

AN HISTORICAL PERSPECTIVE ON THE EVOLUTION OF THE  
UNITED STATES INTERNAL REVENUE CODE FROM 1981-2001

A thesis submitted in fulfilment of the  
requirements for the degree of

DOCTOR OF PHILOSOPHY

of

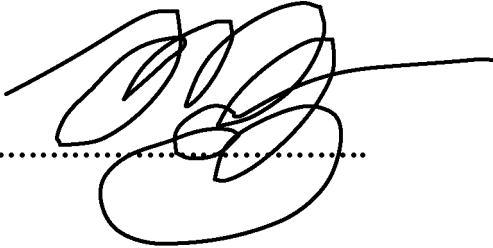
RHODES UNIVERSITY

By

Ryan Johnson  
December 2016

**DECLARATION**

I, **Ryan A. Johnson**, declare that the work presented in this thesis is original. It has never been presented to any other University or Institution. Where other people's works have been used, references have been provided. It is in this regard that I declare this work as originally mine. It is hereby presented in fulfilment of the requirements for the award of the degree of Doctor of Philosophy.

Signed..........

Date.....3/13/2017.....

## **Abstract**

The purpose of this study was to identify and analyse in an historical context the major changes to the United States' Internal Revenue Code during the period 1981-2001. This qualitative study relied on historical and legal interpretative approaches to better understand the political forces, personalities, and interactions that helped shape the legislative changes during this time period. The study focused on deep analysis of primary sources that best illuminated the latent narrative of four major tax actions: The Economic Recovery Tax Act of 1981, the Tax Reform Act of 1986, The Omnibus Budget Reconciliation Act of 1993, and The Economic Growth and Tax Relief Reconciliation Act of 2001.

Archives, periodicals, and political rhetoric were examined in order to help shape the historical narrative. In addition, this study sought to identify major trends and paradigm shifts in the way United States tax policy was formed during the time period examined. The study identified several key trends that emerged in United States' tax policy during this period: the use of budget deficits as political tools; factors associated with accomplishing tax reform; gaps between political rhetoric of individual politicians and their political action; and the virtual disappearance of a political middle ground in United States budget politics. The study concluded by noting the economic and political significance of budget deficits and stressing the need for fundamental changes in voter responsibility in helping achieve lasting, broad-based tax reform and budgetary responsibility in the United States.

Key Words: Taxation, United States of America, budget, deficit, tax reform, historical perspective, Reagan, Bush, Clinton

## TABLE OF CONTENTS

Declaration	i
Abstract	ii
Chapter 1: Study Rationale	
1.1 Goals of the Research	1
1.2 Problem Statement	1
1.3 Scope	3
1.4 Review of the Literature	7
1.5 Overview of the Chapters	11
Chapter 2: Method	
2.1 Introduction	14
2.2 Assumptions and Epistemological Approach	15
2.3 Methods: A Legal Interpretative and Historical Approach	17
2.4 Limitations and Ethical Considerations	19

## Chapter 3: The Economic Recovery Tax Act of 1981

3.1	Introduction	21
3.2	Background	24
3.3	Timeline	25
3.4	Key Figures in the Economic Recovery Tax Act of 1981	25
3.5	Major Provisions of the Economic Recovery Tax Act of 1981	28
3.6	Reagan's Revolution	29
3.7	Criticism of Carter	35
3.8	Reagan and the Democratic Opposition	37
3.9	The Largest Tax Cut in the Nation's History	44
3.10	Legacy	52
3.11	Conclusion	60

## Chapter 4: The Tax Reform Act of 1986

4.1	Introduction	62
4.2	Background	64
4.3	Major Provisions of the Tax Reform Act of 1986	66
4.4	Timeline	68
4.5	Historical Groundwork for the Tax Reform Act of 1986	68
4.6	Key Figures in the Tax Reform Act of 1986	70
4.7	Ronald Reagan on Tax Reform	72

4.8	The 1984 Treasury Report	83
4.9	Previous Legislative Efforts	89
4.10	The House of Representatives Debate of HR 3838	99
4.11	Senate Debate	101
4.12	Transition Rules: The Cost of Compromise	105
4.13	Success Despite Opposition	109
4.14	Conclusion	111

#### Chapter 5: The Omnibus Budget Reconciliation Act of 1993

5.1	Introduction	118
5.2	Background	120
5.3	Major Provisions of the Omnibus Budget Reconciliation Act of 1993	123
5.4	Timeline	124
5.5	Key Figures in the Omnibus Budget Reconciliation Act of 1993	124
5.6	Bill Clinton on Taxes and the Budget Deficit	127
5.7	House and Senate Committee Discussion	131
5.8	Gasoline Tax Provision	137
5.9	Senate Debate	139
5.10	House Debate	143
5.11	Deficit Reduction	146

5.12	Constitutional Objections to Retroactive Taxation	148
5.13	Clinton’s Reflections	150
5.14	Legacy: Partisanship and Gridlock	153
5.15	Conclusion	155

#### Chapter 6: The Economic Growth and Tax Relief Reconciliation Act of 2001

6.1	Introduction	158
6.2	Background	159
6.3	Timeline	161
6.4	Key Figures	161
6.5	Major Provisions	162
6.6	The Transition to George W. Bush	163
6.7	Bush’s Proposal	167
6.8	Congress Takes Up Bush’s Cuts	168
6.9	The Conference Report	174
6.10	Legacy	181

#### Chapter 7: Conclusions and Implications

7.1	Introduction	185
7.2	Budget Deficits	187
7.3	Tax Reform and Partisanship	196
7.4	Taxes and Personal Liberty	199

7.5	Rhetorical and Policy Differences	203
7.6	Conclusion	206
	<b>BIBLIOGRAPHY/REFERENCES</b>	<b>209</b>

# CHAPTER 1

## Study Rationale

### 1.1 Goals of the Research

The main purpose of this research was to analyse the major changes to the United States Internal Revenue Code, as it evolved during the period 1981-2001.

The goals of the research were as follows:

- To identify and analyse significant changes to the United States Internal Revenue Code from 1981-2001, in order to describe and characterize the changes in terms of major policy shifts.
- To chronicle the historical forces, including social, political, and professional, that influenced the Internal Revenue Code changes in their final form.
- To understand why changes to the Internal Revenue Code were made, including both successful and unsuccessful efforts by politicians, lobbyists, and other participants in the process.

### 1.2 Problem Statement

Examining the United States tax code in effect for a particular time period provides a historical glimpse into public affairs at the time of the change. In many ways the evolution of the Internal Revenue Code tells a richly-detailed story about the underlying political environment in which it was forged. Though prior research has been conducted retrospectively on the topic of

the Internal Revenue Code, much of this research falls into two categories: broad economic and behavioural analysis and examination of the technical effects of changes. Limited academic research has been done to bring to light the personalities, stories, rhetoric, and interactions that underpinned the historical development of the Internal Revenue Code and its evolution since 1981. We know a great deal about concrete elements of tax changes, from the perspectives of both economic experts and practitioners. However, we know much less about the rich, detailed, personal elements of how these legislative shifts came to fruition. Did political leaders achieve their goals through these changes? Why did these particular changes succeed while others failed?

Accordingly, this thesis sets out to address this gap in the literature in two ways. First, the proposed research will identify and analyse significant tax changes from 1981 to 2001, with the goal of describing and characterizing major shifts in policy. Second, the proposed research will seek to chronicle with depth and accuracy the historical forces that shaped these changes.

The Internal Revenue Code is the United States' primary system of taxation, by which the income of American corporations, individuals, trusts, estates, and other legal entities are subjected to taxation by the Federal Government. Since its inception in 1913, the United States income tax has been a fixture in American life, and the filing of the annual income tax return is a common experience shared by the majority of Americans. Few issues in the American experience generate more interest, debate, and calls for reform than the Internal Revenue Code.

The Internal Revenue Code and accompanying Internal Revenue Regulations are both complicated and controversial, so much so that even the Commissioner of the Internal Revenue Service reportedly hired a preparer to assist him with his own tax returns (Ballasy: 2010). The Internal Revenue Code changes frequently, for social, political, and economic reasons, spawning

its own cottage industry around continuing professional education for tax return preparers, individuals, and corporate officers who must understand and navigate its murky depths. The Internal Revenue Code has a long and colourful history, governing a politically charged but fiscally effective system of taxation.

Accordingly, the importance of analysing the role of taxation, in its historical socio-political context, cannot be underestimated. Taxes represent, in tangible fashion, the individual citizen's stake in government, policy outcomes, and sense of community (Cobham: 2005). The use of tax dollars toward a public good represents a connection between the citizenry and its governmental representation (Cobham: 2005). As a result, understanding and cataloguing technical shifts in tax policy over time is important, but it is equally important to understand the forces, policies, and personalities that helped shape the United States Internal Revenue Code into its current form.

### **1.3 Scope**

The United States income tax code has changed significantly since 1981, with the executive branch of government signing into law more than 30 tax bills that directly concerned taxation since that time (Tax Policy Center: 2011). A number of these bills were "ad hoc" in nature, intended to respond to emerging crises, such as the 2008-2009 banking collapse, Hurricane Katrina in 2004-2005, and specific periods of high unemployment and economic crisis, such as the period following the 9/11 terrorist attacks. However, some bills represented major tax reform efforts, involving more novel, substantial provisions. Other bills have been purely political efforts, to cut taxes for preferred economic groups, or to favour spending on

preferred social programs. This study chose four major legislative actions and examined the context and means by which they evolved.

This study examined four major legislative actions: The Economic Recovery Tax Act of 1981, the Tax Reform Act of 1986, The Omnibus Budget Reconciliation Act of 1993, and The Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Policy Center: 2011). Each of these acts either included tax principles as a primary consideration, or made substantive changes to the ways in which taxes were administered. Major tax changes in the United States have historically shared some similarities, such as fluctuation in tax rates and changes in exemptions, which invariably shift with the political climate. However, certain legislative acts were “game changers” in the sense that they addressed tax issues in unique ways and in terms of true reform.

The Economic Recovery Tax Act, enacted in 1981, came at a time of economic turmoil in the United States. It sought to stimulate the economy, lowering marginal income tax rates, estate tax rates, and capital gains tax rates. At the same time, it ushered in ACRS, or the “Accelerated Cost Recovery System” to allow businesses faster recovery of capital expenditures. The Economic Recovery Tax Act of 1981 was the first major move toward easing of the individual tax burden under President Ronald Reagan (Tax Policy Center: 2011).

The Tax Reform Act of 1986 is considered to be a landmark piece of tax legislation in that it was a major attempt to capture and tax effectively true economic income, though it came at the cost of complexity (McClure: 1988). The Act increased low-income tax credit programs, raised rates on large estate and gift transfers, and decreased carve-outs for passive activities. It also was part of a movement toward lower overall tax rates, particularly for high income

individual taxpayers and those who benefited most from the standard deduction (Tax Policy Center: 2011).

The Omnibus Budget Reconciliation Act of 1993 was an important piece of legislation in that it began a move away from the Reagan-era approach to taxation, primarily in an effort to increase revenue and reduce budget deficits during the Clinton administration. The Act increased top individual and corporate tax rates, while relieving taxpayers who qualified for earned-income tax credits. The act also expanded the taxable reach of otherwise exempt Social Security income for individuals with higher taxable incomes (Tax Policy Center: 2011).

The Economic Growth and Tax Relief Reconciliation Act of 2001 was a series of tax cuts begun under President George W. Bush. (Tax Policy Center: 2011). The centrepiece of this legislation was a rollback in individual income tax rates, intended to jumpstart the economy in line with “trickle-down” economics, as originally popularized under President Ronald Reagan. The legislation was unique in that it included nearly a decade of phased-in tax reductions, but with many of its provisions scheduled to “sunset” by 2010. It also included increases in credits for working families, across-the-board rate cuts for all income levels, and a rollback and ultimately a repeal of the death tax.

These tax code changes have addressed many different areas, including the underlying tax rate structure, tax bracketing, types of tax preference items, perceptions of fairness, technical complexity, and allocation of the tax burden across demographic groups and types of entities (Tax Policy Center: 2011). With respect to complexity, in 1981, Form 1040, the standard form for individual citizens to file personal income tax returns, contained 66 lines. In 2013, it contained 77 lines and numerous additional informational blanks, many of which pertain to

emerging preferences, deductions, or special adjustments that had evolved into the Internal Revenue Code (Internal Revenue Service: 2014b; Tax Analysts: 2014). It is clear that the modern tax code, as evidenced by the volume and type of information acquired on the administrative filing forms, is taking on many more tasks and gathering many different types of information than it did in 1981.

Despite the fact that the United States income tax code has changed substantially since 1981, the American legislative process is complicated and resistant to change. In order for a proposed bill to become law, it must pass successfully through a number of significant hurdles, both formal and informal. Bills must first be drafted and introduced by a sitting member of either the House of Representatives or the Senate, collectively referred to as “Congress.” Once a bill is introduced, it must be considered and tabled by a committee vote, and subsequently placed on the legislative calendar for a full vote, further debate, or amendment by the legislative body (US House: 2014). A simple majority is required for a bill to pass each legislative body, but even this process can be more difficult than it appears.

Many pitfalls await new and proposed legislation, including the threat of filibuster, presidential veto, or subsequent amendment of key provisions that could undermine the bill’s effectiveness (US House of Representatives: 2014). Once bills are passed legislatively, they must be signed into law by the president. Further review of particular laws often takes place in the judicial branch of government.

An illustrative example of how complicated the United States’ legislative process can be is the Affordable Care Act of 2010, commonly referred to as “Obamacare.” This legislation, ultimately determined to be a “tax” bill by the Supreme Court, greatly expanded governmental

health care coverage, and was extremely controversial. The bill narrowly passed the House, and eventually passed the Senate by way of an uncommon legislative process known as “budget reconciliation.” Ultimately, key provisions of the law were reviewed by the Supreme Court in *National Federation v. Sebelius* (2010) and *Burwell v. Hobby Lobby* (2014). The former case upheld most commercial provisions of the law and treated the law as a form of taxation, while the latter called into question certain mandates in the law under grounds of religious freedom (National Federation v. Sebelius: 2010; Burwell v. Hobby Lobby: 2014). In both cases, all or parts of the law were subject to review and invalidation at the discretion of the Supreme Court.

While the particulars of these cases are not critical to purposes of this study, understanding the levels of review that proposed and even final legislation must endure is critical to analysing the success or failure of reform efforts. In the United States, it can take a significant amount of time to pass a bill, and in the end, the bill may be ultimately rendered ineffective or inapplicable due to judicial review. A great deal can be gleaned by analysing the legislative process, even if the process results in no changes to current law.

#### **1.4 Review of the literature**

Historically, most major pieces of United States tax legislation have been researched from two primary perspectives: economic or behavioural impact, and technical application. As an illustrative example, the Tax Reform Act of 1986 is considered one of the most important pieces of tax legislation in the history of the United States, and has been researched exhaustively. In many ways, the body of research around the 1986 Act is representative of how tax legislation in the United States has been traditionally researched.

From an economic and behavioural perspective, the 1986 Act is understood to have significantly shifted the tax burden from the household to the business sector, and at the same time reduced incentives for private-sector investment (Evans & Kenward: 1988). Other researchers have reported that the 1986 Act resulted in widespread “portfolio adjustment” with respect to foreign investment, timing of transactions, and the legal form of business entities (Auerbach & Slemrod: 1997). However, some researchers posit that the act itself had a more limited effect on observed reduction in capital investment than other factors, such as dampened productive output during the time period (Bartlett: 2011). Specific behavioural elements of the 1986 Act, such as the impact of low income tax credits buried within the legislation, have also been considered. Burman and Phaup (2012) determined that tax expenditures, as opposed to cash expenditures, have become increasingly popular due to their avoidance of the traditional budgeting process. Using the low income tax credits in the 1986 Act as an example, the researchers showed the political and economic expediency associated with tax expenditures (Burman & Phaup: 2012). As demonstrated by the existing body of research, the ways in which the United States economy has responded to most significant tax legislation in economic and behavioural terms is well-documented.

From a technical perspective, much has been written about the 1986 Act. Its relationship to financial accounting standards has been examined (Bierman: 1987). In addition, research has catalogued its practical tax effects, including broadening of the tax base, more progressivity, and increased personal exemptions and earned income credits (Pechman: 1990). Other analysis has discussed the 1986 Act’s changes in the context of the international community. The United States’ effective corporate tax rate, reduced significantly under the 1986 Act, was also found to be higher than many of the Organization for Economic Cooperation and Development Countries

when both tax base and tax rate were taken into consideration (Mucenski-Keck: 2012). Further, simulated calculations and projections in the literature have shown that the tax had a disproportionately positive effect, dollar-for-dollar, on couples and individuals with children (Weinberg: 1987).

Nearly every significant legislative act in the United States has been analysed in these two primary contexts, as illustrated by the body of research surrounding the 1986 Act. However, a much more limited body of research has been performed that helps bring to light the individuals, interactions, and personal stories that helped forge these changes to the tax code. This research seeks to achieve deeper understanding of the personalities and political forces that helped form the Internal Revenue Code over time. What did political leaders, as well as their opposition, believe, state, and write about the efforts to create these changes?

Understanding the political culture that has created changes to the United States Internal Revenue Code is illuminating in a number of ways. As legal changes to the code are made, they leave a historical trail and create precedent for future changes. They also establish baselines for what is considered to be customary behaviour in government, such as whether a budget needs to be balanced; what constitutes a fair tax rate; and, the relationship of a taxing authority to its constituents. Tax code changes also mark departures from historical trends, such as Ronald Reagan's dramatic cuts to individual tax rates in the early 1980s. One of the fundamental functions of government is to properly manage a budget that reflects the priorities and political will of the electorate. Examination of the tax code provides insight into what society values, and why, and how those values shift over time.

Prominent in the United States are also various ideas about increasing unfairness and unnecessary complexity in the United States Tax Code. For example, in 2014 the Obama administration stressed fairness and minimising complexity as key elements of the official position of the President's policies (White House: 2011). While the purpose of this thesis is not to state conclusively which views or policies are most fair, it does seek to understand the historical viewpoints by which legislative changes and tax policies were fashioned.

