politics becomes one of circumscribing constitutional boundaries around the state to limit the Leviathan's self-aggrandizing tendencies. Political scientist

Margaret Levi (1988) offers a similar and in many ways more sophisticated political theory of predatory rule, arguing that "rulers are predatory in that they try to extract as much revenue as they can from the population" (p. 3).

Although there is a certain appeal to the notion that revenue maximization motivates state officials, in practice predation theory just does not explain very much about the politics of taxation in the United States—or more properly, it explains only one aspect of the politics of taxation. Unlike the French and English monarchs of the sixteenth century (bona fide revenue predators), national political elites in the United States have always lacked both the institutional power and the political will to engage in predatory revenue policy. As a result of the peculiar institutional development of the American state, the national government lacked significant centralized powers until well into the twentieth century (Skowronek, 1982). At its inception, the American state was expressly designed through its original constitutional structure to *deny* the federal government easy access to revenue. Under the first, ill-fated constitution of the states—the Articles of Confederation (1777–1789)—the national government was itself denied the power of direct taxation. Rather, it was dependent upon the state governments to collect and pay revenues, which the states often did not do. Although the U.S. Constitution of 1789 strengthened the central government's fiscal powers, those powers were still limited, especially with respect to raising revenue. So, lacking the institutional power to raise revenue, much less to engage in predatory revenue policy, the nineteenth century American state relied on a hodgepodge system of excise taxes and custom duties, supplemented by the occasional sale of public lands, to fund its rather minimal activities. Actually, this system was adequate in financing the limited activities of the federal government—until the Civil War, when the administrative capacities of the federal government were expanded far beyond its traditional nineteenth-century functions. To supplement federal revenue, an income tax was enacted in 1860. It was allowed to expire soon after the war.

Throughout the nineteenth century, the U.S. government was largely financed by tariffs—commodity-based consumption taxes on imported goods and materials. The tariff was a highly successful source of revenue that regularly produced annual budget surpluses for the federal government (Savage, 1988). Nevertheless, political and regional pressure mounted to replace the tariff with an income-based tax, and opposition to the tariff emerged as the defining political issue of the era. "During the 1880s and 1890s, the two competing political parties came to base their economic appeals on sharply conflicting ideological views of the tariff and of taxation in general" (Brownlee, 1996, p. 35). Calls for a graduated income tax first appeared in the 1877 and 1878 platforms of the Greenback party, and again in the 1880 platform of the National Greenback party. The Grangers, the Knights of Labor, and the Farmers Alliance favored an income tax, as did the Populist party in each of its platforms. From

1874 to 1894, no fewer than sixty-eight bills proposing an income tax were introduced in Congress.

The constituents of the political parties understood that replacing the tariff with an income tax meant shifting the burden of public finance away from southern and midwestern agrarian interests and onto northern manufacturing interests and wealthy individuals. The intensity of the politics reflected the salience of the issue for the interests, groups, and regions that were affected. A new federal income tax was finally enacted in 1894, largely at the instigation of Populists in the Democratic party. The politics of the federal income tax of 1894 (which was subsequently held unconstitutional by the U.S. Supreme Court) and that surrounding the subsequent ratification of the Sixteenth Amendment in 1913 were highly partisan and reflected the economic and regional cleavages.

Ironically, the enactment of a new federal income tax, a minor revenue bill attached to the Underwood-Simmons Tariff Act of 1913, proved anticlimactic once the constitutional question was resolved. Reflecting political compromise, the income tax of 1913 applied to only a few of the wealthiest citizens. This was accomplished through a generous $3,000 personal exemption that rendered only a relatively small and well-defined stratum of the citizenry subject to the income tax. For 1913, the first half year under the tax, only 0.8 percent of the population had sufficient income to subject them to taxation; only 358,000 individuals filed income tax returns reporting net taxable income. For these people, the tax was imposed at 1 percent on personal income above $3,000, increasing to 6 percent on income over $500,000. With a 1 percent surtax, the maximum marginal tax rate reached 7 percent. In 1913, the corporate and individual income tax together raised only $28 million. In 1914 (the first full year of the tax), the income tax provided just 7.37 percent of total receipts of the federal government.

Although the new income tax was initially only a minor supplement to the tariff, the increased demand for revenue during World War I forced congressional policymakers to expand the tax. This was easily accomplished by reducing personal exemptions and raising tax rates. In addition, corporate rates were raised and an excess profits tax was enacted. By the end of the war, the top marginal tax rate soared to 77 percent on income over $1 million. Personal exemptions were lowered to $1,000 for single taxpayers and $2,000 for married taxpayers. These changes in the rate structure of the income tax shifted the burden of the tax from being exclusively on the very wealthy to include middle-income taxpayers. (Even still, at the height of the war only a minority of the citizenry was ever subject to the tax; no more than 20 percent of the population was required to file tax returns.) When the steeply graduated income tax was applied to a wider spectrum of the population, it produced revenue beyond anything previously imagined. By 1918, revenue from the wartime income tax and excess profits tax supplied 63.1 percent of total federal receipts, and revenue

from the tariff and all other excise taxes declined to 28.7 percent. The income tax supplanted the tariff as the principal source of federal revenue.