In addition to considering political rhetoric, significant tax law changes are difficult to understand without analysing the economic context and social climate at the time when the change was made. For example, with respect to tax rates, the highest individual tax rate, as applied to married couples filing jointly, was 70% in 1981; 28% in 1989; 38.6% in 2002; and, 39.6% in 2013 (Tax Foundation: 2013). This large change in tax rates, along with myriad other technical shifts during the same time period, represent starkly different theoretical approaches to the tax code. However, it is no surprise that these changes were influenced by economic conditions.

For example, in 1980 the United States was experiencing historically poor economic conditions, which improved gradually through the decade. In 1980, just weeks before his election victory over democratic incumbent Jimmy Carter, former Governor of California Ronald Reagan gave a televised campaign address which typified his administration's approach to the Internal Revenue Code. Reagan called for across-the-board rate cuts and simplification (Reagan: 1980). In this speech, Reagan also provided a surprisingly high degree of technical detail for a public address targeted for the average American, calling for less complex depreciation schedules to encourage economic development and modernization (Reagan Library: 1980).

Just a few months later, in his final State of the Union address and after his election defeat in November of 1980, President Carter also discussed his “take” on tax policy as it relates to growth. Despite historically stark differences in posture between Carter and Reagan on issues of taxes and finance, Carter supported many of Reagan’s positions as part of the 1982 budget proposal (Carter Library: 2014). Would Carter’s conformity with Reagan’s positions have persisted had he won the election? Or was Carter merely conceding defeat and attempting to begin the political reconciliation process in a public way?

The era of Reagan’s term of office also brought to the forefront the idea that the economy is often managed politically, with tax policy as an important tool in that process. The office of the President is well-positioned to set fiscal policy, and history has demonstrated that the chief executive should reasonably expect Congress and the public to fall in line with their policies (Peterson: 1985). For example, Reagan realized, as did other leaders, that running budget deficits have few consequences with respect to the voting public, and may empower the executive to use such deficits as a platform to push for further austerity programs (Peterson: 1985). Taxation is deeply connected with politics, and one of the goals of this study will be to paint a more complete picture of the political forces behind major legislative actions.

In terms of how tax reform occurs, an empirical study conducted by Castanheira and Nicodeme (2012) identified key factors that contribute to viability of large-scale tax reform programs. The study found that, among other variables, existing political incentives encourage targeted reforms rather than broad ones, and that economic crises foster increased likelihood of reform (Castanheira & Nicodeme: 2012). Other research has offered a more comprehensive proposal for tax reform, particularly in an international context. It is apparent that international

competition on the basis of taxation may prohibit a more holistic approach to achieve true tax reform (McClure: 1992). However, deeper analysis of source documents and legislative history is required to better understand both the nature of the subsequent law changes and the political theatre which surrounded them.

## **1.5 Overview of the Chapters**

The following is an overview of the contents of each chapter of this research. Chapter 2 discusses the methodological approach to the research. The research paradigm, a historical and legal approach, is described in detail. In addition, the appropriateness of the research paradigm, in the context of the research questions, is defended along with the research questions themselves. Finally, this chapter highlights the reasons for the selection of the four major legislative acts that were chosen for detailed analysis, and the ways in which these Acts typify the period under study.

Chapter 3 contains analysis of the Economic Recovery Tax Act of 1981 in its historical context. This chapter introduces the economic and political conditions of the late Carter administration that gave rise to the 1981 Act. It also considers the perspectives of President Ronald Reagan and the democratic Congressional leadership in crafting the legislation, as well as the Act's standing as an example of bipartisan tax reform.

Chapter 4 analyses the Tax Reform Act of 1986, a piece of legislation widely considered to be a model for tax reform in the history of American taxation. The unique interplay of personalities that made this reform possible is illuminated, including the perspectives of President Ronald Reagan, House Speaker Tip O'Neill, and Illinois Congressman Dan Rostenkowski. Predecessor legislation to the Tax Reform Act of 1986 is also considered,

championed by reformers like Jack Kemp. The chapter also considers the unique set of conditions that laid the groundwork for this ground-breaking legislation.

Chapter 5 details the development of the Omnibus Budget Reconciliation Act of 1993, a critical piece of legislation passed under President Bill Clinton. This Act is chronicled as an example of the American political movement away from bipartisanship, passing without a single conservative vote. This chapter describes the late presidency of George H.W. Bush and the economic stagnancy that Clinton and his administration sought to improve. The Act, in conjunction with actions taken by President George H.W. Bush, represented the beginning of a shift toward closing the budget gaps that had begun to grow under President Ronald Reagan. The Omnibus Budget Reconciliation Act of 1993 would lead to the last budget surplus in United States' history, in 2001.

Chapter 6 discusses the historical significance of the Economic Growth and Tax Relief Reconciliation Act of 2001, passed in the first term of President George W. Bush. The implications of this Act, particularly the inroads it made into and reversing the existing budget surplus created under the Clinton administration, are highlighted. The drastic long-term implications of this Act are outlined, in particular a return to Reagan-era deficit spending.

Chapter 7 concludes the research and discusses a number of long-term trends observed from 1981-2001 in the development of the United States' tax code. These trends are considered in the context of possibilities for future tax reform; polarity in American politics and its impact on tax policy; and potential conflicts in the way the American public views and votes on tax reform and tax policy. It also concludes by assessing the role of the tax code provisions, in each particular area, in affecting the budget deficit and the size of government.



## CHAPTER 2

### Methodology

#### 2.1 Introduction

This research is qualitative in nature, drawing on both legal interpretative and historical research approaches. Qualitative research seeks rich details, authenticity, and depth of inquiry, while consciously sacrificing generalizability of the findings to do so (Patton: 2002; Glesne: 2011). It is focused primarily on understanding, relying on non-numeric data to describe phenomena (Brikci: 2007). Qualitative research lends itself well to questions of why, how, and what, rather than questions of yes or no, as would be the case with quantitative methods. The selection of method and the research paradigm in which it was situated was driven by the nature of the goals of the research, which were as follows:

- to identify and analyse significant changes to the United States Internal Revenue Code from 1981-2001, in order to describe and characterize the changes in terms of major policy shifts;
- to chronicle the historical forces, including social, political, and professional, that influenced the Internal Revenue Code changes in their final form; and
- to understand why changes to the Internal Revenue Code were made, including both successful and unsuccessful efforts by politicians, lobbyists, and other participants in the process.

From an ontological perspective, the use of a legal interpretative and historical approach was necessary to accomplish the goals of the study and answer the research questions. The research questions in this study demand a depth of understanding and detail that cannot be provided by merely analysing, for example, the enacted changes to tax law during the period researched, or by quantifying changes to tax rates, tax collections and spending outlays. Chronicling such events only illuminates part of the story, the final action or outcome. It does not take into account the forces that shaped the final outcome, such as the feelings and thoughts of the “winners and losers” in the process, and the way the legal and political outcomes were viewed before and after they were enacted. Accordingly, this research was situated within the qualitative paradigm and took a legal interpretative and historical approach to understanding the evolution of the United States’ Tax Code from 1981-2001. The legal interpretative approach to the research provided the necessary framework for determining what changes had occurred to the tax structure. At the same time, the historical approach, framed as a biographical and public affairs enquiry, provided deeper understanding of the processes and participants that created political change. Using this two-faceted method, this research sought to understand *where* the Internal Revenue Code began, *how* it evolved, and *why* it followed the particular path that it did.

## **2.2 Assumptions and Epistemological Approach**

The undergirding principle supporting this approach is that synthesizing the accounts, stories, and circumstances surrounding historical events is a way of better understanding how and why the events unfolded, as well as understanding the implications of those events in social and political context. In adopting this view, this research began by making several assumptions:

- First, the evolution of United States Tax Code during the time period under study, 1981-2001, is a construct of the people who participated in the process, their interactions with one another and their respective positions and institutions, as well as conditions, decisions, and political groundwork that may have been created previously. These social interactions, and reactions, would have political and legal consequences, and would shape the outcomes of the process.
- Second, by understanding the historical evidence that was generated as the United States' Tax Code evolved, a deeper of understanding of why it exists in its current form would be developed, or alternatively, why it did not follow a different evolutionary path.
- Third, the perspectives of the participants in the process, and their writings, thoughts, speeches, and memoirs can be interpreted as a constructed view of historical truth surrounding concrete legal and political actions. Stated differently, historical events can be interpreted by better understanding the thoughts of those who helped influence them, or who were affected by them.

In addition, any study that involves historical research as part of the research design must take into account that the sources selected for study could impact the narrative that emerges and the conclusions the researcher might draw. In this sense, developing a “historically-accurate” narrative may only be possible from a certain point of view, as evidenced by particular sources. Other sources and viewpoints could paint a different picture of the same historical event. This research focused on primary and secondary sources, chiefly including speeches, papers, memoirs, and secondary newspaper accounts of the lawmaking process. These sources helped to develop the narrative around the personalities and processes that helped the United States tax code evolve.

The legal interpretative research aspect of this study was conducted in the “fundamental” tradition, designed to provide deeper understanding of law changes in their social, political, and economic context (Babbie & Mouton: 2009). Each change in the law, observed in a vacuum, provides very little qualitative meaning. While, for example, an individual’s income tax liability at an existing rate of tax, and at a prior rate, can be calculated, there is tremendous value in understanding *why* political authorities sought to change the rate. Was it to encourage a particular behaviour? Was it to close a budget gap? Or, alternatively, was it viewed as a mistake or as a success, when judged retrospectively?

### **2.3 Methods: A Legal Interpretative and Historical Approach**

The proposed study drew on a legal interpretative and historical approach, using primary and secondary sources in order to determine how historical events transpired, who was involved, and why particular Internal Revenue Code changes ultimately came about (McKerchar: 2008; McDowell: 2002). It is notable that hundreds of changes to the United States’ Tax Code are made every year, and while each one has an impact, this research could not possibly contemplate them all. Accordingly, in attempting to interpret the period from 1981-2001, it was necessary to make qualitative selections as to the most important legislative activity upon which to focus. While many legislative acts involve tax or budget changes as an element, this research focused on acts that were principally focused on tax or budget matters. In selecting these acts, consideration was directed towards the severity or gravity of the changes made in the bill; the historical impact or legacy of the bill itself; and the extent to which the bill was a departure from policy, or blazed new political trails with respect to taxation and budgeting. Using these criteria, four key acts were selected:

- The Economic Recovery Tax Act of 1981;
- The Tax Reform Act of 1986;
- The Omnibus Budget Reconciliation Act of 1993; and,
- The Economic Growth and Tax Relief Reconciliation Act of 2001.

These acts each are of generally accepted significance, and represented important political milestones. They were not only important from a tax standpoint, the aforementioned bills were also signature pieces of legislation for the sitting president who sponsored and signed each one.

In analysing the historical record surrounding each piece of legislation, this research drew on the following data sources, all of which were openly accessible to the general public.

- the Internal Revenue Code, as amended, including available legislative history since 1981, as well as Regulations, Policy Statements, and Procedure Manuals;
- Supreme Court, Tax Court, and US Court of Appeals cases;
- the United States Congressional Record, including committee reports and discussion;
- memoirs, speeches, and policy statements for political participants in the IRC, including presidents, senators, members of Congress, and aides; and
- peer-reviewed and professional articles addressing the IRC and its history.

Efforts were made to internally validate each source or item selected, in historical tradition. Artifacts were selected, reviewed, and documented in order to establish their historical accuracy and to understand and place into appropriate context their political nature. Stated differently, political sources are inherently situated in a particular political paradigm, and are by definition biased. With each document, the author or participant was considered in appropriate context. For

example, a former adviser to a president may be inherently biased in favor of his or her former employer. Accordingly, throughout the research process, attempts were made to triangulate the primary and secondary source data to achieve a balanced view of the event, and to take into account any diverse perspectives that were available. As narratives and themes emerged within the historical record, those themes were developed to construct an overall view of the opposing views and perspectives of the event, as well as to develop a sense of the legacy of the bill itself.

Finally, once the four major acts were thoroughly analyzed, and once data saturation was achieved, the data were re-interpreted and synthesized to identify significant themes and shifts that characterized the entire period under study. In this way, the research not only created a historical narrative of what had occurred, and why, but it also illuminated historical shifts that transcended the individual acts themselves. For example, while Ronald Reagan's administration and the two acts he presided over during his tenure typified tax reduction efforts and deficit creation, it became clear through the historical record that, 20 years later, President George W. Bush would adopt many of Reagan's approaches to tax policy. In another instance, it became clear through analysis of the entire period that George H.W. Bush and Bill Clinton, though from different political parties, agreed fundamentally on the importance of fiscal budget responsibility. Each Act was also analyzed through the lens of the effect of the legislation on the budget deficit, as well as the overall size of government, as defined by governmental expenditures. This research also sought to draw conclusions about the period under study in terms of tax fairness, successful tax policy, and what constitutes and contributes to real tax reform.

## **2.4 Limitations and Ethical Considerations**

The limitations of this study are known: qualitative research is inherently subject to the bias of the researcher. It is possible that different researchers would choose different acts upon which to base similar analysis. It is also possible that the researcher's own political affiliation might bias the selection of source material. Also, the qualitative nature of the research makes it strictly contextual: it is time and place bound, and cannot be generalized to any other circumstances (Patton: 2002).

In addition, all the data used in this study was in the public domain, and accordingly, no ethical considerations arose. Interviews were not conducted; opinions were considered in their written or spoken form. Historical documents and artifacts were validated to the extent possible using sourcing and contextualization: that is, contemporaneous records were given substantial weight, while later records were viewed as secondary sources.

Finally, this study sought to analyze a particular period in the history of American tax policy, specifically the time period from 1981-2001. Though the four major legislative changes discussed in this study are all generally understood to be of landmark importance, it should be understood that historical analysis during a specified time frame is difficult. For example, the development of The Economic Recovery Tax Act of 1981 would have likely been impacted by the political and economic conditions that had developed during the Carter administration, and possibly before. By further example, though this study identifies certain parallels between Reagan and George W. Bush's approach to budget deficits and tax policy, both presidents would have been influenced by both their own tax philosophy, and by the social and political conditions, favourable or unfavourable, under which they inherited the presidency. While this

study considers these factors in reaching its conclusions, this is a noteworthy limitation of any historical research which analyses a particular time frame.

## CHAPTER 3

### The Economic Recovery Tax Act of 1981

#### 3.1 Introduction

The Economic Recovery Tax Act of 1981 represented a major turning point in United States tax policy. The bill was President Ronald Reagan's first major attempt at tax reform, and came on the heels of a deep recession that had begun under President Jimmy Carter (Tax Foundation: 1983b). Passed in August 1981, the Act was considered to be a "watershed event in the history of Federal taxation." (Tax Foundation, 1983a:1).

Since beginning his presidential campaign, Reagan had watched the unemployment rate increase from around 6.2% in 1980 to nearly 8% in 1981 (Bureau of Labor Statistics: 2015). Before the recession began to slow, unemployment would ultimately reach 11% in January of 1983 (Bureau of Labor Statistics: 2015). It is clear that the economic situation Reagan inherited from the Carter administration was dire, and economists have since debated whether this was in fact the worst economic crisis in the United States since the Great Depression of the early 1930s. In a 2009 article in the Washington Times, Richard Rahn analysed the economic situation in the context of the 2009 economic crisis in the United States (Rahn, 2009: 1):

Both President Reagan and President Obama inherited an economy suffering from a year of no growth, along with rising unemployment. The numbers are almost identical. But Mr. Reagan faced a far direr situation in that inflation was in the double digits and the prime interest rate was at 20 percent. In contrast, Mr. Obama inherited an economy in which inflation was falling. In

fact, inflation has been close to zero for this year and interest rates were very low. A situation in which the number of jobs available is falling is bad enough, but if inflation is also destroying purchasing power, the misery is compounded.

It is clear that Reagan understood that the United States was in a critical economic situation that would likely get worse before it improved. In a 1980 campaign speech, he spoke about the economy and his strategy to grow it (Reagan, 1981: 1):

At the heart of that strategy for economic growth are eight major steps:

- 1) We must keep the rate of government spending at reasonable and prudent levels.
- 2) We must reduce personal income tax rates and accelerate and simplify depreciation schedules for business in an orderly, systematic way to provide incentives to work, savings, investment, and productivity.
- 3) We must review regulations that affect the economy, and change or eliminate them to encourage economic growth.
- 4) We must establish a stable, sound, and predictable monetary policy.
- 5) We must promote the export of American products abroad.
- 6) We must revitalize American industry.
- 7) We must adopt an energy policy that will allow our economy to grow, and our standard of living to rise.
- 8) And we must restore confidence by following a consistent national economic policy that does not change from month to month.

Reagan emphasized two key tax policy goals: reduction in individual tax rates, across all tax brackets, and more aggressive, simplified depreciation schedules to relieve corporate taxpayers. Underlying both of these concepts was the idea that Reagan wanted tax changes to be easily

understood, simple to implement, and consistent. As will be discussed in subsequent chapters, Reagan's operating philosophy was in line with principles associated with "broad-based" tax reform. Broad-based tax reform is an approach to tax policy that is generally understood to stress lower statutory tax rates that apply to all, or nearly all situations uniformly, with fewer carve-outs for individual and corporate taxpayers. This is in contrast to more targeted tax policy, which may produce high statutory rates of tax, yet allow for numerous carve-outs and exceptions which erode the effective tax rate. The latter approach arguably distorts the tax system by producing a less efficient tax result. Under a more targeted system, taxpayers can achieve disparate results, either through planning or avoidance, and the costs of voluntary compliance, as well as enforcement, appear to grow. Though notions of what constitutes "good" tax reform vary, this study focused on broad-based tax reform as the ideal standard by which other tax reforms or changes may be compared, due to its focus on simplicity and equity. The 1981 Economic Recovery Tax Act would take shape as a step toward broad-based reform: across-the-board, flat cuts in individual tax rates, and additional depreciation conventions that would promote growth. The former certainly contributed to simplicity. The latter, though stimulating growth and capital investment, did little to simplify tax depreciation rules.