Tax rates were reduced significantly during the 1920s during successive Republican administrations. President Warren G. Harding left tax policy mostly to his treasury secretary, Andrew W. Mellon, who led his famous campaign for a return to "tax normalcy." Although tax rates were lowered throughout the 1920s, budget surpluses were actually generated, and the relative contribution of the income tax to total federal revenue increased. By the end of the decade, tax rates and federal expenditures had been returned to prewar levels and the federal income tax was pretty much what it had been in 1913. This situation changed dramatically with the onset of the Second World War.

It is often said that World War II transformed the federal income tax from a "class" tax into a "mass" tax. Before the war, only a few wealthy citizens were subject to the income tax. By the end of the war, the vast majority of U.S. citizens had become taxpayers. The Revenue Act of 1942 lowered personal exemptions to only $500 for individuals and $1,200 for married couples. This expanded the application of the tax to the vast majority of the citizenry. Evidence of expansion of the tax base was the number of tax returns filed by individuals, which increased nearly eightfold from 1940 to 1945. The number of individuals subject to the income tax increased over the course of World War II, eventually reaching more than 74 percent of the population. In addition, the Revenue Act of 1942 raised the normal personal income tax from 4 percent to 6 percent and added a progressive surtax ranging from 13 percent on income over $6,000 to 82 percent on income over $200,000. By 1944, the top marginal tax rate rose to 94 percent for individuals (on income in excess of $2,000,000) and 40 percent for corporations (in addition to the excess profits tax).

As income tax rates were increased and exemptions lowered during the war, the volume of revenue collected increased dramatically. Total receipts from the income tax rose sevenfold, and revenue derived from both corporate and individual taxes combined increased to $34 billion for 1945. The impact of World War II on the structure and function of the federal income tax can be summarized as follows: tax rates increased, personal exemptions were lowered, revenue increased, and a majority of the population became subject to the tax. Most significantly, the changes made to the tax code to finance World War II were not withdrawn after the wartime crisis ended, as had been the case following the World War I. In 1950, 59 percent of the population was subject to the individual income tax; the figure increased to 81 percent by 1970. Revenue from the individual income tax, which provided more than 45 percent of federal receipts at its wartime peak in 1944, has since remained at a constant 40 to 45 percent of federal receipts.

Since World War II, the income tax has been the cornerstone of the system of public finance in the United States. For fiscal year 1997, the corporate income

tax provided 11.5 percent of federal revenue and the individual income tax provided 46.7 percent, collectively totaling $919 billion—significantly exceeding prior budget revenue estimates. Revenue from the income tax was supplemented by wage taxes (34.2 percent), the federal estate and gift tax (1.3 percent), excise taxes (3.6 percent), and miscellaneous user fees (2.7 percent). These other sources of revenue are hardly insignificant, and in an era of budget deficits and revenue neutrality all sources of revenue must be pursued. But it is the income tax that finances the activities of the modern American state. This is especially the case given that the revenue raised by federal wage taxes (imposed at a total rate of 15.3 percent on the $68,400 wage base and at 2.9 percent on wages above that amount for 1998) is specifically earmarked for the various social security programs. Separating social security from the rest of the activities of the federal government, the income tax provides some 88 percent of the revenue for those programs.

Most interesting, although the income tax has enormous capacity to raise revenue, policymakers obviously do not use the income tax to *maximize* revenue for the state, except during the revenue crises experienced during most wars. In peacetime, policymakers find it irresistible to use the income tax for political purposes—which typically means introducing legislation to *reduce* taxes for favored interests and groups or implementing public policies through tax preferences that likewise reduce taxation for favored investments or programs. Such unabashed political use of the federal income tax makes little sense from the perspective of the state's purported interest in maximizing revenue. It makes all the sense in the world, however, relative to the perspective, interests, motives, and goals of individual congressional policymakers. Their political interests dictate in favor of using the income tax to cultivate support among constituents and to implement public policies through the tax code. This results more often in pork barrel tax legislation than in revenue predation.

Although revenue concerns constantly press upon federal policymakers, their behavior hardly comports with a model of revenue predation. The expanding tax expenditure budget, more than twenty years of budget deficits, and a national debt of $5.5 trillion bear witness to this. It is not that policymakers are inept as revenue predators. Rather, they are subject to considerable political pressure from constituents to help alleviate the impact of the highly progressive rate structure of the income tax. As politicians, policymakers are highly skilled at using the tax laws to assist constituents in order to enhance their own political standing. The politics of taxation necessarily involves raising revenue, but raising revenue requires the consent and support of constituents and political parties. As Irene Rubin (1997, p. 66) has put it, "The politics of taxation is not a politics of coercion, it is a politics of persuasion." It should be added that the politics of taxation is also a politics of accommodation—distributing benefits to supporters and constituents through the tax code. Rather than would-be

Leviathans, federal policymakers are rational politicians who use the tax laws for a variety of political purposes.

PARTISAN POLITICS AND THE INCOME TAX

One of the main uses of the income tax by politicians is as a means for implementing their partisan agendas. This use of the federal income tax reflects the fact that early in the history of the nation the major political parties cultivated their own very distinct fiscal and tax policies. In the nineteenth century the parties were sharply divided over the use of tariffs. Later the conflict was over income taxation. Since the modern income tax was enacted in 1913, Democrats and Republicans have disagreed on many substantive issues of tax policy—even while finding considerable bipartisan agreement over a wide range of policies (the oil and gas depletion allowance, the deduction of charitable contributions, and increases in social security benefits, to name a few). When each party has been in control of the legislative process, is has enacted a good deal of its partisan agenda through the tax laws.

Democrats are responsible for a wide assortment of partisan tax policies: tax credits for low-income earners, housing, and education; the deduction of home mortgage interest to encourage home ownership; tax preferences for employee stock ownership plans (ESOPs) and retirement plans to benefit labor; limits on executive compensation; and preferential tax treatment for employer-provided health insurance. Democrats favor a steeply progressive income tax with high rates for the wealthy and tax preferences for the constituents of the Democratic party—labor, unions, the poor, and so on. A significant portion of the social welfare state of the United States is funded through "indirect spending" via the tax expenditure budget (Howard, 1997). Republicans have pursued a similarly wide range of social and economic policies through the tax code. Their tax policies are designed to implement some of the most fundamental tenets of the Republican party: broad income tax cuts to stimulate the economy, preferential tax treatment for capital gains, tax-favored economic enterprise zones as a cure for urban blight, and various tax credits and expenditures aimed at encouraging savings, investment, and the accumulation of capital. The list goes on and on. The most significant difference between the tax policies of congressional Democrats and Republicans lies in the particular policies they choose to write into the tax laws, rather than in whether or not to use the tax laws to implement policies.

Why have policymakers in both parties found the tax code such an inviting vehicle for implementing public policies? The tax legislative arena has proved to be generally more accessible and hospitable to the personal interests, ambitions, and goals of individual congressmen than the arena of budgeting and

appropriations. It is simply easier to provide constituents with benefits through the tax code than through direct budgetary expenditures (Reese, 1980, pp. 198–201). Tax expenditures are often highly technical and hence are less visible to the public (and the media) than direct budgetary expenditures. The members of the tax committees are particularly advantaged in providing such tax preferences to constituents; higher levels of campaign contributions are evidence of the importance of such strategic committee assignments (Manley, 1970; Strahan, 1990). Once adopted, programs enacted through the tax code typically have an indefinite life rather than requiring annual authorization as budgetary programs do. For these reasons, partisans on both sides of the aisle find the tax code to be a convenient instrument for implementing their favored public policies. As a result, the tax laws, ostensibly designed to raise revenue, provide all sorts of economic incentives that reduce the tax burden for those who engage in favored behavior. Public policies executed through tax preferences erode the tax base and reduce revenue for the Treasury. They also are a less efficient means of funding public policies, because tax benefits are distributed too broadly, with some of the economic incentives going to those who would have engaged in the favored activity without the tax preference. Furthermore, the revenue loss from tax preferences is difficult to predict and control because statutes are open-ended invitations to an unlimited number of taxpayers to take advantage of the favored tax treatment. Notwithstanding these shortcomings, the use of the tax laws by congressional policymakers in pursuit of their own political agendas is an integral component of the normal politics of taxation.

TAXATION AND CONSTITUENCY SERVICE

Beyond the expenditures that implement partisan agendas, the tax preferences that congressional policymakers find most conducive to satisfying their ambitions and goals as elected politicians are those targeted to their own constituents. Politicians use the income tax to cultivate support from the dominant economic and social interests in their districts and states. The congressperson as ombudsperson introduces amendments to the income tax that are intended to protect and enhance the economic well-being of local interests and constituents. In this way the income tax code is also used as a nonpartisan vehicle for politicians, Democrats and Republicans alike, to curry favor with constituents, resulting in numerous special-interest provisions buried within the arcane language of the income tax code. A significant portion of the eight hundred or so major sections of the federal income tax are dedicated not to raising revenue but rather to implementing policies that effectively reduce federal revenue by allowing special deductions, exemptions, or credits for favored groups, interests, or policies.