As this research will discuss, the Economic Recovery Tax Act of 1981 reduced tax revenues significantly and created large budget deficits. Further, driven by a significant strategic defense buildup under Ronald Reagan and political opposition to domestic spending cuts, the stage was set for an era of unprecedented deficits (Pollack: 1996). As a direct result of the 1981 Act, tax policy and legislative activity in the mid-1980s would be characterized by a new paradigm: deficit politics, a reduced tax burden, and a quest for revenue neutrality (Pollack:

1996). Forces on both sides of the political aisle would be forced to justify, account for, and manage the deficits that their policy proposals created.

### **3.2 Background**

By 1980, the economic conditions in the United States had shifted dramatically away from the era of “easy finance.” (Brownlee, 1996: 115). Booming economic conditions prior to the oil crises of the 1970’s had created a period during which raising tax revenues was relatively easy: inflation was low, tax bases were high, economic activity was robust, and likewise, tax rates could necessarily be low as well (Brownlee: 1996). However, as these conditions began to change, raising revenue also became much more difficult: high inflation and a struggling economy led to low tax bases and limited the possibility for rate increases (Brownlee: 1996). This myriad of conditions necessitated a new approach: enter Ronald Reagan and his supply-side approach to economics and taxation.

Reagan’s campaign platform advocated for smaller government and increased reliance on the private sector in an effort to improve the economy. This was a classic conservative stance, but at the time many considered this approach to be counterintuitive (Robson: 2015). Not only was this counterintuitive from an economic perspective, it arguably defied natural management tendencies. When difficult circumstances arise in a management environment, the logical conclusion often reached is for authority figures to seek more control, to intervene and manage the problem more closely (Henderson: 2006). This type of close intervention may seem logical, but it does not necessarily transmit to better outcomes as the increased scrutiny does little to solve the underlying problem (Henderson: 2006).

Alternatively, Reagan clearly believed that intervening less in the economy could actually jumpstart consumer activity and improve public confidence. Buoyed by the backlash against the Carter administration's failures, and rising anti-government sentiment among voters, Reagan moved ahead with an economic plan that would shrink the size of government, give rise to new budget deficits, and reduce the power of the income tax in American public policy (Brownlee: 1996).

### **3.3 Timeline**

The timeline of the Economic Recovery Tax Act of 1981, and its movement through the legislative process, is outlined below (Govtrack: 2015b):

- July 23<sup>rd</sup>, 1981 introduced
- July 29<sup>th</sup>, 1981 House version passed
- July 31<sup>st</sup>, 1981 Senate version passed
- August 3<sup>rd</sup>, 1981 Senate Conference report adopted
- August 13<sup>th</sup>, 1981 signed by the President into law.

### **3.4 Key Figures in the Economic Recovery Tax Act of 1981**

Four figures were most important to the development of the 1981 Act—President Jimmy Carter, President Ronald Reagan, Speaker of the House Tip O'Neill, and Illinois Representative Dan Rostenkowski. Carter and Reagan epitomized two distinct policy approaches. Carter stressed the importance and value of equality, fair taxation, and a strong role for the Federal government. Reagan believed in the individual, and the rights of individuals to make their own economic decisions. These leaders were from markedly different walks of life, with Carter, a

former peanut farmer; Reagan, a Hollywood actor; O’Neill, a career public servant who made easy caricatures for the political right; and, Rostenkowsi, an awkward speechmaker with a gift for working a “deal.”

*James Earl “Jimmy” Carter, Jr.*

A graduate of the U.S. Naval Academy, Jimmy Carter was born into a family of peanut farmers, and hailed from the state of Georgia. He was deeply religious, of the Baptist faith, and began his political career in 1962, ultimately becoming Governor of the State of Georgia (White House: 2016). Carter was known to be a soft-spoken champion of the average American. Despite his unpopular and largely unsuccessful presidency, Carter was ahead of his time on a number of political issues, such as the environment, energy efficiency, and equality under the law (White House: 2016). Carter would serve just one term as President, from 1977-1981. In 2002, he was awarded the Nobel Peace Prize for “work to find peaceful solutions to international conflicts, to advance democracy and human rights, and to promote economic and social development.” (White House, 2016: 1).

*Ronald Reagan*

Ronald Reagan served two terms as President of the United States, and is known as one of the most influential Presidents of the 20<sup>th</sup> century. A champion of individual liberty, economic growth, and limited government, Reagan became known as a proponent of “Reaganomics”, a conservative version of supply-side economics. A former actor and governor of the state of California, Reagan was a renowned speechmaker and left his second term as one of the most broadly popular Presidents in history (White House: 2014). Reagan played an important and very

public role in positioning tax reform for success, particularly in signaling to both political parties that tax reform was both possible and necessary. However, Reagan's approach to budget deficits, tax policy, and deficit spending remain controversial to this day even among experts (White House: 2014).

*Thomas P. "Tip" O'Neill*

Born in 1912, Tip O'Neill was a powerful and well known Democratic Speaker of the House, and a Representative from Massachusetts (Biographical Directory of the US Congress: 2015d). O'Neill was elected to Congress seventeen times, serving as chair of the Select Committee on Campaign Expenditures, as majority whip, majority leader, and Speaker of the House of Representatives (Biographical Directory of the US Congress: 2015d). His reputation as a dealmaker and artist of political compromise was legendary, and he detested above all other things a political stalemate when action was needed (O'Neill: 2012). In the words of his son, O'Neill was also champion of the less fortunate, and a foil for Ronald Reagan when he needed to be (O'Neill, 2012: 1).

As speaker of the House, he was obliged to fight what he and his party believed were disastrous steps being taken by the Republicans. My father fought tirelessly to see that Reagan's policies did not run roughshod over the disenfranchised.

O'Neill would retire from Congress in 1986 without losing an election. He forged a strong relationship with Ronald Reagan, and despite their political differences, O'Neill and Reagan would become legendary for their ability to compromise (O'Neill: 2012).

*Dan Rostenkowski*

Dan Rostenkowsi was a Democratic Congressman from Chicago, and was known as an unmatched Capitol Hill “dealmaker.” He epitomized the slightly greasy feel of a traditional Washington insider, plain-speaking, a bit rough around the edges, but willing to do whatever it took to move his agenda forward. He was elected to Congress at the age of 30, and remained the youngest member for a number of years (New York Times: 2010). Rostenkowski was unpretentious and blue-collar, a product of Mayor Richard Daley’s Chicago political regime. Rostenkowski had a checkered record as a speechmaker and lacked public relations agility. Reportedly, a speechwriter had once given Rostenkowski a speech with the word “hyperbole” in it. Rostenkowski proceeded to pronounce the word “hyper-bowl” when he delivered the address. (Birnbaum & Murray: 1992) He was also master of mixed metaphors, claiming once that guiding the 1986 Tax Reform Act through Congress was like walking through an “egg field” instead of “mine field.” (Birnbaum & Murray: 1992). A “machine politician”, he eventually became Chairman of the House Ways and Means Committee, and a gained a reputation as powerful broker of compromise, with friends on both sides of the political aisle. He played an instrumental but unexpected role in moving the Tax Reform Act of 1986 forward. True to his roots, he lived in his childhood home until his death at 82 in 2010 (New York Times: 2010). A significant stain on Rostenkowski’s career was his indictment and conviction on fraud charges, which effectively led to his unseating in Congress and the end of his political career.

### **3.5 Major Provisions of the Economic Recovery Tax Act of 1981**

The Economic Recovery Tax Act of 1981 was arguably most influential as a sea change in tax doctrine. It introduced a counter-narrative, one that insisted on smaller government, in the hope that lower individual tax burdens would free the economy to grow and expand. However,

specifically, it consisted of several important and influential provisions (Tax Policy Center, 2015b: 1-3).

- 1) the Act replaced Asset Depreciation Range guidelines with the Accelerated Cost Recovery System; provided faster write-off of capital expenditures, with most equipment written off over 5 years, structures over 15 years, and liberalized "safe-harbor" leasing rules;
- 2) reduced marginal tax rates by 23% over 3 years, and indexed brackets for inflation;
- 3) reduced the maximum estate tax rate from 70 to 50%;
- 4) increased the estate tax credit to exempt all estates less than \$600,000 in value;
- 5) extended eligibility for IRAs to include active participants in employer pension plans; increased Keogh annual contribution limit to \$15,000; and
- 6) reduced the capital gains tax to 20%.

Of these changes, the most significant, both economically and politically, were the changes in individual marginal tax rates; indexation of tax brackets; reduction in the capital gains tax rate; and the introduction of the Accelerated Cost Recovery System.

### **3.6 Reagan's Revolution**

Reagan's tax policies would become widely known as the "Reagan Revolution." (Pollack: 1996). This name seemed to stick because these policies were in fact revolutionary: they were in stark contrast to historical approaches to taxation in the United States and gathered momentum with surprising speed and vigor (Pollack: 1996; Brownlee: 1996). Professor John Robson recounted Reagan's "hands off" approach to managing the economy and some of the initial impressions it generated (Robson, 2015: 00:30-3:00):

It's hard now to remember just how revolutionary it was at the time, and what mockery Reagan endured while campaigning for president on the theory that government should get out of the way

and let the economy create wealth, instead of taking responsibility for it. Ever since the early 1930's people have been convinced that it was up to the government to make sure that we were prosperous. That private firms were somehow short-sighted, stupid, greedy, and destroyed wealth rather than created it.

Reagan's move away from "big government" echoed the views of the American public at the time. In a Pew Research Center poll taken in 1981, 65% of Americans believed that "government had gone too far in regulating business, while another 62% agreed that "they rarely trusted the government in Washington." (Pew Research, 2010: 1). Accordingly, Reagan's tax proposals, particularly his proposed reductions in marginal individual tax rates, appeared to tap directly into this sentiment.

Reagan also viewed taxes as a barometer of freedom: increases in taxes effectively removed autonomy from the individual and placed it in the hands of government (Meese: 2006). He believed that individuals would make better decisions about how to spend their money than the government, and as a result, whenever possible, they should keep what they had earned (Meese: 2006). Former Attorney General Edwin Meese recounted Reagan's strong opinions on this issue, and the families that played a role in strengthening his convictions (Meese, 2006: 20:30-21:30).

The key element in all of this, without which none of them would have worked, was the tax rate reduction, which we are celebrating today. He (Reagan) was very well aware of President Kennedy's tax rate reductions, which he started, and which were enacted shortly after his assassination. Cutting taxes was not a new idea with Ronald Reagan. He had talked about the excessive rate of taxation when he was doing the GE Circuit. Part of his contract when he was doing the GE Theatre was to meet with the various employees at the GE plants around the

country during the weeks between the showings of GE Theatre, which came on once a week. In those meetings with those workers, and also talked about with them, he learned the importance of low tax rates as a means for helping America's families. For him, taxation was not just a matter of revenue-raising for the government, or a matter of what people had to pay out of their budget. For him taxation was a matter of freedom. Because he felt the more money people had for themselves, the more they made the decisions about what to do with that money.

As Meese suggests, Reagan viewed taxes as much more than a budgetary duty or requirement to pay as a citizen. Rather, it is clear that Reagan had begun to craft a much more fundamental ideology surrounding taxes and budgets: that taxes equated more government, and more government had not worked in the Carter years and would not work now. This was a political position Reagan would take frequently during both of his terms: that he was on the side of the American people, not on the side of the government, despite being a government employee himself (Reagan: 1982). He also believed strongly in the rightness of the individual to make decisions that were in the individual's own best interests, and that the collective power of individuals, acting alone, were greater than that of the government (Reagan: 1982). Reagan had very effectively tapped into a strong anti-government sentiment, which naturally travelled hand-in-hand with anti-tax sentiment (Brownlee: 1996).

While Reagan was to become the face of the Economic Recovery Tax Act of 1981, and ultimately, the face of 1980s tax reform, he was not the first to consider rolling back the power of the income tax (Pollack: 1996). As early as 1977, President Jimmy Carter had shown interest in tax reform, particularly with respect to reducing the tax burden on middle-class Americans. Carter had placed tax reform high on his administration's priority list, even calling for a complete overhaul of the United States' tax system in his acceptance speech before the

Democratic National Convention (Pollack: 1996). He had on numerous occasions expressed his deep disgust with the tax code's particularities and inequities (Brownlee: 1996). Carter had also seriously considered alternatives, such as a consumption or value-added tax, as a supplement or replacement for the regressive, small base, piecemeal system that was then in place (Brownlee: 1996). However, no consumption or value-added tax had ever gained traction at the Federal level in the United States, though such taxes were common at the state and local level. Carter was also unsuccessful in moving toward other types of Federal taxes that might displace the income tax.

Earlier, in 1977, Senator William Roth and Representative Jack Kemp had introduced a tax reform bill known as "Kemp-Roth I." This bill called for a 1/3 reduction in individual income tax rates, as well as a 3 percent reduction in the corporate tax rate, though the bill was ultimately voted down (Pollack, 1996: 88). Notably, Reagan would subsequently use a more modest form of Kemp-Roth I as the foundation for his tax proposals (Pollack, 1996:88). In 1978, Carter did sign into law a relatively weak tax relief measure, a bill which had been "de-fanged" and debilitated by political fighting (Brownlee: 1996). However, Carter's efforts, and those of others stopped short of adopting any other substantive alternatives to the system in place. This, coupled with the anti-government movement that had begun to coalesce, quashed the possibility of substantive reform as desired by Carter (Brownlee: 1996).

In the push for the passage of the Economic Recovery Tax Act of 1981, both on the campaign trail, and after his election in November of 1980, Reagan was effectively asking the nation to take a gamble in order to fix the ailing economy by departing from traditional Keynesian economic principles (Robson: 2015). Many politicians, particularly Democrats, felt Reagan's positions were risky in terms of their projected revenues and costs (Roberts: 1981). Reagan sought to strengthen his political position by pulling all necessary political levers,

including taking his case to the American people, as he did in a speech on February 5<sup>th</sup>, 1981 (Reagan, 1981:1).

Good evening. I'm speaking to you tonight to give you a report on the state of our Nation's economy. I regret to say that we're in the worst economic mess since the Great Depression. A few days ago I was presented with a report I'd asked for, a comprehensive audit, if you will, of our economic condition. You won't like it. I didn't like it. But we have to face the truth and then go to work to turn things around. And make no mistake about it, we can turn them around. I'm not going to subject you to the jumble of charts, figures, and economic jargon of that audit, but rather will try to explain where we are, how we got there, and how we can get back.

Reagan established a strong populist tone in this speech, and interestingly, rhetorically “turned the tables” on the Federal government. As Reagan portrayed the situation, the Federal government was not auditing the American taxpayer anymore; Reagan and the American people were auditing the Federal government. He also took a can-do, positive tone, a departure from the negative tone often set by the realistic but pessimistic Carter administration (Brownlee: 1996). This speech was concise, and its message was clear: America’s problems could be fixed; they were no longer a mystery; brighter days were ahead. Reagan went on to lay groundwork for how significant the economic problems were, and why reform was needed (Reagan, 1981: 1).

First, however, let me just give a few “attention getters” from the audit. The Federal budget is out of control, and we face runaway deficits of almost \$80 billion for this budget year that ends September 30th. That deficit is larger than the entire Federal budget in 1957, and so is the almost \$80 billion we will pay in interest this year on the national debt. Twenty years ago, in 1960, our Federal Government payroll was less than \$13 billion. Today it is 75 billion. During these 20 years our population has only increased by 23.3 percent. The Federal budget has gone up 528

percent. Now, we've just had 2 years of back-to-back double-digit inflation -- 13.3 percent in 1979, 12.4 percent last year. The last time this happened was in World War I. In 1960 mortgage interest rates averaged about 6 percent. They're 2 1/2 times as high now, 15.4 percent. The percentage of your earnings the Federal Government took in taxes in 1960 has almost doubled.

In this speech, Reagan had addressed complicated and frightening economic matters, faced them head on, and made the case for lowering the individual taxpayer's Federal tax burden. It is clear Reagan hoped that his proposed reduction in individual taxes would help the economy. Borrowing from Kemp-Roth I, the centerpiece of Reagan's proposals was an across-the-board cut in the marginal personal tax rate, designed to infuse cash into the pocket of the average American (JEC Report: 1996; Pollack, 1996:88). Further, Reagan's proposals for the Economic Recovery Tax Act of 1981, followed by the Tax Reform Act of 1986, ushered in an era of reduced marginal rates for individual taxpayers (JEC Report: 1996).

Conservative consultant Arthur Laffer captured well the conservative ideology under which the Reagan administration undertook its efforts to collectively reduce individual tax rates (Cato Institute, 1991: 7:30-8:15):

Likewise, remember what things were like back then when you judge the whole policies. In 1980 at the end of the year, the prime interest rate was 21.5% at the beginning of '81. The highest marginal rate on unearned income, 70%. I mean, the Soviets were still a major threat to the world. The conceptual framework that we had been living on before this was that you can tax workers and producers, and pay people not to work and not produce, and you expect more people to become workers. It just doesn't make sense.

Laffer summarized well the position of the Reagan administration. Clearly Reagan believed that by reducing tax rates across the board, individuals would be able to spend more of their money,

or increase their rate of savings, both of which would jumpstart the United States' economy. Reagan's opposition to high individual marginal tax rates was clear. The question was, what would be the effects of such a cut, and would it stimulate the struggling U.S. economy without triggering insurmountable budget deficits?

### **3.7 Criticism of Carter**

In a speech in October of 1980, Reagan outlined his criticisms of the Carter administration's approach to taxes and fiscal responsibility. Specifically, he had consistently sought to paint Carter as out of touch with the average American taxpayer, and as someone who believed "big government" was the only solution to the nation's problems (Reagan, 1980: 4-5).