The tax expenditure budget that Bruce Davie describes in Chapter Eleven provides evidence of the use of the tax code by congressional policymakers as a tool for implementing public policies and distributing benefits to constituents via special tax preferences. Because policymaking through tax expenditures is relatively easy and conducive to the political and electoral needs of representatives and senators, it has become a common mode of congressional policymaking in the postwar era. Stanley Surrey and Paul McDaniel (1985) calculated that the volume of government spending through tax expenditures increased by 179 percent from fiscal year 1974 to fiscal year 1981 (Surrey and McDaniel, 1985). Reform efforts in 1986 went far in eliminating many special tax preferences and reduced the rate of growth in the tax expenditure budget. The spending spree picked up steam again, however, in the late 1980s and early 1990s. A recent study by the U.S. General Accounting Office (1994) estimated that tax expenditures totaled almost $402 billion in 1993 and would continue to increase annually by 4 percent. That projection turned out to be fairly accurate. According to the president's budget for FY96, the revenue loss attributable to federal income tax expenditures was $533 billion—a 5.2 percent increase over 1995. For fiscal year 1997, the total revenue loss attributable to tax expenditures was $554 billion—a 4.1 percent increase over 1996. Projections for fiscal year 1998 put the figure at $567 billion, showing a modest reduction in the rate of increase in the tax expenditure budget. Although measurement of the total revenue loss attributable to tax expenditures is problematic (as Bruce Davie explains in Chapter Eleven), these figures provide evidence of the overall tendency of policymakers to spend through tax expenditures.

One revealing example of how the tax laws are used by politicians to curry favor with local interests can be found in the legislation crafted by congressional Republicans in 1995 to implement their partisan agenda. A massive tax bill was included in the omnibus revenue bill known as the Seven-Year Balanced Budget Reconciliation Act of 1995. Even while trying to implement their party's policy agenda (the so-called Contract with America), the politicians on the tax committees could not resist the opportunity to introduce some special provisions designed to advance the economic well-being of constituents. For instance, Republicans on the Ways and Means Committee included in the House draft three provisions for the funeral industry. Although these were minor provisions with limited revenue impact (collectively losing only $500,000 in annual revenue), the only justification for including them in the bill was that four committee members had particularly close ties to family-run funeral businesses. Senate Republicans had their own list of special-interest provisions buried in the tax bill. Indeed, every Republican on the Senate Finance Committee, except for conservative presidential candidate Phil Gramm of Texas, had inserted a special-interest provision into the Senate bill. Beneficiaries (and their respective supporters on the committee) included newspaper companies (Robert Dole of

Kansas), small gas and electric companies (William Roth of Delaware, the home of the Delmarva Power & Light Company), water utilities and real estate developers (Charles Grassley of Iowa), college football coaches (Orrin Hatch of Utah, a close friend of Brigham Young University's football coach), life insurance companies (Alfonse D'Amato of New York), and independent gasoline marketers (Don Nickles of Oklahoma).

None of these special-interest provisions actually made it into law, because President Clinton vetoed the bill in December 1995. But proposals such as these circulate every time a tax bill is crafted and many eventually find their way into the tax code. The Taxpayer Relief Act of 1997 reads like a Christmas list of special tax provisions targeted at constituents of the Republican party. For example, the legislation reduced the maximum tax on capital gains for individuals to 20 percent (a perennial goal of Republicans since the preferential rate for capital gains was repealed in 1986), lessened the burden of the corporate alternative minimum tax and eliminated it altogether for small business corporations, and increased current exemptions to the federal gift and estate tax—as well as creating an entirely new $700,000 exemption for owners of small businesses and farms. The Republican bill also included provisions expanding the availability of individual retirement accounts (IRAs) and creating the new Roth IRA (named after Senate Finance Committee chairman Roth, who now has the dubious honor of being the only individual having a section of the tax code named after him). Because any tax bill requires a broad, nonpartisan coalition behind it, Republicans were forced to make concessions to Democrats. The Clinton administration was behind several new education tax credits, a provision that effectively eliminates tax on the sale of a home, and proposals to shut down certain "abusive" financial transactions designed by Wall Street investment firms to allow clients to defer gain realized on stock and securities. These provisions had originally been proposed by the Clinton administration in 1995 in response to the Republican party's Contract with America tax bill and were included in the 1997 tax bill as a compromise to secure the president's support (or at least tacit acceptance) of the bill.

None of this is to suggest that Republicans are any more prone than Democrats to use the tax laws for constituency service. The Democrats, who controlled Congress and the tax committees for decades before 1994, used the tax laws for the very same purposes, favoring their own constituents and implementing their own partisan agenda through the tax code. Both sides of the political spectrum appear equally enamored of the electoral benefits derived from using the tax code to provide nonpartisan constituency service to the home district. The point is that even those who campaign on a strong antitax theme are all too ready to use the tax laws to distribute benefits to their own constituents.

In the context of the two-party system in place since World War II, consensus is required to enact the kind of massive, omnibus tax legislation that has

become commonplace. This consensus is achieved through a wide dispersal of benefits to produce majoritarian coalitions of convenience. A nonpartisan pattern of trading votes for tax benefits (logrolling) insures passage. This practice has been the norm for postwar tax legislation. The resulting tax policy has left the tax code riddled with a dizzying array of tax credits, preferences, and deductions which in turn create pressure on the rate structure of the income tax as policymakers struggle to make up the revenue shortfall attributable to the tax expenditures. The overall result is a steeply graduated rate structure, a broad tax base, and numerous tax expenditures granting relief to constituents of both political parties. The result is a "piecemeal, complicated, inconsistent, and inequitable tax structure that periodically needs overhauling" (Rubin, 1997, p. 30). Occasionally reform legislation is passed. More often, the rhetoric of tax reform is invoked by politicians who wish to distance themselves from their own creation—the tax code. In short, it is an understatement to say that contemporary U.S. tax policy is a highly complex, almost schizophrenic enterprise.

ANTITAX POLITICS IN THE UNITED STATES

Another foundation of U.S. tax policy is a deeply rooted tradition of antitax politics in American political history, beginning with the antitax protests during the American Revolution and the Whiskey Rebellion of 1794 (a regional rebellion in western Pennsylvania against collection of the first federal excise tax, which was imposed on distilled spirits). The antitax populism behind the Proposition 13 movement—a revolt against local California property taxation—was a powerful political force throughout the early 1970s (Hansen, 1983; Sears and Citrin, 1982); it was largely an expression of grassroots resistance organized by nonpoliticians and directed at the formal political system. But in many cases, the antitax sentiment is orchestrated from above by politicians who use the theme to secure office for themselves and their party. Many candidates expose antitax rhetoric to get elected; few run, and fewer still get elected on the slogan of *raising* taxes. This lesson was learned all too well by presidential candidate Walter Mondale, who told his supporters at the 1984 Democratic convention of his sincere belief that taxes would need to be raised in coming years—and was thereafter trounced in the general election by antitax Republican Ronald Reagan.

In the postwar era, antitax themes have been particularly strong in the national political arena, especially within the Republican party. After World War II, the GOP and its business constituency found a hospitable political climate in which to pursue an antitax campaign. Reducing the steep wartime tax rates still in place was the dominant Republican issue in the 1946 elections. Republican candidates campaigned for a 20 percent overall cut in income tax rates.

They succeeded with this theme and took control of both chambers of Congress for the first time since 1930. The new Republican leadership in Congress then sought to implement broad tax cuts. The Democratic Truman administration strongly and persistently opposed any such tax cuts. Three times Truman vetoed Republican tax bills. The compromise bill that finally became law, the Revenue Act of 1948, lowered the maximum individual income tax rate to 82 percent from the historic wartime high of 94 percent.

During the 1980s, antitax politics again became a potent force within the Republican party. During the presidential campaign of 1980, Ronald Reagan endorsed a proposal for tax rate reduction introduced in 1977 by Representative Jack Kemp and Senator Roth. The Kemp-Roth proposal had called for a 33 percent reduction in individual tax rates and a lesser reduction in the corporate rate. In the spring of 1981, newly elected President Reagan introduced his own legislative proposal for tax rate reductions styled on the Kemp-Roth proposal. Reagan's proposal ran into opposition from congressional Democrats. By midsummer 1981, however, the new president brought together a bipartisan conservative congressional coalition to enact the Economic Recovery Tax Act of 1981. Although the 1981 tax cuts were less than those proposed under Kemp-Roth, they still constituted at the time the most significant tax rate reductions in the history of the federal income tax, reducing the maximum marginal tax rate for individuals to 50 percent from 70 percent (roughly where it had stood since the Kennedy tax cuts enacted in 1964). During the second Reagan administration, the maximum marginal tax rate for individuals was further reduced to 28 percent under the historic Tax Reform Act of 1986.

The antitax rhetoric expressed by Reagan Republicans during the 1980s has resurfaced as a powerful force in the Republican party in the 1990s. Following their success in the 1994 midterm elections, Republicans took control of both chambers of Congress for the first time since 1954. A strong antitax wing of the GOP emerged in control of the House. Following the GOP landslide in 1994, Representative Bill Archer (Republican from Texas) was appointed chairman of the House Ways and Means Committee and instigated a campaign to repeal the income tax altogether. Ever since, Archer has repeatedly expressed his contempt for the federal income tax: "I personally would like to tear the income tax out by its roots and throw it overboard." Archer favors replacing the income tax with some form of consumption-based tax similar to a European-style value-added tax.