The symbol of this administration is a finger pointing at someone else. And on October 14th, after spending most of the first part of the campaign running away from his economic record, he finally made a speech on the economy. And he came up with a new list of who, or what, to blame for inflation. The number one item on his list was, and I quote: "the failure to raise adequate revenues at a time of greatly increased public spending." What that means in plain English is that he didn't raise our taxes enough. Now, Mr. Carter has already imposed the two largest tax increases in our nation's history. And by 1981, he will have succeeded in doubling the tax load on the American people—the equivalent of a tax increase on a family of four of more than \$5,000 a year. Now, I'd like to ask him: isn't that enough? Apparently not—according to his economic plan, annual taxes will go up \$86 billion next year alone, and \$500 billion over the next five years.

Reagan's approach seemed to be to free up the American consumer to spend or save, rather than pay taxes into the Federal budget. He was counting on an unrestrained economy to produce enough growth and consumer confidence to allow him to run budget deficits in the short-term in

order to create better long-term results. Reagan also criticized Carter's spending approach (Reagan, 1980: 4-5):

He's increased government spending by nearly 60 percent in four years. It is this incredible increase in spending that has caused inflationary deficits—not low taxes. We don't have inflation because we are living too well. We have it because government is living too well. Mr. Carter is acting as if he hasn't been in charge for the past three and a half years; as if someone else ran up nearly \$200 billion in federal red ink; as if someone else was responsible for the largest deficit, including off-budget items, in American history; and, as if someone else was predicting a budget deficit for this fiscal year that began October 1st of \$30 billion or more. Finally, he blames "the long decline in our productivity growth." I would like to ask him: which president has presided over six straight quarters of falling productivity? Which president by 1981 will have increased the punitive tax burden on our economy by some \$300 billion? Which president has created two new cabinet departments and has increased the burden of federal regulations?

Reagan's criticism is interesting, if not ironic, given that both he and Carter would run deficits throughout their presidencies, both in constant dollars and inflation-adjusted numbers (White House: 2016). Despite this, one can identify a clear political opening for Reagan given these circumstances, particularly with respect to his goal of instituting a "supply-side" approach to revenue and taxation. With the economy struggling, nearly any departure from Carter's policies would likely be seen as a viable alternative. Reagan sought clear contrast between his own fiscal approach and Carter's: he positioned himself as trusting the American taxpayer with their own money. Carter, on the other hand, was portrayed as on the side of government, "smarter" than the average citizen. However, many of Carter's late-term policies echoed Reagan's. In his January 1981 State of the Union speech, shortly after his massive November election loss to Ronald

Reagan, Carter called for changes to the tax code, favouring corporate reductions rather than individual ones (Carter Library, 2014: 2-3).

I have declined to recommend such actions to stimulate economic activity, because the persistent inflationary pressures that beset our economy today dictate a restrained fiscal policy. Accordingly, I am asking the Congress to postpone until January 1, 1982, the personal tax reductions I had earlier proposed to take effect on January 1 of this year. However, my 1982 budget proposes significant tax changes to increase the sources of financing for business investment.

Carter recognized the dangers of inflation, but also recognized the need to promote new capital investment in order to get the economy moving again. Other than Carter's curtailment of the individual tax benefit, there is striking similarity between these proposals and Reagan's proposals during the 1980 campaign cycle (Carter Library, 2014: 2-3).

The level of investment that is called for will not occur in the absence of policies to encourage it. Therefore, my budget proposes a major liberalization of tax allowances for depreciation, as well as simplified depreciation accounting, increasing the allowable rates by about 40 percent. I am also proposing improvements in the investment tax credit, making it refundable, to meet the investment needs of firms with no current earnings. These two proposals, along with carefully-phased tax reductions for individuals, will improve both economic efficiency and tax equity. I urge the Congress to enact legislation along the lines and timetable I have proposed.

Not only were Carter's proposals in line with Reagan's in terms of *what* should be accomplished, he likewise stressed efficiency, equity, and simplicity, as did Reagan (Carter Library: 2014).

### **3.8 Reagan and the Democratic Opposition**

Reagan's overwhelming popularity and landslide electoral win were nightmarish obstacles for hardline Democrats and huge advantages for Reagan and the supply-side Republicans. Democratic leaders, including House Speaker Tip O'Neill, seemed to believe this as well. They were convinced that public sentiment and media attention were irrevocably on the side of the President (O'Neill:1988). This, coupled with an anti-government political climate spawned by the struggles of the Carter administration, empowered Reagan's coalition and led to trouble for Democratic leaders. In particular, even entrenched Democratic leaders, such as Speaker Tip O'Neill, were accused of being moot, disempowered, and without direction (New York Times, 1981b:1-2):

Tip O'Neill had tried to hold the Democratic majority of the House together in the face of an all-out campaign by a skillful, determined president. The Speaker had lost the first two rounds, the battles over the budget, in May and June. Now, a month later, he was back on the ropes, facing a Congress filled with young men with blow-dry hairdos who were more at home with computer printouts and media advisers than with the Speaker's old-style, personal kind of politics. They had been children when he first stood at this rostrum almost three decades ago. The passionate, New Deal liberal had changed little since then, while many of his listeners, even within his own party, were, in his view, defectors.

The Democratic party and its leadership had been undermined by Reagan's perceived electoral mandate. Ironically, this paved the way for greater compromise and less gridlock in that more moderate Democrats, such as Illinois Representative Dan Rostenkowski, became more important in the negotiations with the President.

Substantive discussion and debate of the Democratic and Republican plans began to gain momentum in the spring of 1981. Representative Dan Rostenkowski (Democrat, represented the state of Illinois) gave a speech in April of 1981 in which he outlined the Democratic opposition

to Reagan's tax plan. One of the key criticisms in the Democratic rebuttal was also one of Reagan's sources of pride: individuals could spend the proposed incremental tax reductions in any way they wanted. Rostenkowski pointed out the weakness in this approach: "What we don't know is where--and how much--people will save and invest. We don't know whether a middle-income family will invest their tax cut in U.S. Steel--or a trip to Disneyland." (Rostenkowski, 1981: 1). Rostenkowski's comments were in sharp contrast to Reagan's belief that the individual knew best how to spend their own income. In addition, Democratic party leaders sought a plan that would oppose Reagan's momentum, but that would also pass Congress (Smith: 1981). In creating space between Reagan's plan and the Democratic alternative, the difficulty was that more differentiation reduced the likelihood of an acceptable compromise (Smith, 1981: 2):

"Danny's problem," (referring to Rostenkowski) said another senior House Democrat, "has been - do you want to join a winning combination with the President or is the price the Administration is asking too high and you'd rather offer a Democratic alternative that you probably don't have the votes to pass." But Mr. Rostenkowski's aides said he was opposed to staging "a Democratic Alamo" and suffering another shattering defeat. He preferred to mold a consensus package to lure back some of the conservative Democrats being so ardently wooed by the White House.

Rostenkowski was honing his skills as a backroom negotiator, skills he would put to use in both the 1981 Act and later the Tax Reform Act of 1986. Rostenkowski was known to prefer to work one-one-one, out of the limelight, carefully avoiding too much public relations and speechmaking (Smith: 1981). He proved to be skilled at this kind of political maneuvering (Smith, 1981: 2):

"He wants a bill he can take from the committee and take to the floor and win," said one Rostenkowski aide. "He's met the White House exactly halfway," commented Jim Wright of

Texas, the House Majority leader. "Not a one-year bill or a three-year bill, but a two-year bill. The 15 percent rate cut he's announced is half of what the President originally wanted," he said, "and it will save \$60 or \$70 billion in budget deficits by leaving off the third-year tax cut."

Rostenkowski represented the middle ground: a Democrat, willing to compromise with the President. Rostenkowski and other moderates became more important as powerful, traditional leadership apparently faltered (New York Times, 1981b:2-3).

The President, in his six months in office, had engineered a revolutionary change in the direction of Government, reducing its size, powers and appetites. He had effectively taken control of the Congress, raising questions about the ability of the House and Senate to compete on anything like an equal footing with a popular President who knows how to use the power of his office. Moreover, the Reagan victories had led many in Congress to entertain doubts about Tip O'Neill and his leadership.

It is important to note that the political climate surrounding the debate of the Economic Recovery Tax Act of 1981 was still that of a divided government. Despite a heavy electoral mandate in the executive branch, which may be inferred by Jimmy Carter's landslide loss in the 1980 election, Reagan still faced a largely Democratic Congress and clearly needed to compromise in order to govern. As discussed throughout this research, there are some unexpected advantages to a balance of power between the parties which control the executive and legislative branches of government. Specifically, with shared power both sides appear to be more likely to compromise, and less likely to take up extreme political positions or resort to mechanical means to defeat legislation. Former House Representative Charlie Stenholm discussed this division and how it influenced legislative behaviour (Stenholm, 2015: 1):

When Ronald Reagan was elected president in 1980, Democrats lost 23 seats, but still controlled the House 244 to 191. In the Senate, Democrats lost 12 seats and gave up control to the Republicans by a margin of 53 to 46, with one independent. We had a divided government. Tip O'Neill, who was Speaker of the House at that time, could have insisted that any bill coming out of his chamber have a majority of Democrats supporting it, but he knew that he did not have that kind of power and really did not want it. He told the new president that "We will cooperate in every way" — not that Democrats would necessarily vote for what the president wanted, but that we would allow the House to work its will. Tip also recognized that the people of America had voted for change and the new president deserved a chance to pass his agenda. That required at least 26 Democrats (usually a few more) on every bill, because even then some Republicans and Democrats would not vote for anything.

Tip O'Neill and Ronald Reagan were well known as politically different men who managed to find enough personal common ground to work through differences and compromise (Bedard, 2010:1). Bedard captures the thoughts of Tip O'Neill's biographer, John Farrell, who made it clear that these two men shared a special, one-of-a-kind relationship unlikely to happen again in American politics (Bedard, 2010:1):

"Reagan and O'Neill had so much in common," says Farrell, a U.S. News contributing editor. "Don't get me wrong," says Farrell. "Folks in Berkeley detested 'Ray-gun,' and folks in Orange County thought Tip was a clueless lump of what the Irish call blarney. But you didn't have the domination of the parties by their bases the way you do now." The model for today's regime, he says, is more like the dueling relationship between Bill Clinton and Newt Gingrich.

Likewise, Reagan understood that he needed the other side, the political left, to help him achieve anything in his first term. Despite the poor economy and struggles of the Carter administration,

Reagan needed to work across the political aisle to secure enough votes for any measure (Bedard, 2010: 1).

John Heubusch, who heads the Ronald Reagan Presidential Foundation, says: "When Reagan came to Washington, it was a certainty that he could not get any of his bold ideas into action until or unless he had a bipartisan solution. That was a given. So his initiatives, his lobbying approach, and his communications strategy, and the personal relationships he built were with all this in mind." And Reagan gambled with his fellow Irishman sometimes to a draw. "He'd ask for more than he expected to get and was willing to settle for less than the whole loaf," Heubusch adds.

This willingness to work together, regardless of party affiliation, appeared to be important in that it sent a signal to other legislators that compromise was possible, even expected.

In the meantime, Reagan remained a persistent and popular politician, and had successfully wooed many conservative Democratic Congressmen for their support (New York Times: 1981). These Democratic politicians were known as "boll weevils" for their willingness to break ranks and vote Republican (Malone: 1983). These Congressmen were mostly conservative and represented districts in the Southern United States. Accordingly, the term "boll weevil" referred to the pest insect that fed on cotton plants, which were native to the Southern United States. It was a political jab, implying that these southern Democrats could not be counted on as solid Democratic votes despite carrying the Democratic party label.

These "boll weevil" Democratic votes would prove to be critical to Reagan's success in Congress. A number of the so-called "boll weevils" and other moderate Democrats had formed a coalition known as the Conservative Democratic Forum. The group was comprised of 45 Democratic Congressmen, mostly from the South. This group effectively ensured the success of Reagan's proposals, primarily by their willingness to break solidarity with the party voting line,

which undermined the authority of party leaders (Roberts: 1981). In general, the group expressed openness to considering budget and tax issues from both sides, making them “free agents” in their deliberation of Reagan’s tax cuts (Roberts: 1981). As a rule, the group favoured budgetary restraint, primarily supporting Reagan’s proposed spending reductions, but cautiously opposing the severity of his proposed plan to reduce taxes and revenues (Roberts: 1981). Several key members of this group, including Representative Ken Holland of South Carolina, Representative Ed Jenkins of Georgia, and Representative Kent Hance of Texas were interviewed as part of a New York Times piece on this breakaway movement (Roberts, 1981: 1-2):

All prefer a smaller cut than the President proposes, to take effect at a later date, perhaps not until 1982. They disagree on whether the cuts should be for one year or several years, and whether the cuts should be across-the-board or skewed toward lower-income groups. But they agree on proposals to reduce taxes on estates, unearned income and capital gains. All would like to see the cuts arranged to stimulate savings more directly. None of the three conservatives underestimates Mr. Reagan's power to stir up support for his tax package, but they feel that the President used up considerable political capital in pushing through his budget. As Mr. Holland put it, "The second Holy War has a little less passion than the first one, and the Administration knows that."

The budget battle referred to by Representative Holland was one in which Reagan pushed through approximately 45 billion in spending cuts in March of 1981. These cuts would succeed but not without a considerable battle in Congress. The Federal budget was already thin, and Reagan had signaled that he was unwilling to touch defense spending, while many Democrats expressed concern over domestic spending: particularly social programs such as Social Security, early childhood education, veteran’s benefits, and welfare (New York Times: 1981c). Given the polarity and “sacred” nature of the potential cuts—defense spending for the conservatives, and

social programs for the progressives-- a difficult road lay ahead for budget director David Stockman (New York Times, 1981c: 1):

Not only will arm-twisting be in order, more elbow grease than even Mr. Stockman plans to apply may be needed. Add last week's ingredients - President Reagan's assurance that social programs for the "truly needy" would be preserved - to his oft-stated intention to increase military spending, and the room to cut the budget narrows even further. And that means that the fighting over what to preserve will be at closer quarters still. In social programs, Mr. Reagan said he would leave intact \$210 billion - or 25 percent of the budget - for seven programs that affect 80 million people, many of them elderly. Principal on the list are Social Security's Old Age and Survivors Insurance, the Medicare health insurance program, Veterans Administration disability benefits and Supplemental Security Income for the blind, disabled and elderly poor.

Representative Holland's "holy war" comments, as well as the comments about Stockman, chronicle the enormous amount of energy Reagan would expend in passing his budget in 1981. The Reagan administration's economic plan, however, received a glimmer of hope from the Conservative Democratic Forum. In March of 1981, the group had signalled acquiescence to Reagan's budget reduction demands by suggesting possible sources of budget cuts (New York Times, 1981c: 1). Proposed reductions included cuts in foreign aid and de-unionization of Federally-contracted construction workers. Reagan was happy with the group's willingness to negotiate, saying "I like this... I might consider becoming a Democrat again." (New York Times, 1981c: 1). This political humour was a reference to Reagan's affiliation with the Democratic party earlier in his life (New York Times, 1981c:1). Though the budget would pass, Reagan expended significant energy to get it done, and now had to move ahead to the tax reduction plan he proposed as part of the Economic Recovery Tax Act of 1981.

### **3.9 The Largest Tax Cut in the Nation's History**

In a 238-195 vote, which included the votes of many Democrats, Reagan's tax cuts would pass in July of 1981, at that time making them the largest tax cuts in American history (New York Times, 1981b:1). Politically, everything had changed (New York Times, 1981b:1). As already quoted on page 38, Reagan had capitalized on his public appeal:

The President, in his six months in office, had engineered a revolutionary change in the direction of Government, reducing its size, powers and appetites. He had effectively taken control of the Congress, raising questions about the ability of the House and Senate to compete on anything like an equal footing with a popular President who knows how to use the power of his office.

Several attempts to oppose the severity of the cuts were rejected, including plans to reduce the cuts to one year by Representative Morris Udall of Arizona, and Representative David Obey of Wisconsin (Cowan: 1981). Republican Representative Barber Conable of New York also offered a substitute plan, which would pass as the final version during the reconciliation process (Cowan: 1981). Conable stated, referring to the arduous political process involved in the tax cut debate, that the "mood of both sides is to get it behind us." (Cowan, 1981:1).

#### **Reduction in Marginal Individual Tax Rates**

According to tax historian Joseph Thorndike, Ronald Reagan was a "taxcutter legislatively, emotionally, and ideologically. But for a variety of political reasons, it was hard for him to ignore the cost of his tax cuts." (CNNMoney, 2010: 1) In pushing for lower marginal personal income tax rates, Reagan clearly hoped to lower unemployment, broaden the tax base, and decrease the ability of certain individual taxpayers to unfairly avoid taxation.

A 1996 draft report prepared by the Joint Economic Committee of the Congress of the United States addressed Reagan's plans and the issues his administration faced associated with marginal tax rates. The report concluded that high marginal tax rates "discouraged work effort, saving and investment, and promoted tax avoidance and tax evasion." (Joint Economic Committee, 1996: 1). This indicated that, at least in theory, Reagan's proposal to decrease marginal tax rates should have resulted in more individual work effort, increased personal savings, and less tax avoidance.

It is clear that high marginal rates, particularly in the top income brackets, incentivize taxpayers' avoidance behaviour because of the perceived economic payoff associated with avoidance. However, it is also apparent that the taxpayers who are most likely to successfully avoid taxes at high marginal rates are by definition wealthy taxpayers: they earn enough income to actually face high marginal rates, and are likewise well-positioned to create avoidance strategies through financial vehicles, tax planning, and use of legal counsel. As a result, one can conclude that high marginal rates may be inefficient because they generate resistance from taxpayers. This resistance, when successful, erodes their economic and budgetary value on a dollar-for-dollar basis. Stated differently, one can conclude that tax increases may not be as beneficial to the tax revenue budget when it is likely they will be opposed, or will require substantial enforcement resources to enforce them.