The most politically viable proposal for replacing the income tax surfaced even before the 1994 elections. Representative Richard K. Armey (Republican from Texas), House majority leader in the 104th and 105th Congresses, introduced a proposal for a flat tax. Under Armey's proposal, a 17 percent tax would be imposed on the wages of an individual in excess of relatively high standard deductions and generous dependent allowances. None of the traditional de-

ductions of the current income tax system would be allowed. Business activity would be taxed at the same rate, with a deduction allowed for wages paid. Thus the tax on individuals would be progressive to the extent that average tax rates rose in proportion to the individual's income, and the overall tax base would be consumption rather than income because the return on capital investment would not be taxed. Armey's flat tax is virtually identical to the broad-based consumption tax proposed more than a decade ago by Stanford University academics Alvin Rabushka and Robert Hall (1985).

In the fall of 1997, the antitax wing of the GOP turned against the agency charged with administering the tax laws—the Internal Revenue Service (IRS). Tapping what they perceived to be a strong undercurrent of antitax sentiment, Republican leaders focused popular discontent with the tax laws on the IRS. Out on the campaign trail, Republican politicians took to blaming the IRS for the excessive complexity of the tax laws (dubbed the IRS Code) and for the burden of taxation itself—conveniently ignoring that it is Congress and not the administrative agency that writes the tax laws. In September 1997, Senate Finance Committee chairman Roth conducted televised committee hearings investigating alleged abuses of taxpayers by the IRS. In dramatic testimony, IRS agents (concealing their identities) testified before the committee on the alleged abusive conduct of the agency in its collection activities. The hearings were a great public relations success for antitax Republicans, who viewed the publicity as the first step in a full assault on the income tax itself. Soon after the hearings, the Ways and Means Committee approved a bill proposing new safeguards for taxpayers litigating with the IRS and restructuring the agency by putting it under the control of an independent supervisory board made up of nongovernmental executives. The bill sailed through the House in early November 1997 by a vote of 426 to 4 and was enacted into law in 1998.

Although they are only one faction within their own party, members of the antitax wing of the Republican party have attracted much attention for their cause and have organized a viable national political movement against the income tax. In the 1990s, antitax politics also has been particularly successful at the state level, with twenty-seven states enacting tax reduction legislation in 1997 alone. With publisher Steve Forbes contemplating entering the GOP presidential primaries again in 2000 (having campaigned in 1996 on his own version of the flat tax) and with House Ways and Means Committee chairman Archer promising extensive committee hearings in 1998 to "educate" the public on the need to replace the income tax (whether with a flat consumption-based tax or a national sales tax), the antitax message of the Republican party is sure to dominate the policy agenda in the immediate future.

The antitax rhetoric of the GOP imposes significant restraints on all policymakers—even Democrats, who might otherwise be tempted to raise taxes for the federal government. Indeed, there has been enormous political pressure

on all politicians in the United States to reduce taxes even in the face of the significant budget shortfalls experienced in the 1980s and 1990s—a lesson learned all too well by President Clinton. Clinton was forced to offer his own tax-cut proposals in an effort to quiet the thunder of Republicans in the wake of their significant electoral successes in the 1994 midterm elections, during which antitax rhetoric again ran rampant. Later, Clinton sheepishly disavowed the extent to which his own 1993 tax legislation raised taxes (which it did—on those taxpayers with incomes above $250,000). In 1997, the Democratic president gave in and accepted a proposal from congressional Republicans for $95 billion of net tax cut over five years.

The persistence of this deep-rooted antitax ideology has had a significant impact on the development of tax policy. Ironically, although broad-based tax reduction is a fundamental tenet of the Republican party and cutting marginal tax rates is dogma to the proinvestment, supply-side wing of the GOP, all such tax cuts run counter to what is most advantageous to congressional policymakers *qua* politicians—namely, tax cuts targeted to constituents. As much as Republican politicians like cutting taxes in general, they (and their Democratic colleagues) have a greater interest in granting tax relief to constituents in their home districts and to those organized interests and groups that constitute their respective party coalitions. This helps explain why the 1995 Republican tax bill vetoed by President Clinton and the tax legislation enacted in 1997 included, despite all the antitax rhetoric, so many special tax preferences benefiting constituents of *both* political parties.

PLURALISM, INCREMENTALISM, AND THE INCOME TAX

How then to explain the complex politics of taxation in the United States? Pluralism is the most common model advanced by political scientists to generally describe U.S. politics. The pluralist model assumes that policymaking is decentralized, that political power is widely dispersed within civil society, and that the policymaking apparatus is readily accessible to numerous social and economic interests. Pluralist theory holds that policymakers are subjected to pressures from a wide range of organized groups, and that those who are most intensely affected by particular issues will organize and lobby policymakers hardest with respect to those issues. Overall, congressional policymakers respond to such lobbying by enacting policies that accommodate the best organized and most strategically situated interests—those with access to the decision-making institutions. Policy decisions are the outcome of bargaining among the groups that are organized and represented in the decision-making process. Pluralist power structures tend to produce a distinctive politics to the extent that numerous interest groups potentially possess the power to influence

specific and narrow aspects of policymaking, but no single group is capable of dominating the entire policymaking process.