The Joint Committee concluded that reducing marginal tax rates correlated with long-term economic growth, and reduced the attractiveness of tax shelters and other avoidance schemes (JEC, 1996:1). Retrospectively, it appears that Reagan's rate reductions were effective in addressing these issues (Joint Economic Committee: 1996). The rate adjustments appeared to help shift the tax burden towards the wealthiest taxpayers, as the percentage of income tax

burden borne by the richest 10% of taxpayers increased during the period 1981-1988, from 48% to 57.2% (Joint Economic Committee, 1996:1). Further, it seems clear that tax avoidance strategies, primarily employed by wealthy taxpayers, become less effective when there is less incentive or ability to use them effectively.

With respect to tax fairness, one could conclude that high marginal tax rates also contribute to perceptions of unfairness in the tax code. This manifests in two distinct ways. First, the way the particular deductions and rates apply to taxpayers may be different based on the quality of their legal strategy. Second, instances of successful tax avoidance strategies, when made known to the public through news articles or other media, provide anecdotal evidence to the average taxpayer that the individual tax system unfairly benefits wealthy taxpayers. In a 2012 analysis, Hofman, Hoelzl, and Kirchler contend that “In a climate of mutual trust, citizens have positive representations of the tax systems and tax authorities and cooperate spontaneously. High subjective tax knowledge, favourable attitudes, personal and social norms of cooperation, as well as perceived fairness of the tax system are the basis of a motivational tendency to cooperate, of trust, and of voluntary compliance.” (Hofman, Hoelzl, & Kirchler: 2012, 1). Accordingly, Reagan’s proposals with respect to individual marginal tax rates set the tone for increased tax fairness, a tone which would continue throughout the 1980s in subsequent tax legislation.

### **Indexation of Tax Brackets**

In addition to the reduction in marginal tax rates for individual taxpayers, the Economic Recovery Tax Act contained provisions that indexed tax brackets to offset the effects of “bracket creep.” (Pollack, 1996: 189). This phenomenon refers to the tendency for income to be subjected to tax at artificially high rates due to the numerical increases in income due to inflation,

particularly when these increases did not result in real changes in purchasing power. Treasury Department Economist Eugene Steuerle emphasized the powerful impact of this indexation on the United States' tax scheme (Pollack, 1996: 189-190).

The major individual reform instituted in 1981 was not direct reduction in tax rates, but the establishment of indexing of tax brackets...this provision was not even part of the original Reagan proposals, but has altered the patterns of tax legislation ever since. No longer could Congress follow the pattern of tax reductions that merely offset tax increases due to inflation. By 1990, the adjustment for inflation alone was estimated to have reduced receipts by over 57 billion relative to an unindexed tax code... eventually the indexing provision will dominate all other provisions of the 1981 Act.

Steuerle suggested that the indexation of inflation reduced politicians' ability to rely on "pork barrel" politics, meaning that politicians pursued favoured legislation in the tax code that would benefit their own home districts (Pollack, 1996:190). It is clear that prior to the indexation amendment, bracket creep covertly provided a revenue source for politicians to rely on when introducing spending increases or tax preferences. Indexing reduced the amount of income that would be taxed at inflated rates, and quashed this as a convenient revenue source. An alternative way to view the possible effects of indexing is that such indexing may actually "impair the flexibility of Congress to resolve and determine the many issues encompassed in the Federal budget." (Davies, 1986: 55). Though this idea of "revenue neutrality" would influence the tax paradigm for years to come, it did not entirely do away with the concept of budget deficits (Pollack, 1996: 191).

### **Accelerated Depreciation**

The 1981 Economic Recovery Tax Act initiated favourable accelerated depreciation provisions intended to spur economic growth, at the expense of Federal tax collections. With respect to the reduction in corporate tax rates, resulting from the increased depreciation deductions, a 1986 staff working paper prepared by Congressional Budget Office staff analysed the effects of the 1981 Act (Congressional Budget Office, 1986: 49-51).

ERTA reduced corporate income taxes by instituting the Accelerated Cost Recovery System (ACRS) of depreciation deductions and the Investment Tax Credit (ITC). TEFRA (the Tax Equity and Fiscal Responsibility Act of 1982) took back some of these reductions, but the net effect of the two tax bills was to lower corporate taxes, leaving corporations with higher after-tax incomes. This income was either distributed as dividends, directly increasing individual incomes, or kept by the corporation as retained earnings. Higher retained earnings tend to increase the value of corporate stock. This increases individual incomes through higher realized capital gains when this stock is sold. Thus some change in the distribution of individual incomes resulted directly from the corporate tax changes in ERTA and TEFRA.

This suggests that the corporate benefits of reduced tax rates would have flowed through to individual taxpayers, either through stock appreciation, or through higher capital gains. Clearly, it also begs the question: who benefited from the ownership of appreciated stock, or capital gains? It can be argued that wealthier taxpayers tend to hold more stock, and therefore would be positioned to benefit from these tax cuts. This formed the basis for the “supply side” economic argument, that encouraging wealthier taxpayers to invest and spend is a tide that causes “all boats” to rise.

The Congressional Budget Office’s staff reports suggest that this effect is at least functionally true (Congressional Budget Office: 1986, p. 49). With respect to the tax returns

associated with top earners, the staff report outlined how a larger percentage of tax collections came from wealthier taxpayers (Congressional Budget Office: 1986, p. 49-51).

The data show that the largest percentage increase in taxes paid was by returns in the top percentile of the income distribution. This occurred because income grew more rapidly in the top group than for taxpayers as a whole, with growth in the realization of capital gains contributing a large amount of the increase in relative income in the top percentile.

The report also explained why this may have occurred from a behavioural perspective (Congressional Budget Office: 1986, p. 49-51). However, the report makes clear that higher earners were responsible for a greater share of tax payments under the Reagan administration's reduction in marginal tax rates (Congressional Budget Office: 1986).

This difference between the actual change in the distribution of taxes paid and the distribution based on static analysis suggests the possibility that higher tax payments by the top percentile of returns may have resulted at least in part from behavioral responses to the ERTA reductions in marginal tax rates. These behavioral responses either could have caused personal income to grow faster than average for taxpayers in the upper part of the income distribution, or taxable income to increase relative to personal income for these taxpayers. Behavioral changes that could have raised the tax base relative to personal income include:

- Increased realization of capital gains relative to personal income;
- An increase in the ratio of taxable money wages to total compensation resulting from, for example, reduced demand by employees for nontaxable fringe benefits such as employer contributions for medical insurance;

- A reduction in the ratio of itemized deductions to personal income resulting from, for example, smaller growth in charitable contributions or in borrowing to finance purchases of homes, automobiles, or other consumer durables; and
- An increase in the proportion of income from investments attributable to taxable sources, such as interest and dividends, rather than nontaxable sources such as corporate retained earnings, tax-exempt bonds, or "tax shelter" investments that are allowed very favorable capital recovery deductions under current law.

Effectively, the Congressional Budget Office's analysis shows that wealthier taxpayers paid a greater portion of the overall tax burden collected by the Internal Revenue Service in the years following the Economic Recovery Tax Act of 1981 (Congressional Budget Office: 1981). From this perspective, the cuts certainly made the tax code more progressive, though the economic effects remain up for debate.

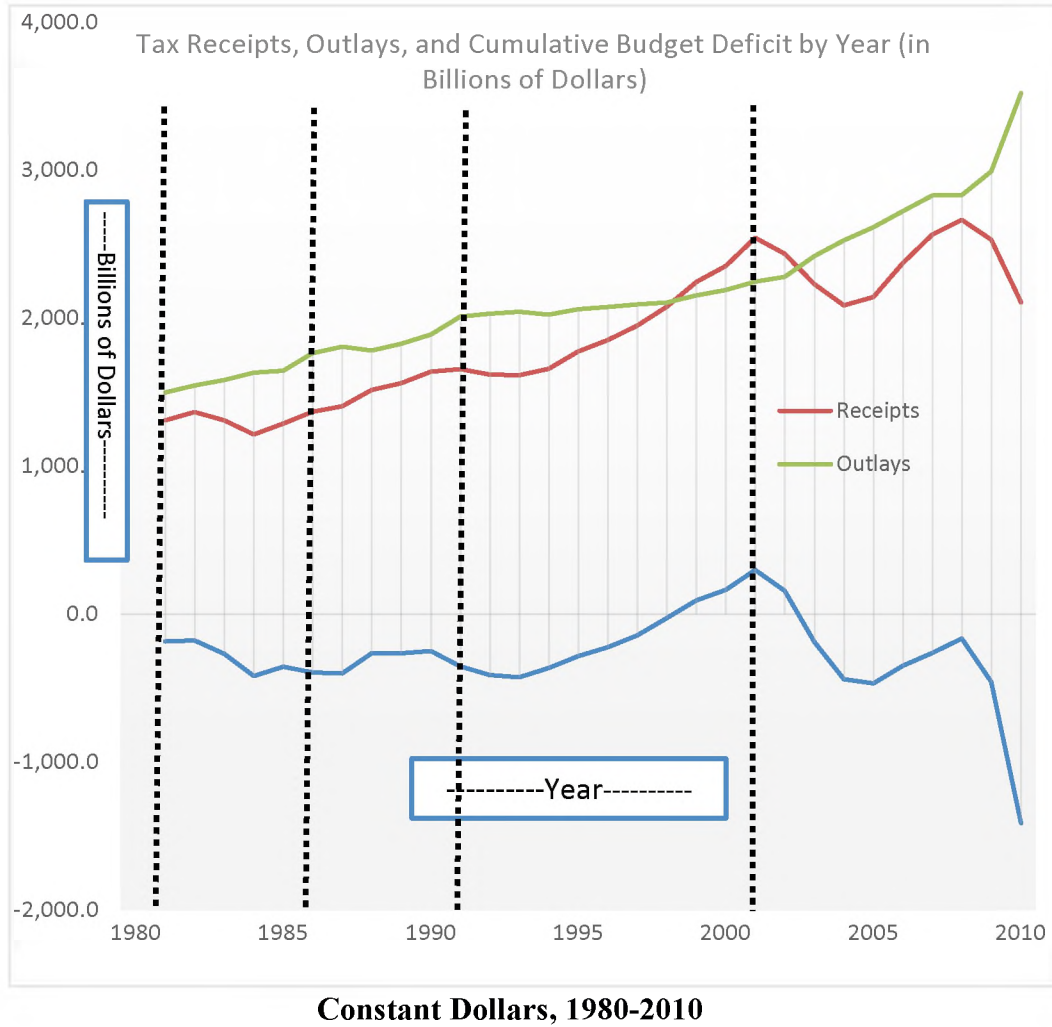
Individual states in the United States typically do not retain any sovereignty over the laws the Federal government passes with respect to their ability to tax citizens. That is, individual states may enact new or additional taxes, but may not refute or oppose specific tax provisions in the Internal Revenue Code under U.S. Constitutional law, known as Supremacy doctrine. As a result, historically, most U.S. states typically adopt entirely, or in substantial portions, the Federal tax provisions, making minor adjustments or additions based on the needs of their particular state. Upon passage of the 1981 Act, many states feared the trickle-down effect of lost revenues at the Federal level, and reacted in defense of their own budgets (Davies: 1986). They responded by either not conforming to the Federal rules, or implementing new provisions that supplemented the loss of revenue at the Federal level (Davies, 1986: 242). More than half of U.S. states passed provisions that stunted the effect of the Federal changes, either with higher

corporate rates, more addback provisions, or other means (Davies, 1986: 242). This resulted in greater compliance complexity, and likely lessened the intended effects of Reagan's policies (Davies: 1986).

### 3.10 Legacy

The Economic Recovery Tax Act of 1981 left a mixed legacy, rife for debate and analysis. The Act represented a bold change of direction with respect to managing the Federal budget and raising revenue through taxation. It ushered in low individual and corporate tax rates, broadened the tax base, and reduced the role of government, ideologically, if not practically. In Figure 3.1, the tax rate decreases, and subsequent deficit climbs, associated with Ronald Reagan's policies become apparent. However, one of the most lasting and notable elements of Reagan's program of tax reduction was that it came on with remarkable swiftness, and with little political opposition (Brownlee: 1996). It also began a period of significant increase in budget deficits, as well as a steady climb in expenditures, which exceeded the rate of tax collections for most of the 1980's (Tax Policy Center: 2015c). This was dramatically true, until some of the 1981 Act tax cuts were eased in 1982. However, expenditures continued to outpace collections steadily until the late 1980's (Tax Policy Center: 2015c). By these measures, Reagan's 1981 tax cuts would continue to expand the size of government, as measured by expenditures, but offered no accompanying change in tax collections to offset them.

**Figure 3.1: Tax Receipts, Outlays, and Cumulative Budget Deficit by Year in**



(Source: Tax Policy Center: 2015c)

Historian Elliot Brownlee observed that “... Reagan’s supply-side ideas encountered no effective intellectual resistance.” (Brownlee, 1996: 116). It is apparent that part of what made this transition so politically easy was the sordid state of the United States’ economy, coupled

with the perceived weakness of the Carter administration's management of the economy. However, another important factor was the fact that the United States had already begun to abandon the idea of a balanced budget over the last decade (Brownlee: 1996). In part, this abandonment was a result of lack of consensus among economists as to whether there was an appropriate theoretical size for the Federal budget deficit, or even whether there was one plausible theory of fiscal policy (Brownlee: 1996). However, without the budget deficit operating as a theoretical constraint, it is evident that Reagan's plans became much easier to implement both in theory and practice.

In retrospect, two distinct schools of thought have emerged with respect to the 1981 Act. First, many believe the 1981 Act jumpstarted the American economy and, over the course of Reagan's first term, began to pull the United States out of recession. The second school of thought is that Reagan's policies did little to influence the economy, and were mere window dressing for much larger economic factors which truly created the positive change in economic conditions.

One way to assess both of these schools of thought is to take a cost-benefit approach to analysing Reagan's programs. According to June O'Neill, of the Hoover Institution, the key question is to determine whether the 1981 Act's effects were "worth" running deficits in the short term (O'Neill: 2001). Ultimately, some experts agree that they were cost-effective (O'Neill, 2001: 3):

As it turned out, tax revenues as a percentage of GDP averaged around the same level as they were during the Carter years – the annual average for 1981-88 was 18.1 percent (that is with some help from subsequent tax-raising legislation). But in the absence of ERTA, taxes would have been a much higher proportion of national output – about 21 percent of GDP in 1984 and still higher

later on. That would have been enough to eliminate 80 percent of the 1984 deficit. But the price for that deficit reduction would have been sharply higher marginal tax rates that likely would have impeded economic growth in the long run. Moreover, by accommodating higher levels of spending with tax increases, pressure to restrain spending growth (and therefore help control future deficits) would have been diminished.

Effectively, O'Neill suggested that the lower marginal tax rates spurred growth enough to offset, and make economically viable, the impediments to deficit reduction they helped create (O'Neill: 2001).

As part of a recounting of the 1981 Act's legacy, the Cato Institute sponsored a summit in 1991 with the theme "Reagan Supply-Side Tax Cuts After Ten Years: Economic Miracle or Voodoo Economics?" A panel of experts convened at this summit to discuss the historical implications, in their view, of the 1981 Act. In some sense, it was clear that supporters of Reagan's policies could readily point to the economic expansion that occurred in the years following implementation of the provisions of 1981 Act. Opponents could likely point to the creation of deficits, which spawned a unique set of problems that needed to be addressed.

Analyst and vice-President of the Progressive Policy Institute, Bob Shapiro, supported the rate reduction scheme enacted in the 1981 Act (Cato Institute, 1991: 1:28:00-1:29:00):

I agree with Bob and with Art, that the tax burden had to be relieved in 1981, I think for average people it still has to be relieved. And for business I certainly wouldn't have supported the business provisions apart from the corporate rate reduction. The main difference is that in addition we needed to dedicate Federal spending to the elements of growth, to get people's pretax incomes growing, which is to say education, and research and development, and infrastructure, all

of the elements that get the economy growing and actually increase people's incomes before tax, so that we worry less about manipulating their incomes after tax.

Rudolph Penner, Senior Analyst at the Urban Institute, differed in opinion. He felt that the marginal tax rate changes made little difference in the scheme of things, when compared with other economic periods (Cato Institute, 1991: 1:24:20-1:25:00).

In looking at the big picture, it's important to note that the 1980s on average don't look all that different say from the 1950s once you smooth at the business cycle, which of course, the 1950s was a time of 90 percent tax rates. I think what all this indicates is that the marginal tax rate changes don't make as much difference as even I thought they would in the early 1980s when the thing was passed.

Penner went on to stress that, in his opinion, monetary policy was a much more important factor in turning around the economy than the tax changes in the 1981 Act (Cato Institute: 1991).

In contrast, Bob McIntyre, the director for the Citizens for Tax Justice, felt that the move toward deficits in any form was irresponsible (Cato Institute, 1991: 1:26:00-1:27:00).

It was very clear that year that there had to be a tax bill. Number one. Taxes were already being pushed up by inflation, and there had to be some adjustment for that. If they had in fact done that, and adjusted people's taxes for inflation, so that there was a true across-the-board tax change... we wouldn't have had the great deficits of the 1980s and our children wouldn't be burdened with this enormous debt we have now, and we would all be better off.

Arthur Laffer, well-known political consultant, indicated that he was generally in favour of the 25% individual tax rate reductions which applied across the board (Cato Institute: 1991). Laffer also indicated that he believed that all other tax preference items in the bill, aside from the rate

cuts, were not helpful and he would have opposed them (Cato Institute: 1991). Laffer also, only half-jokingly, proposed a bonus system whereby Federal agencies would be rewarded by meeting program objectives and reducing their own budget (Cato Institute: 1991).

Old bad arguments never die. In fact, they don't even fade away. Especially when they're based upon hopes. If you look at the times. Number one, the tax cuts, as you mentioned, while they were passed in 1981, did not take effect the day they passed. In fact the tax cuts were phased in. So when you really want to try to judge the effect tax cuts had, you have to look at when they started, not when they were passed. It's amazing how tax cuts don't work until they take effect.