The politics-as-usual of taxation is generally portrayed as typical of a pluralist politics. Indeed, the pluralist model is highly descriptive of policymaking for the income tax during most of the twentieth century. The model focuses on Congress and the tax committees and assumes that a dynamic interest-group politics drives tax policy. Groups have organized around narrow economic interests and lobbied for relief from the relatively high marginal tax rates that have prevailed since the 1940s. Policymakers respond to the appeals of special interests (especially those located in their own home districts) for special tax preferences. Political scientist David Truman took as a given that well-financed special-interest groups with a great stake in outcomes will prevail in the tax legislative arena (Truman, 1971, pp. 361, 422). In the politics of the income tax, outside interest groups (both public and private) have ready access to the policymaking process. As a result of the openness of the congressional policymaking process, the preferences of many competing interests are successfully translated into tax policy. Many of the institutional barriers that congressmen relied on in the 1950s and 1960s to shield themselves from the pressures of special-interest groups (most particularly, the centralized control of the tax legislative process by Wilbur Mills, longtime and powerful chairman of the House Ways and Means Committee) were weakened by the post-Watergate reforms enacted in the mid-1970s, which had the unintended effect of exposing congressional members to greater lobbying and pressures exerted by such groups. In the 1980s, the tax policymaking process became even more receptive to interest-group politics. Indeed, during the decade it seemed that policymakers accommodated at one time or another virtually every organized interest group with its own special tax provisions.

Normal pluralist politics usually results in a process of incremental development for the income tax. Pluralist structures of political power tend to produce incremental policymaking because interest-group pressures most often lead to incremental modifications of existing policies. The pluralist-incrementalist model has thus been successfully applied to describe the normal policymaking of the federal income tax (Conlan, Wrightson, and Beam, 1990). Tax policy is said to advance through incremental or gradual departures from existing law rather than through radical advances. According to one astute observer of U.S. tax policy, "The tax code offers a variety of easily grasped levers. In this sense, it is an incrementalist paradise, susceptible and seductive to political tinkerers" (Witte, 1985, p. 245). In incremental policymaking, special provisions enacted for organized interests and groups are preserved in the tax laws, while new policies (very often at cross-purposes with old ones) are continually added.

This model explains a good deal about how the tax laws develop and why the tax expenditure budget increases each year. It also helps explain why tax

policy is incoherent, with many provisions in the tax code expressing policies that are in conflict with other provisions. Congress enacts a provision that bestows special tax treatment on a favored group or interest and then (perhaps because of a change in the party that controls Congress) enacts other tax code provisions favoring diametrically opposed interests. The result is that some provisions benefit labor and others benefit business. Occasionally Congress is pressured by public opinion and media reports to enact provisions designed to limit a taxpayer's ability to make use of these special tax credits and deductions. For example, the alternative minimum tax was created to ensure that those taxpayers who make use of the overly generous tax preferences pay some income tax. Rather than repeal the original preferences, congressional policymakers found it more advantageous politically to enact new, complicated provisions to restrict the benefits derived from those preferences—thereby giving the appearance that Congress was doing something about special interests without actually taking a position adverse to those interests. This approach is typical of the pluralist tax politics that prevails in the United States.

Notwithstanding the descriptive power of the pluralist-incrementalist model, the model does not explain all of the politics and development of the federal income tax, especially that witnessed in recent decades. Partisanship and ideology have resurfaced as strong, even dominant forces shaping contemporary tax policy. This was the case in 1981 when supply-side economics dominated tax policy, in 1993 when Democrats passed by the slimmest of margins a 10 percent surtax on taxpayers with the highest income, and again in 1995 when antitax Republicans took control of the tax committees. In these cases, political ideologies dominated the tax-policymaking process, producing policies very much at odds with what would be predicted by the incrementalist-pluralist model. Although the normal politics of the income tax (such as use of the tax code for constituency service) is well described by the pluralist model, the most important tax legislation enacted in recent decades expresses a political use of the income tax by policymakers to advance their partisan agendas. Nonincremental tax policymaking has become commonplace in the past two decades.

Certainly, the most difficult tax legislation to explain from the perspective of pluralism and incrementalism is the Tax Reform Act of 1986. In his January 1984 State of the Union address, President Reagan called upon the Treasury Department to produce a study of tax reform. In response, the Treasury generated a series of tax reform proposals. For tax experts in the Treasury, "reform" meant eliminating all the special tax expenditures that Congress had inserted into the tax code for political reasons. Unexpectedly, the political movement for tax reform gained momentum, and Congress reluctantly took up the cause. Eventually, the White House and the tax committees were occupied for nearly two years with the campaign for tax reform. Even more surprising, the effort bore fruit in the fall of 1986 with the enactment of the Tax Reform Act of 1986.