Laffer pointed out that Reagan's individual tax rate reductions did not take effect as quickly as many assume (Cato Institute: 1991). Specifically, he cited that the first rate cut was only 5%, taking effect in October 1981. This was, effectively, just a 1.25% cut for the entire year. Then, the second rate cut, of 10%, took effect on January 1<sup>st</sup>, 1982. The largest and most significant cut occurred on January 1<sup>st</sup>, 1983. This is when, in Laffer's opinion, the cuts truly began to make a difference (Cato Institute: 1991).

Starting on January 1<sup>st</sup>, 1983. That's when the tax cuts started. So if you look at the economic impact of the Reagan tax cuts, you've got to start on January 1<sup>st</sup>, 1983, when they actually took effect. When you look at that point on you get very different answers than if you compare administrations.

This argument of "timing and responsibility" for economic outcomes has frequently been a flashpoint for pundits to assign blame, or credit, for economic results. While it is clear that consensus has rarely been achieved on this point, it is important to take into account the precise timing of the passage and implementation of tax measures. For example, Carter was still in the

Oval Office in early 1981, meaning that he would have proposed the 1982 Federal Budget, despite Reagan's election in November of 1980.

Others contend that Reagan's policies were timely and effective under the specific circumstances Reagan faced, but at the same time they created new challenges (Bloomberg, 2004:1).

Inevitably, the measure of Reagan's legacy of the '80s must be taken against what followed: the Clinton years of the '90s. Reagan became President when America was economically sclerotic. His tax changes, combined with a tight monetary policy, helped to make the country competitive again. The price paid, however, was a soaring budget deficit. Reagan and his supply-side advisers believed that big tax cuts would pay for themselves by generating higher tax revenues through greater economic growth. It never happened.

As discussed previously, the consensus on the particular tax effects of the 1981 Act remains cloudy. According to the Tax Policy Center, there was a substantial dip in Federal tax revenue, both in real dollars and as a percentage of GDP in 1982 and 1983 (Tax Policy Center: 2015c). However, these same measures stabilized between 1985 and 1990, showing revenue increases, and continued to remain stable into the 1990s and the transition to the Clinton administration (Tax Policy Center: 2015c).

Finally, it appears that the Economic Recovery Tax Act of 1981 was to a large extent a response designed to alleviate dire economic conditions that had developed in the United States under the Carter administration, as opposed to an attempt to alter the tax scheme or benefit specific taxpayer groups (Prasad: 2012). Accordingly, comparatively less of the available historical record is focused on specific tax provisions and their legal effect, when compared to the large volume of sources that are focused on the impact of the 1981 Act on the United States'

economy and the Federal budget. In particular, much of Reagan's tax platform was built around an approach to handling "stagflation," a unique combination of ongoing high unemployment, low growth, and inflation that had become acute late in the Carter administration (Prasad: 2012). Reagan's approach tax reform in 1981 was much more economic and ideological than it was legalistic. As discussed earlier, Reagan viewed tax cuts as a desirable goal because it returned economic freedom to the American taxpayer. In addition, Reagan believed it could theoretically solve the nation's economic problems at the same time (Reagan, 1990: 232).

I have always thought of government as a kind of organism with an insatiable appetite for money, whose natural state is to grow forever unless you do something to starve it. By cutting taxes, I wanted not only to stimulate the economy but to curb the growth of government and reduce its intrusion into the economic life of the country.

Effectively, it seems Reagan was choosing to engage tax policy, not for "tax" reasons, but rather for economic ones. It is also arguable that Reagan and the Republicans who supported tax cuts were, in fact, supporting contradictory outcomes and hoping that things would turn around (Prasad: 2012; Reagan, 1990). In a 2016 interview, campaign managers Elliot Curson and Jeff Bell discussed an ad they created and ran for Ronald Reagan on his tax cuts (Maher, 2016: 1).

Then we did an ad on tax cuts. Reagan said, "I didn't always agree with President Kennedy, but when he came out with a 30% tax cut, everybody benefited, even the government gained, since they generated \$54 billion in unexpected revenue. If I become president, we're going to do that again."

Reagan was calling for tax reforms that he, at varying points, suggested that he hoped would increase revenue, decrease the size of government, return money to the taxpayer, and decrease Federal intervention in the lives of the average American. These were incongruent goals (Prasad:

2012). However, the common thread is that Reagan, and members of Reagan's administration, often spoke about the 1981 Act in terms of economic change rather than tax policy.

### **3.11 Conclusion**

While their legacy remains a source of debate, it is evident that the Reagan tax cuts in the Economic Recovery Tax Act of 1981 generated large deficits, and did not pay for themselves (Bloomberg: 2004). Nonetheless, it is entirely possible that these policies may have provided other social, political, or economic benefits that made them worthwhile. Such analysis is beyond the scope of this research. However, regardless of one's viewpoint of Reagan's tax policies in 1981, one certainty emerged: the position of the income tax as a convenient tool for increasing tax revenues was substantially reduced as a result of the 1981 Economic Tax Recovery Act (Brownlee: 1996). Between 1980 and 1990, the Federal income tax, as a percentage of all taxes paid in the United States, had dropped from 63 percent to just 57 percent (Brownlee, 1996:118). Also, by 1985, the Federal tax system had become significantly less progressive, as a result of the reduction in "bracket creep" as well as the 1981 tax cuts.

In addition, the Economic Recovery Tax Act of 1981 set the stage for new ways of viewing income taxes and budget deficits. Reagan viewed deficits as political tools, not "hard" financial numbers whose variances needed to be managed carefully. This was an unexpected development, yet one that would pervade budget politics for many years to come (Peterson, 1985: 601).

But the Reserve's very success has had an ironic consequence no economist of the Keynesian era could have anticipated: it has provided presidents and acquiescent Congresses with a virtually unprecedented license to incur deficits. Although political leaders will denounce deficits, none

want to give up their favourite policy objectives - defence, social security, domestic welfare, or tax cuts - to address a problem whose unfortunate consequences are now said to be long term.

This new “deficit doctrine” would dominate the tax policies in the 1980s, and will be discussed later in this research as part of the Tax Reform Act of 1986. In addition to domestic changes, the Economic Recovery Tax Act of 1981 was an important catalyst for an international movement toward tax reduction for economic growth (Brownlee: 1996). Similar programs were instituted in the United Kingdom, Japan, and a number of European states (Brownlee: 1996). The “Reagan Revolution” had profound and immediate effects on the way tax policy was administered in the United States, and beyond. Nonetheless, the question as to whether Reagan’s domestic tax cuts were a “good idea” remains an open one.

## CHAPTER 4

### The Tax Reform Act of 1986

#### 4.1 Introduction

This chapter will discuss the Tax Reform Act of 1986, arguably the most influential piece of tax legislation in American history. The Tax Reform Act of 1986 exemplified compromise, active engagement across the political spectrum, and pursuit of progress, not perfection in tax legislation. This chapter will focus on the emergence of the United States from a damaging recession, and the role the Act played in deficit reduction. Further, it discusses the colourful, sometimes flawed personalities who shaped the change. This research seeks to chronicle the evolution of this landmark legislation into law, ushered in by a fascinating cast of characters. First, a gruff Illinois representative, whose political career would end in scandal; an enormously popular president, principled but willing to compromise; a maverick Senator, blunt to a flaw; and, finally, an ex-professional football player who laid much of the philosophical groundwork.

Many Americans in the 1980s were skeptical of their government and its ability to be fair and efficient. In addition, the United States tax code had begun to sag under its own administrative weight: countless exemptions, special rules, loopholes, and tax shelters had become so attached to the code over the years that the tax rules had lost much of their meaning. In some areas of the law, taxes had emerged as the primary driver of individual and business behaviour. Further, tax rates had become artificially inflated in order to offset the costs of a myriad of special provisions, pushing the highest marginal individual tax rates up to 50% in 1985 (Holid & Labate: 1985).

From the perspective of the average American in the 1980s, it may have appeared that Washington politicians had lost their credibility, the result of years of pork-barrel politics and lobbying activities. The United States had suffered through a deep recession, the onset of “stagflation”, and slow economic growth since the close of the Carter administration in 1979 and 1980. In an effort to spur economic growth, the Reagan administration had implemented a series of tax cuts beginning in 1981 and 1982 (McCaleb: 1984). However, by 1984 the U.S. Treasury had begun to run huge deficits, spurring politicians to examine tax rules more closely, particularly tax-advantaged shelters and loopholes (McCaleb: 1984). In addition, it was clear that the pressure generated by budget deficits had encouraged politicians from both sides of the aisle to consider new approaches to tax policy and alternative systems of taxation.

In this environment of uncertainty the Tax Reform Act of 1986 began to develop. This move to reform was spurred on by a small group of strong-willed but unlikely champions. One analyst stated “nobody thought that a retired B-list actor, a corrupt Chicago pol, and a man who held weekly strategy breakfasts with rich campaign donors would produce the Tax Reform Act of 1986.” (Burman, 2006: 359). Of course, this refers to three principal architects of the Act: the B-list actor was President Ronald Reagan; the corrupt politician was Illinois Representative Dan Rostenkowski; and, the “breakfast strategist” was Oregon Senator Bob Packwood. While there were many other individuals who played key roles in the move toward the 1986 Internal Revenue Code, such as Jack Kemp and Dick Gephardt, these three individuals played critical roles in ensuring the success of this landmark legislation in Congress.

## 4.2 Background

The Tax Reform Act of 1986, or H.R. 3838, was passed by the House of Representatives on December 17, 1985. The Senate Finance Committee reported favourably on the proposal, including proposed amendments, on May 6, 1986, and nearly 40 days of public debate began (US Senate Committee on Finance: 1986). The legislation, which passed later that year, was considered the most sweeping reform to the Internal Revenue Code since 1954. Accordingly, due to its widespread impact, H.R. 3838 was named and came to be widely known as the “Internal Revenue Code of 1986.” (Joint Committee on Taxation: 1986). It remains the core of the current Federal tax code to the present day, though some of its provisions have been amended in subsequent legislative efforts. Though imperfect, it is generally accepted as a strong example of broad-based tax reform, having been achieved with broad bipartisan support and a spirit of compromise from all interested parties.

In its final Committee report endorsing H.R. 3838, the Senate Finance Committee of the United States Congress stressed three major values of the legislation: a simpler, fairer, more efficient tax system (Joint Committee on Taxation: 1986). The report outlined simplicity in terms of reducing the costs of compliance; weakening the thriving tax shelter industry; and ensuring that economic investment is undertaken with real economic motives in mind, not goals artificially induced by the complexities of the tax system (Joint Committee on Taxation: 1986). The Committee’s notions of fairness were also made clear in the report (Joint Committee on Taxation, 1986: 23):

A primary goal of the committee is to provide a system that ensures that individuals with similar incomes pay similar amounts of tax. The ability of some individuals to reduce their tax liability

excessively leads to a direct erosion of the tax base, requiring higher tax rates. Other individuals unable to take advantage of tax shelters may lose confidence in the tax system and may respond by seeking to evade their tax liability.

This philosophy was also exemplified in the Tax Reform Act's focus on reducing overall tax rates by limiting specific carve-outs and tax preference items for individual taxpayers. The legislation was clearly designed to force tax liabilities to more closely align with true economic activity. As a result, many of the provisions of the bill were designed to broaden the individual tax base, and suppress special accounting circumstances that created divergence from true economic income. Ultimately, however, individuals also bear the burden of corporate taxation as well, as the economic pass-through of the economic burden pricing of goods and services in the marketplace.

Accordingly, in addition to individual tax fairness, H.R. 3838 sought to achieve greater balance between corporate taxpayers. The bill specifically cites income manipulation mechanisms as serious problems, including timing and nature of foreign income, dividend payments, and earnings management. Further, the bill sought to increase the corporate share of tax receipts as a portion of total tax revenues. Stated differently, the Senate Finance Committee desired to relieve the individual taxpayer at the expense of the corporation, and to create greater equity among subcategories of both individual and corporate taxpayers (Joint Committee on Taxation: 1986).

The final key goal of the Tax Reform Act of 1986 was efficiency. The Act represented a critical move away from tax incentives, which the bill's supporters believed had unintended and occasionally illogical consequences for taxpayer behaviour and economic activity ((Joint

Committee on Taxation: 1986). Further, the bill's authors also believed that reduction in special tax incentives improved motivation for individual efforts at generating income and savings.

Specifically, the committee attacked the system of tax shelters in place (Joint Committee on Taxation, 1986: 25):

The present Federal tax system contains a number of preferences, which have not satisfactorily served the purposes for which they were designed. In the past few years, tax incentives have led to the excessive construction of office buildings and record vacancy rates; overinvestment in agricultural tax shelters by high-income investors with little knowledge of farming; and, distortions at all levels of business - from financing choices to production decisions.

The Tax Reform Act of 1986 was drafted to promote fairness, efficiency, and simplicity, and those responsible for writing the provisions in the bill clearly felt that their proposal would accomplish these goals. These were lofty goals for any piece of tax legislation, and the provisions were clearly written to accomplish much more than making routine changes to the tax code. As the political process unfolded, the Tax Reform Act of 1986 began to take shape as a historically-important piece of legislative work.

#### **4.3 Major Provisions of the Tax Reform Act of 1986**

The Tax Reform Act of 1986 made a number of significant changes to the existing Internal Revenue Code. With fairness, simplicity, and neutrality as its guiding principles, as well as a goal of closing the Federal budget deficit, the Act attacked areas where disparity was most apparent. Major alterations were implemented, particularly in the area of individual taxation: a simplified rate structure, home mortgage interest deductions, passive activities and tax shelters,

capital gains taxes, and alternative minimum taxes. Specifically, the Tax Reform Act of 1986 accomplished the following significant provisions related to individual income taxes (Wilkie, Young, & Nutter: 1986; Tax Policy Center: 2011):

- reduced the top marginal rate from 50 percent to 28 percent, below the top corporate tax rate;
- eliminated the long-term capital gains deduction;
- first introduced passive loss limitations, phasing in disallowances of taxpayers' deductions from business losses originating in "passive activities";
- limited IRA eligibility and pension contributions; and
- increased the earned income tax credit for low-income taxpayers; created a new low-income housing tax credit.

In the area of corporate taxes, the following provisions were enacted (Wilkie, Young, & Nutter: 1986; Tax Policy Center: 2011):

- reduced the top marginal rate from 46 percent to 34 percent;
- broadened the definition of "business" income and restricted recognition and timing of expenses such as bad debt charge-off, added uniform capitalization for inventories, lengthened depreciable lives for business assets, and repealed the investment tax credit (as explained later in this research);
- expanded corporate alternative minimum tax by subjecting to immediate taxation a portion of economic income that was not otherwise included in the regular taxable income;

- repealed the General Utilities doctrine, which had allowed, in certain circumstances, tax-free corporate liquidations;
- extended research and experimentation credit; and
- repealed the investment tax credit.

#### **4.4 Timeline**

The timeline of the Tax Reform Act of 1986, and its movement through the legislative process, is outlined below (Votesmart.org: 2015):

- December 3<sup>rd</sup>, 1985 introduced
- December 17<sup>th</sup>, 1985 House version passed
- June 24<sup>th</sup>, 1986 Senate version passed
- September 25<sup>th</sup>, 1986 House Conference report adopted
- September 27<sup>th</sup>, 1986 Senate Conference report adopted
- October 22<sup>nd</sup>, 1986 signed by the president into law.

#### **4.5 Historical Groundwork for the Tax Reform Act of 1986**

As early as 1982, a number of factors had begun to clear the way for passage of the 1986 Tax Reform Act. Though President Ronald Reagan played a significant role in opening the door for tax reform during his second term in office, it is also notable that a number of previous efforts, both successful and unsuccessful, had helped frame the debate and create coalitions of support around key issues. For example, supply-side conservatives, such as Jack Kemp, pushed

for broad rate reductions. Mainstream, politically popular Democrats, such as Senator Bill Bradley (Democrat, represented the state of New Jersey) and Dick Gephardt (Democrat, represented the state of Missouri), pushed for a broad tax base, reduced loopholes, and fairness and relief for the lower-middle class and to ensure the reduction of the number of poor on the tax rolls. Powerful politicians such as Dan Rostenkowski and Bob Packwood, entrenched in the informal mechanisms and political pageantry of Washington politics, pushed for reform for their own reasons, both personal and political.

In 2010, Representative Richard Gephardt (Democrat, represented the state of Missouri) testified in a series of hearings on Capitol Hill in which major participants in the passage of H.R. 3838 were asked to reflect on the bill and its legacy. Gephardt reflected on the broad purposes of comprehensive tax legislation, and its role in society and in the life of the average citizen (Gephardt, 2010: 3):

It is time for us to look again at whether we can dramatically simplify the tax code so that it is broadly understood and – while perhaps not loved, at least respected. We need to look over every provision in the code and ask: does this really serve the greater good, is this the best way to help grow the economy, can we really afford the myriad of provisions that only benefit the privileged? And finally, we have to make certain that the tax code itself is not the driver of everyday investment decisions, leaving those to the free market and the great common sense of the American people.

Gephardt make several astute observations about what good tax legislation should be, and what it should avoid. In particular, his opinion that good tax legislation should be “respected, not loved” captures the spirit of equity that is indicative of good government (Gephardt, 2010: 3). Gephardt’s comments also capture timeless characteristics associated with good tax policy, and

make an excellent yardstick for evaluating the overall effectiveness and fairness, not just of H.R. 3838, but any tax bill. Gephardt's reflection was one shared by many participants in the political process surrounding the Tax Reform Act of 1986: that Act was an unexpected, effective, and bold political stroke. As this research will illuminate, it is even more surprising in that this landmark piece of tax legislation was ushered in during difficult political circumstances and championed by unlikely supporters. A detailed review of the historical record demonstrates that the Tax Reform Act of 1986 passes Gephardt's test of good tax legislation: while not everyone loved the bill, it was respected by almost everyone involved in the political process.

#### **4.6 Key Figures in the Tax Reform Act of 1986**

Four key figures were instrumental in the passage of the Tax Reform Act of 1986 – Ronald Reagan, Dan Rostenkowski, Bob Packwood and Jack Kemp. Each of these individuals played a unique role in the success of the 1986 Act, and helped shape its final form. From fascinatingly different walks of life and political spheres, they managed to collaborate to create a landmark piece of tax legislation.

##### *Ronald Reagan*

Ronald Reagan served two terms as president of the United States, and is known as one of the most influential presidents of the 20<sup>th</sup> century. A champion of individual liberty, economic growth, and limited government, Reagan became known as a proponent of “Reaganomics”, a conservative version of supply-side economics. A former actor and governor of the state of California, Reagan was a renowned speechmaker and left his second term as one of the most broadly popular presidents in history (White House: 2014). Reagan played an important and very

public role in positioning tax reform for success, particularly in signalling to both political parties that tax reform was both possible and necessary. However, Reagan's approach to budget deficits, tax policy, and deficit spending remain controversial to this day even among experts (White House: 2014).

### *Dan Rostenkowski*

Dan Rostenkowski was a Democratic Congressman from Chicago, and was known as an unmatched Capitol Hill "dealmaker." He epitomized the slightly greasy feel of a traditional Washington insider, plain-speaking, a bit rough around the edges, but willing to do whatever it took to move his agenda forward. He was elected to Congress at the age of 30, and remained the youngest member for a number of years (New York Times: 2010). Rostenkowski was unpretentious and blue-collar, a product of Mayor Richard Daley's Chicago political regime. Rostenkowski had a checkered record as a speechmaker and lacked public relations agility. Reportedly, a speechwriter had once given Rostenkowski a speech with the word "hyperbole" in it. Rostenkowski proceeded to pronounce the word "hyper-bowl" when he delivered the address (Birnbaum & Murray: 1992). He was also master of mixed metaphors, claiming once that guiding the Tax Reform Act through Congress was like walking through an "egg field" instead of "mine field." (Birnbaum & Murray: 1992). A "machine politician", he eventually became Chairman of the House Ways and Means Committee, and gained a reputation as powerful broker of compromise, with friends on both sides of the political aisle. He played an instrumental but unexpected role in moving the Tax Reform Act of 1986 forward. True to his roots, he lived in his childhood home until his death at 82 in 2010 (New York Times: 2010). A significant stain on

Rostenkowski's career was his indictment and conviction on fraud charges, which effectively led to his unseating in Congress and the end of his political career.

### *Bob Packwood*

Bob Packwood was a maverick Republican Senator from Oregon and Chair of the Senate Finance Committee in 1986. He attended law school at New York University, though he was a third-generation Oregonian. Packwood was a blunt, yet politically savvy politician who could be highly independent and unpredictable. He was a staunch supporter of special interest groups and “sweetheart” deals on Capitol Hill, particularly when they benefited the Oregon timber industry. This is particularly ironic given his later role in tax reform. His forthright speech was legendary: he reportedly once told President Richard Nixon, to his face, “Your weakness is credibility. This has always been your short suit with the news media and the general public.” (Birnbaum & Murray: 1992). While Packwood passed easily among the Washington elite, he remained a bit of an enigma. He was a pro-abortion Republican who ultimately became one of the most influential tax policymakers of his generation. However, he was known to be earthy and unassuming; Packwood was said to dress very shabbily away from the office, and according to his spouse, needed a complete wardrobe overhaul and “cleanup” effort prior to assuming the Chair post on the Senate Finance Committee (Birnbaum & Murray: 1992). Ironically, Packwood was forced out of office in 1995 due to very public rumours and evidence of sexual misconduct while in office.

### *Jack Kemp*

Jack Kemp was former National Football League quarterback, member of Congress, Secretary of Housing and Urban Development, and Republican vice-presidential candidate. Kemp was the author of Kemp-Roth tax legislation in 1981, the first of the “Reagan” tax reforms (Jack Kemp Foundation: 2014). Kemp continued to be a bipartisan voice for economic growth, urban development, and tax reform and simplification throughout his political career. Many of his proposals, even the unsuccessful ones, were included as part of other successful legislative efforts, such as his Kemp-Kasten proposed legislation (Jack Kemp Foundation: 2014).

#### **4.7 Ronald Reagan on Tax Reform**

President Ronald Reagan played an important symbolic role in moving the Tax Reform Act of 1986 along toward its passage late that year. At that point in time, Reagan was one of the most popular presidents in the history of the United States, and was coming away from an election in which he had won 49 of 50 states in an unprecedented landslide (Birnbaum & Murray: 1992). His tremendous popularity therefore lent weight and importance to any issue he chose to back. Reagan also desired to be seen as a president who reduced tax rates, some of which exceeded 70 percent at the top margins, and in this regard the tax reform movement dovetailed with Reagan’s own tax philosophy (Birnbaum & Murray: 1992).

##### *Precursors of Tax Reform*

Before direct tax reform efforts began in earnest, the Reagan administration had begun to shift the tone in Washington away from “big government” efforts and toward the private sector. Reagan sought to move away from Jimmy Carter’s policies, which in his estimation had caused

the economy to stall. Reagan began to push for the private sector to help repair the economy and close the budget deficits the tax cuts of 1981 and 1982 had opened. In his State of the Union address before a joint session of Congress on January 26, 1982, President Ronald Reagan first hinted at his interest in empowering private commissions of citizens to tackle the problems of the Federal government, particularly the expanding Federal budget deficit. Reagan frequently employed the imagery of the “individual citizen” taking on a large, inefficient Federal bureaucracy, with Reagan typically positioning himself rhetorically as on the side of the individual. Reagan’s stance on “big government” foreshadowed the empowerment of private commissions, particularly the Grace Commission, which would ultimately make recommendations as to ways to improve the state of the Federal budget. This was one of the first steps that had begun to blaze the trail toward successful, comprehensive tax reform. Reagan spoke in 1982 on this topic (Reagan: 1982, 6):

Our faith in the American people is reflected in another major endeavor. Our private sector initiatives task force is seeking out successful community models of school, church, business, union, foundation, and civic programs that help community needs. Such groups are almost invariably far more efficient than government in running social programs.

As suggested by the President in his rhetoric, he sought to empower private citizens and reduce the influence of the Federal establishment. Ultimately, he would convene the Grace Commission, also known by its formal name, the *President’s Private Sector Survey on Cost Control*. The commission’s goal was to rein in and reduce the influence of what Reagan believed was a large, inefficient, overly-centralized Federal government.

The Grace Commission was made up of hundreds of executives and community leaders, and included a roll of several thousand volunteer participants (PPSSC: 1984). The Commission prepared a massive report for the President on the performance of the Federal government, involving thousands of hours and hundreds of volumes of specific recommendations. The President initially requested that the commission members pursue the stated mission of identifying waste and budgetary problem areas “like tireless bloodhounds” and the commission responded accordingly (PPSSC, 1984:10).

In 1984, the Grace Commission presented its final conclusions to President Reagan as to where and how costs might be controlled in the Federal government (PPSSC: 1984). The Grace Commission’s report helped validate and bolster Reagan’s belief that reduced government spending was the primary means to control the deficit, though Reagan would later use increased tax revenues as a tool as well. In the commission’s press release, the members set the tone for deficit reduction (PPSSC, 1984: 10-11):

In the course of the search by our 36 Task Forces, chaired by 161 top executives from around the country and staffed by over 2,000 volunteers that they provided, we came up with 2,478 separate, distinct, and specific recommendations which are the basis for the carefully projected savings. For practical purposes, these savings, if fully implemented, could virtually eliminate the reported deficit by the 1990s versus an alternative deficit of \$10.2 trillion in the decade of the 1990s if no action is taken.

The commission’s findings reflected Reagan’s interest in the private sector as a means for measuring, improving and criticizing the performance of government services. The report went on to explicitly endorse the correctness of Reagan’s policy of not raising taxes to close the

budget deficit, saying that Reagan was “so correct in resisting attempts to balance the budget by raising taxes.” (PPSSC, 1984: 11). Further, the report also cited Congressional interference as a major hurdle in the way of truly closing the budget gap (PPSSC: 1984).

This idea of “Congressional interference” was emblematic of the problems Congress would later face as it wrestled with tax reform on the House and Senate Floors. Every budget-saving effort came at a political cost for the representative or Senator who had secured it for a corporation or individual constituent. This inherent pressure between generating large-scale budget savings and accomplishing micro-level political goals would remain at odds throughout the debate over H.R. 3838. However, as the discussion around the Tax Reform Act of 1986 unfolded, it became clear that tax reform would be a necessary step in the process of closing budget deficits generated early in Reagan’s first term.

This should not have come as a surprise, given that members of Congress answer directly to their home districts electorally. Given the choice between retaining spending priorities at home and participating in large-scale Federal budget-trimming efforts, most elected officials would choose the desires of their district without fail. The Congressional climate is not conducive to fostering large-scale cooperation; rather, it rewards political particularity, such as the funding of state-level projects and special interests. These kinds of projects are things that can be “bought and sold” during the political horse-trading process. They are the lubricants for the political machinery in Washington D.C. Congressional officials are therefore rightfully concerned with their popularity and perception “back home.” This is particularly true in the House of Representatives, where individual representatives are elected every two years. This creates great pressure for representatives to bring results home to their political district. On the

other hand, with elections every six years, Senators had more room to negotiate, and more time to recover from difficult political circumstances should hard choices be required.

As the threat of rising budget deficits continued to plague Reagan, the impetus to move ahead the march toward comprehensive tax reform began to galvanize. In fact, members of Reagan's inner circle were surprised at how significantly a series of tax cuts, championed by Reagan in the first few years of his term, had damaged the budget (Birnbaum & Murray: 1992). Reagan had pushed for tax cuts as a growth mechanism, but after seeing the massive budget deficits these cuts created, he understood that he needed to address deficits quickly and decisively. However, it was not politically expedient for a sitting Republican President to acknowledge that tax cuts had contributed to deficits. Accordingly, Reagan would maintain his public position that Federal spending was the problem, not revenue reductions (Reagan: 1985).

It is also noteworthy that previous legislative efforts in 1982 and 1984 gave Reagan a key strategic angle in attacking budget deficits: rate reductions, coordinated with a broadened tax base. These two tools, when instituted at the same time, would prove to be economically and politically effective (Weinberg: 1987). This broad-base, low-rate approach to tax policy permitted substantial increases in revenue with minimal political fallout, as the average citizen primarily makes a strong connection between tax rates and the tax they pay to the government (Weiss: 2010). However, in the same scenario, the average taxpayer is much less adept at determining the tax impact of a broadened tax base with a lower tax rate. Accordingly, it is usually politically expedient to avoid rate changes and cuts in specific tax benefits, because citizens will take note and voice their frustration at the ballot box. The key lesson for the Reagan administration was that broad-based tax reform could work to reduce the deficit under these

conditions, and that any politically “dire consequences” would be extremely unlikely (Weiss: 2010).

In a 2006 panel discussion entitled *Tax Reform 20 Years Later: Time for Another Round?* Panelist Joseph Minarik considered Reagan’s role in pushing ahead tax reform (Tax Analysts: 2006, 33):

President Reagan's flexibility on revenue increases immeasurably facilitated the achievement of tax reform by allowing him to raise corporate taxes by approximately \$25 billion per year, \$120 billion over a five year estimating horizon, to finance individual income tax cuts in the 1986 Act. This was extraordinarily helpful because for the most part what happens to individual income taxes drives the political verdict. And President Reagan's transfer of tax obligations from individuals to corporations was in the end the grease that allowed the tax reform machine to run. In addition to the corporate tax revenue kitty that helped to close the 1986 deal, there were ready tools at hand for legislators to implement that, namely the repeal of the biggest corporate tax preference, the investment tax credit.

As Minarik suggests, the individual voter makes the greatest difference in whether tax reforms succeed or fail, given that they typically vote on simple economic terms (Tax Analysts, 2006: 2). This would suggest that if lobbyists and well-heeled political insiders could be defeated, or at least held at bay, the individual voter would likely support tax reform. This is particularly true if the tax burden were to be shifted to corporate taxpayers, as it ultimately would be in H.R. 3838.

Reagan addressed the nation regarding the Federal Budget and Deficit Reduction on April 24, 1985. His position on the growing deficit remained steadfast: out-of-control government spending was the cause of the growing budget deficit, and the expanding deficit

must be closed without raising taxes. Clearly, the work of the Grace Commission, and the US Treasury Department's first report on potential tax reform offered Reagan some political cover to expand revenue without appearing to burden taxpayers. In Reagan's words (Reagan, 1985: 1):

The simple truth is: No matter how hard you work, no matter how strong this economy grows, no matter how much more tax money comes to Washington, it won't amount to a hill of beans if government won't curb its endless appetite to spend. Overspending is the subject we must now address -- how budgets got so far out of balance and, yes, what together we can and must do to correct this.

Deficits are politically troublesome, as they would prove to be to Reagan as well. Closing them requires top-line tax revenue increases, or the elimination of tax preferences that benefit particular groups, or both. Even more troubling is the fact that taxpayers are notoriously sensitive to changes in tax rates and the presence of special deductions or carve-outs that disproportionately benefit them, or harm them relative to other groups of taxpayers. Despite all of the complexities in the tax code, the average taxpayer has always been adept at identifying and criticizing disparities between themselves and other taxpayers. Accordingly, President Reagan faced a dilemma: he wanted to promote economic growth, attack "stagflation", and remain taxpayer-friendly, all while remaining true to Republican principles of conservative taxation and responsible spending policies.

Part of what made the Tax Reform Act of 1986 come to life was the fact that Reagan's political goals aligned broadly with both the needs of the economy and the desires of Congress. In particular, H.R. 3838's fairness provisions, described in detail later in this chapter, allowed Reagan to continue his public discourse against taxation and spending under the guise of

simplification and right-sizing of the tax code. In his April 24<sup>th</sup> speech he seized the opportunity to frame this argument in terms of morality (Reagan, 1985:1).

Well, there is no magic money machine. Every dollar the government spends comes out of your pockets. Every dollar the government gives to someone has to first be taken away from someone else. So, it's our moral duty to make sure that we can justify every one of your tax dollars, that we spend them wisely and carefully and, just as important, fairly.

Unfortunately, hardly anyone could honestly call Federal budgets wise, careful, or fair. Is it fair to ask one small business to help subsidize its competitors? Is it fair to ask workers in the private economy to pay for civil service pensions that are much more generous than the retirement benefits they receive? Is it fair to ask low-income families to help pay for the college education of children from families with incomes as high as \$100,000 a year? Is it fair to ask taxpayers to help pay billions for export subsidies to a handful of America's biggest corporations?

Well, it isn't fair, and you know it. But that's the law of the land right now, just part of the legacy of 50 years of trying to do good things for all by treating your earnings like government property.

The time has come to decide what benefits we can properly expect from the Federal Government for ourselves, our neighbors, and those in need; and what government can take from us in taxes without making everyone worse off, including those who need our help. The one thing we cannot do is stay on the immoral, dead-end course of deficit spending.

Reagan used this speech to begin to place himself on the “side of the taxpayer” despite having full knowledge that the effect of the bill would be to decrease the deficit using both revenue and spending adjustments. It is also important to note his strong populist tone in separating himself from Congress. Reagan characterized himself as being on the side of fairness, justice, and

frugality, while at the same time he must have certainly been aware of, and perhaps complicit with, Congressional Democrats' position on revenue increases. This was brilliant political gamesmanship, and is an excellent example of how Reagan earned the title of "The Teflon President" from former Congresswoman Pat Schroeder (Schroeder: 2004). Her reference to President Reagan borrows from the notion that bad news simply did not affect Reagan, much like burned breakfast would not stick to Teflon coated cookware (Schroeder, 2004:1):

Remember how we were promised a big tax refund, a huge increase in military spending and a balanced budget? Selling that was like selling a hot-fudge-sundae diet. When the national debt grew during his administration, you couldn't blame Reagan. He came across with that Irish twinkle. Americans are optimistic by nature, and they loved that Reagan believed to his core in the American Dream. If someone accused him of hurting college students by cutting loans, President Reagan could be seen on the nightly news writing a personal check to a struggling student.

In his State of the Union Address in February of 1986, President Reagan went as far as to frame tax reform as a return to traditional American values. He also pushed for simplification of the Internal Revenue Code, a balanced budget, and reduced tax revenues. Reagan's speech characterized tax reform as a gateway to fairness in government (Reagan, 1986a: 2):

Before we leave this city, let's you and I work together to fix it, and then we can finally give the American people a balanced budget. How often we read of a husband and wife both working, struggling from paycheck to paycheck to raise a family, meet a mortgage, pay their taxes and bills. And yet some in Congress say taxes must be raised. Well, I'm sorry; they're asking the wrong people to tighten their belts. It's time we reduced the Federal budget and left the family

budget alone. We do not face large deficits because American families are undertaxed; we face those deficits because the Federal Government overspends.

Now history calls us to press on, to complete efforts for an historic tax reform providing new opportunity for all and ensuring that all pay their fair share, but no more. We've come this far. Will you join me now, and we'll walk this last mile together? You know my views on this. We cannot and we will not accept tax reform that is a tax increase in disguise. True reform must be an engine of productivity and growth, and that means a top personal rate no higher than 35 percent. True reform must be truly fair, and that means raising personal exemptions to \$2,000. True reform means a tax system that at long last is pro-family, pro-jobs, pro-future, and pro-America.