This act has been widely hailed as the most significant tax-reform legislation in the history of the federal income tax (Witte, 1991, p. 4; Shaviro, 1990, p. 5). By virtue of the sheer volume of revisions and amendments to the tax laws that it implemented, the 1986 act was the most massive restructuring in the eighty-year history of the federal income tax. For this reason alone the 1986 act is impossible to explain from the perspective of pluralism and incrementalism. What accounts for such a dramatic departure from politics-as-usual for the income tax? Some have described the 1986 act as the product of unusual circumstances and the extraordinary convergence of ideas and political interests (Conlan, Wrightson, and Beam, 1990; Kingdon, 1995, pp. 213–217). In a distinctly unique moment in political time, conservatives and supply-siders in the Reagan administration who favored tax rate reduction found common ground with liberal Democrats in Congress who supported the reform proposals of tax experts in the Treasury Department. Likewise, politicians who normally were not in the vanguard of the tax reform movement (in particular, then Ways and Means Committee chairman Dan Rostenkowski and Senate Finance Committee chairman Robert Packwood) were swept along by the tax reform movement because they feared being perceived by the public as obstacles to reform.

Whatever the merits of this description of the politics behind the 1986 act, it remains difficult (if not impossible) to predict when political interests, reform efforts, and "ideas" will again converge to produce a tax reform bill. Tax reform disappeared from the policy agenda after 1986. Nevertheless, the repeated political use of tax expenditures creates new pressure for tax reform. Eventually, the complexity of the tax laws and the revenue loss attributable to the increase in tax expenditures stimulates interest in pruning and simplifying the tax code. But when and under what circumstances are such reform efforts likely to succeed? Such radical departures from the normal politics of the income tax lie outside the pluralist-incrementalist model.

A good deal of the politics surrounding the 1997 tax bill can be explained by the pluralist-incrementalist model. Existing provisions were amended and modified (such as changing the taxation of capital gains, reducing the impact of the alternative minimum tax on corporations, and so on) to produce slightly better tax results for constituents of the Republican party. Through trade-offs and compromises, the Democratic administration secured perks of its own—such as phasing out tax credits for education for high-income taxpayers. Overall, the resulting legislation added significantly to the complexity of the income tax by introducing many new and complicated concepts and computations to the tax laws. However, even while Congress was considering this bill that added to the complexity of the tax code and conferred so many tax benefits on the constituents of both political parties, political rhetoric against the income tax ran rampant. Several highly partisan proposals for "fundamental tax reform" (that is, for repealing the income tax altogether) have attracted unexpectedly strong

support in Congress. At times it appears that another dramatic departure from the typical pattern of pluralist tax politics and incremental development is just over the horizon.

It remains to be seen whether the 1997 tax act was a return to the normal politics of the income tax or whether it was a harbinger of radical tax reform. Accordingly, we should not be too comfortable with the pluralist-incrementalist model and dismiss 1986 as a mere aberration. Although pluralism and incrementalism describe a good deal of tax politics most of the time, legislation such as that enacted in 1986 as well as that favored by Archer and Armey, lies outside the model. Because the tax laws are used not only to raise revenue but also to implement the partisan agendas of the two major political parties, contemporary tax policy is a highly complicated, erratic, and ultimately unpredictable enterprise.

CONCLUSION

The U.S. tax laws are used by policymakers for a variety of political purposes that are dictated by the constitutional structure of the U.S. regime. Under the democratic electoral system, it is politicians who make tax policy. Congressional tax policymakers serve as ombudspersons for their constituents and as leaders of the two political parties that control Congress. On top of this, the same policymakers are charged with raising the enormous revenue required to finance the activities of the U.S. government. The revenue function of the income tax is at odds with the instrumental, political uses of the tax.

The structures of the political system impose conflicting demands on tax policymakers, impelling them both to raise revenue and to implement policies that are functionally equivalent to direct budgetary expenditures. When the income tax is used by policymakers to implement public policies and to cull favor with local constituents, the Treasury is inevitably deprived of revenue. On top of all this, a strong antitax ideology pervades U.S. politics—most typically given voice by the Republican party. At various moments, such as in the late 1940s and early 1980s, this antitax rhetoric has prevailed in the political contest between the two major parties. The victory of the Republican party in the 1994 elections was driven by this antitax ideology and has altered the dynamics of the tax-policymaking process in favor of tax reductions—and will perhaps one day even lead to the abandonment of the income tax altogether. But even those politicians who rant and rave most against the income tax find it irresistible as a tool for achieving their own political purposes. This attitude dictates that the income tax will be around for a long time, serving both as the primary source of revenue for the federal government and as an important political tool of U.S. policymakers.

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