Reagan readily acknowledged the size of existing budget deficits, but blamed excessive Federal spending as the primary cause (University of California-Santa Barbara: 2014). The 1986 Federal budget deficit was approximately 221 billion dollars, an all-time high to date, and accordingly, it was politically necessary for Reagan to address it as he discussed with Congress in February 1986 (Reagan: 1986b). A significant disclosure in this speech was in fact a proposed broadening of the personal exemption, which would have benefited all taxpayers, regardless of income. As with any tax proposal, fairness is a function of one's position on the issue. Just several days before the State of the Union Address, Reagan transmitted his annual report to Congress on the economy, a portion of which addressed tax reform (Reagan: 1986b):

Over the years, successive modifications of the Federal tax code have resulted in a complex tax system that contains many loopholes and artificially encourages some types of activities at the expense of others. Furthermore, the inflation of the 1970s distorted the overall pattern of capital taxation and pushed personal incomes into ever-higher tax brackets, discouraging saving and investment. Our actions to reduce tax rates have corrected many of these distortions and

inequities. Individual income tax rates have been reduced and indexed to the inflation rate; effective tax rates on new investment have been lowered substantially. Still, more must be done. In May 1985, I submitted to the Congress a comprehensive reform of the tax code to make it simpler, fairer, and more conducive to economic growth. I proposed reducing marginal tax rates for individuals and businesses, broadening the tax base by eliminating the majority of existing loopholes, taxing different activities consistently so that resources are allocated on the basis of economic merit and not tax considerations, and compensating for or eliminating much of the remaining influence of inflation on effective tax rates on capital.

Reagan was on message, and his rhetoric had begun to align with public opinion, the needs of the Federal budget, and the desires of Congress. The President had helped put the United States on the road to tax reform by making it a priority in his public discourse. Now it would be up to Congress to take up this challenge and act.

#### **4.8 Tax Reform for Fairness, Simplicity, and Economic Growth: the 1984 Treasury Report**

In November of 1984 the Treasury Department issued a historically-important report to the President: *Tax Reform for Fairness, Simplicity, and Economic Growth*. This report was a bold plan for tax reform, and despite the loss of some of its provisions in the final version of H.R. 3838, it remained a significant proposal to fundamentally change the United States' tax scheme (US Treasury: 1984). The major guiding principles of the proposal were highlighted in Chapter 4 of the report:

It is worth repeating here the watchwords (described further in chapter 2) that guided development of these reforms: simplicity; fairness; lower rates; economic neutrality; economic growth; and fair and orderly transition. (US Treasury, 1984: 37)

There is great similarity between these principles and those that ultimately became core tenets of the Tax Reform Act of 1986. Specifically, the Treasury report recommended a number of actions to accomplish these core goals with respect to individual and corporate taxpayers.

With respect to simplicity, the Treasury recommended “fairness for families” in the context of the individual income tax. The report promoted an expansion of personal exemption amounts so as to have the effect of reducing to zero the potential income tax liability of any families with incomes below the poverty level (US Treasury: 1984). In addition, the report called for rate reduction and simplification, proposing just 3 rates to apply across all types of individual tax returns: 15%, 25%, and 35%. Each of these rates would apply similarly to single, joint, head of household, and married filing separately returns, but with different income exemption amounts.

Reagan’s 1986 speech to Congress on the economy bore many similarities to the recommendations in the 1984 Treasury Report, as it should have, given that it was crafted by Reagan’s own Treasury Secretary Donald Regan. However, one of the primary points of agreement across both sides of the political aisle was that the tax code had actually begun to illogically drive economic decisions. The problems identified in this speech, as well as the Treasury Report, were both fundamental and industry-specific. The study (US Treasury, 1984: iv) cited broad objectives:

The objectives of our study included: lower marginal tax rates; reduced interference with private economic decisions; simplicity; revenues equal to those of the existing tax system; fairness for families; equal treatment of all sources and uses of income; an unchanged distribution of tax burdens across income classes; and encouragement to economic growth. We believe that our proposals for a modified flat tax best reconcile these competing objectives. They include some features that are similar to those in flat tax proposals that have been offered by members of Congress, but our proposals are much more comprehensive.

The Treasury report also provided great insight into lessons learned by recently unsuccessful tax reform efforts, as will be discussed in more detail later in this research. Stated differently, the Treasury Report appeared to acknowledge that for comprehensive tax reform to succeed, it needed to remain cohesive, and it needed to remain impervious to favouring or harming any particular group more than another (US Treasury, 1984: iv).

Most importantly, any change in the package inevitably means that the proposed rate structure must be redesigned in order to keep tax burdens constant -- in total and across income classes. Each credit, deduction or deferral of tax that is retained in current law means that tax rates higher than those proposed in the Report will be necessary to attain the same level of revenues. Moreover, if any special tax benefits are left intact, it will be more difficult to resist appeals by others for special treatment. These proposals are bold, and they will be controversial.

The 1984 Treasury Report was comprehensive, tackling both high-level principles and details: Specifically, the report singled out a number of areas where accounting changes were needed or where new principles should be applied. Several of these included (US Treasury, 1984: 166):

1. Match expenses and receipts from multi-period production.

2. Restrict use of cash accounting method.
3. Limit bad debt deductions to actual loan losses.
4. Disallow installment sales treatment when receivables are pledged.
5. Repeal corporate minimum tax (only if basic reforms are fully implemented).

*Tax Reform for Fairness, Simplicity, and Economic Growth* focused first on the divergence of real economic income and taxable income. Specific industry concerns, though discussed, were secondary to the ideas pointed out in items (1) and (2) above: use of the cash method to accelerate deductions and defer income and improper matching of expenses and revenues. It is notable that these were basic accounting issues, not specific tax preference items. Analysis of the 1984 report revealed the Treasury Department's belief that the Alternative Minimum Tax was a "necessary evil" to offset the variety of tax preferences buried in the Internal Revenue Code. As highlighted in item (5) above, the Alternative Minimum Tax helped maintain some sense of equity in the code, and as a result could not be repealed unless other mechanisms were enacted to maintain fairness (US Treasury: 1984).

Beyond fundamental issues, such as matching of expenses and revenue, *Tax Reform for Fairness, Simplicity, and Economic Growth* also tackled specific industries which received preferences in the existing tax code, particularly Energy, Banking, and Insurance. Some of the subsidies targeted in the 1984 report were as follows (US Treasury, 1984: 166):

1. Energy and Natural Resource Subsidies
  - a. Repeal windfall profits tax.
  - b. Repeal percentage depletion; use cost depletion, adjusted for inflation.

- c. Repeal expensing of intangible drilling costs.
- d. Repeal special rules for mining reclamation reserves.

## 2. Special Rules of Financial Institutions

- a. Repeal special bad debt deductions for banks and thrift institutions.
- b. Disallow 100% of interest incurred to carry tax- exempt bonds.
- c. Repeal tax exemption of credit unions.

## 3. Life Insurance Companies

- a. Limit insurance reserve deductions to the increase in cash surrender value.
- b. Repeal special deduction of percentage of taxable income of life insurance companies.

Each of these proposed changes would further the goal of reducing carve-outs and broadening the tax base, to make corporate taxes apply more evenly across industries. Specific subsidies were targeted, with the tradeoff being fewer tax brackets and lower rates for everyone: a more predictable tax system.

It is important to note that, in general, a more complex tax code can accomplish more specific political goals than a broad-based tax code, by way of special deductions and exemptions. However, in a hearing during 2010 on the current state of the United States Tax Code, Senator Max Baucus offered his reflections as to the effect of such complexities, and why the reforms proposed in the 1984 Treasury Report were important. Senator Baucus played a major role in shaping the Tax Reform Act of 1986. He and other key participants were asked to reflect on the evolution of the Internal Revenue Code since 1986 (US Congress, 2010: 1):

The 1986 tax reform leveled the playing field. No longer could a wealthy individual escape taxes by buying into a shelter. No longer could a clever investment strategy get investors out of paying their fair share. No longer could businesses participate in notorious tax shelters. Similar taxpayers paid similar taxes. But since 1986, Congress has made more than 15,000 changes to the code. Congress made these changes with the best intentions; some to collect revenue, some to stabilize the economy, others to further certain social objectives, all made for legitimate reasons. But each change created additional complexity, and each change created the potential for exploitation. Once again, just as in the 1980s, many can largely avoid paying taxes if they know how to manipulate the code. A long list of deductions, credits, and exclusions is available to help avoid taxation. Those who do not have a savvy accountant and refuse to participate in tax games often end up paying more. Many honest taxpayers end up feeling like chumps.

Baucus' point was clear. Changes to the tax code, specifically loopholes and special exceptions, drive complexity, which in turn drives administrative inefficiency. Taxpayers who can afford to spend significantly more time and resources on compliance efforts certainly will do what can be done to reduce their tax burden, and accordingly they may be rewarded with favourable, potentially inequitable, outcomes. The result is that the financially successful taxpayer is rewarded with a reduced tax burden, thanks to successful legal and administrative maneuvering, while the less astute taxpayer is punished with a higher tax liability.

Baucus also provided a favourite quote of Senator Bob Packwood, another architect of the Tax Reform Act of 1986, stating: "Senator Packwood was fond of saying, "Many taxpayers accept complexity that favors them." (US Congress, 2010:7). In some sense, Baucus is right. Tax complexity oils the proverbial gears and pistons of the United States' political machinery. Politicians who can deliver specific tax preferences to their constituents or favoured political

groups solidify their incumbency and remain popular in the home district. Alternatively, removal or reduction in specific tax preferences may reduce the utility of the individual politician to the individual voter. Stated differently, it is easier to complicate the tax code than simplify it, primarily because of the way politicians are rewarded for their efforts by voters. Tax preferences can be marketed to voters, and are ready-made evidence of the value delivered by the politician to his or her constituents. In the absence of strong intervention, the tax code would likely move toward greater volume, deeper complexity, and disparity between taxpayers.

Alternatively, tax simplification efforts require significant political will and a coordinated effort between individual Congressional representatives and the executive branch. For example, a representative must first be willing to give up home district or home state-centered tax preferences in favour of the common good. Next, reform requires similar efforts on the part of other representatives, who are equally willing to enter into an implied agreement not to create tax advantages for their own political allies or home districts. Finally, the executive branch of government must be willing to sign simplification legislation that could create a significant number of economic “losers” who have lost their government-sponsored tax preferences, either as individuals or stakeholders in corporations. Taxpayers feel more clearly what is lost through simplification, in the form of individual economic impact, than what is gained by improvement in administrative efficiency, reduced overall tax rates, and collective fairness. Further, as every political figure knows, what the individual taxpayer feels, even in superficial terms, is critically important to electoral outcomes.

#### **4.9 Previous Legislative Efforts**

The groundwork for the Tax Reform Act of 1986 was laid by a number of unsuccessful legislative efforts. Though these efforts did not succeed legislatively, many of their tenets were incorporated into the 1986 Act. In particular, the work of Bill Bradley and Dick Gephardt was most influential in producing comprehensive tax reform. Bradley and Gephardt were clearly centrist politicians, and would prove willing to work for compromise.

### *The Fair Tax Act of 1982*

The Fair Tax Act, also known as “Bradley-Gephardt” was an unsuccessful reform effort instituted with cooperation between Missouri Congressman Dick Gephardt and New Jersey Senator Bill Bradley. In a speech outlining his purposes and thinking in pushing for this reform bill, Gephardt explained his move toward a low-rate, broad tax base reform effort. Gephardt was reportedly unaware of Bill Bradley’s own independent efforts at drafting reform, and decided to join forces with him (Gephardt Collection: 2014). Initially, Gephardt was interested in pursuing a consumption tax, rather than overhauling the existing income-based tax system. However, after several failed efforts, and recognizing the complications in completely changing the tax paradigm in the United States, he settled instead on fundamental reform of the existing system (Gephardt Collection: 2014). Many of Gephardt’s and Bradley’s provisions formed the core tenets of subsequent reform efforts, including the Tax Reform Act of 1986.

Specifically, The Fair Tax Act pushed for a variation of a flat tax (Gephardt Collection: 2014). The Act recommended just three lower corporate tax rates, removal of as many corporate and individual loopholes as possible without compromising the bill’s ability to pass, and expansion of those individuals at the lower end of the income schedule who would not be subject to any income tax. Under the Fair Tax Act, a family of four would pay no tax up to \$11,200 in

household income (Gephardt Collection: 2014). The three corporate rates would have been 14%, 26%, and 30%, with Gephardt contending that over 70% of Americans would be subject to tax at the lowest rate (Gephardt Collection: 2014). In his speech, Gephardt urged that the public remain aware of the practical difficulties of truly comprehensive reform. He also expressed concern that other tax objectives, such as budget outcomes, would become confused and commingled with fundamental tax reform efforts. Ultimately, this bill was introduced by Bill Bradley but did not progress past Committee discussion (Govtrack: 2015).

### *Jack Kemp's Reform Efforts*

Tax Policy Center analyst Howard Gleckman (Gleckman, 2009: 1) discussed Jack Kemp's importance to the tax reform efforts of the mid-1980s:

Kemp was a key member of the most improbable band of reformers: Bradley; Rostenkowski; Senate Finance Committee Chair Bob Packwood (Republican, represented the state of Oregon), who had built his career larding the revenue code with the sorts of tax subsidies that reform was intended to eliminate; and Reagan, who never could muster quite the same enthusiasm for the '86 reform as he could for his '81 tax cuts. But like the others, Kemp was willing to work across the aisle to make reform happen. It is, sadly, hard to imagine a politician today doing what Kemp did back in 1983-86.

Kemp had offered a wide range of tax reform efforts over the years, including a number of creative, forward-thinking proposals: flat taxes, modified value-added taxes, lower rates, and broadening of the tax base. Though Kemp was a loyal "supply-sider" and conservative he also worked well across the aisle and was open to new directions and proposals.

### *The Pool Party – August of 1983*

In 1983, Kemp hosted a renowned “party” around his swimming pool which evolved into an important, though highly informal strategy session for future tax reform. In a discussion forum hosted by the Miller Policy Center at the University of Virginia, a number of participants in Kemp’s reform efforts recalled this strategy session. This meeting between Jack Kemp and many of his colleagues helped chart the course of Conservative reform efforts for the next several years, leading up to the Tax Reform Act of 1986. John Mueller, Kemp’s speechwriter and staff economist opened the panel by highlighting the political significance of this otherwise casual meeting (Miller Center: 2011, mm 4:00-5:00):

I think I should start by saying that tax reform (in the 1980’s) stressed all the fault lines in both parties, but also stressed the fault lines in the supply-side movement, precisely because of the difference in emphasis as to whether it’s things like the investment tax credit or rate reduction, which have the most oomph, so he would not have the unified party behind him as he did in the beginning.

Mueller also noted that the conventional wisdom in recent reform efforts, such as those sponsored by Bill Bradley, followed two major tenets. First, tax reform should not change the distribution of the tax code – it should be distributionally neutral so that no group bears a disproportionate burden. Second, it should be revenue neutral (Miller Center: 2011).

Much of the discussion around Kemp’s pool was around the proper direction Conservative tax reform should take. There had been recent reform efforts sponsored by Democrats, including the Bradley-Gephardt bill, but it emerged during the discussion that it would be healthy if Conservative Republicans had their own version of reform to offer as an alternative to the Democratic proposals. Mueller again recalled the discussion around the pool as

to how Conservatives should best respond to Democratic reform efforts (Miller Center, 2011, 7:00-8:00).

Most of them (those at Kemp's pool) actually did not have a firm view on the issue. It was my job as Jack's liaison to the supply siders to poll everybody, which I did in the next month. I polled them about their analyses of the specific bill, whether it would fly or not, and we came to the conclusion after about a month's discussion that we could do a lot better. Bradley-Gephardt did get the rates down... but it also repealed indexing, which is a big deal when there's still inflation. It got much of its revenue by disallowing most of the deductions over the 14% rate. There really wasn't a firm reason for doing that, we felt we had differential treatment of different taxpayers. But we thought we could build a better mousetrap because the so-called flat tax was very salient at the time.

Indexing for inflation was a major piece of the tax reform debate, and has remained an important principle in tax reform since the 1986 Act. Essentially, inflation was a great concern in the United States during the 1980s. Unchecked, it could have the effect of pushing individual incomes into higher tax brackets merely due to the artificial increase in wages. In testimony before the Maryland Ways and Means Committee in 2014, Tax Foundation expert Lyman Stone clarified the problem of indexation in taxation (Tax Foundation, 2014: 1).

Taxpayers suffer from what is known as "bracket creep." This phenomenon causes wage inflation to push nominal wages, or a worker's wages "on paper," up even as taxpayers' purchasing power remains the same. With higher nominal wages, they are pushed into higher tax brackets and owe more taxes. Paying higher taxes on income that is worth the same amount is especially damaging for low-income taxpayers.

Accordingly, any discussion about tax reform required consideration of indexation before real economic comparisons could be made. Indexation would later be considered a major “lesson learned” after the Bradley-Gephardt proposed legislation in 1982. Modern tax systems needed it to make tax changes meaningful, as clarity, consistency, and predictability were major pillars of any good tax system, and uncertainty around inflation jeopardized this (Stone: 2014). Still, Republicans desired a legislative plan of their own, which could borrow some common tenets from Democratic proposals, but could also show a degree of originality.

Bill Bradley himself expressed concerns that cutting tax rates would almost certainly result in lost revenue. However, when referring to the Taxpayer Relief Act of 1986, he indicated that he thought lowering tax rates was a great idea, but that politicians needed to realize that they also had to pay for them (Miller Center: 2011). Bradley, in retrospective discussion about tax reform, also indicated that he felt the historical record clearly showed that supply-side economics did not work as intended. He believed it had a negative effect on the budget and growth over the long term.

#### *The Fair and Simple Tax Act of 1984*

H.R.5533, or the Fair and Simple Tax Act of 1984, was introduced on the House floor by Jack Kemp on April 26<sup>th</sup>, 1984. Ultimately, it would die in committee but represented another step in the evolution toward the Tax Reform Act of 1986. This legislative effort, also known as “Kemp-Kasten” was a further modification and enhancement of prior reform, particularly Bradley-Gephardt. Robert Kasten, a chief aide of Jack Kemp, discussed this integration of Democratic proposals into a “new” bill (Miller Center, 2014: mm 12:00-13:00):

Most Republicans hoped to lower rates at that point. That was the hope. And I think the background, including the flat tax debate, is an important part of the foundation of what we did. And people were concerned because of the politics of it, not just the real estate lobby. People were not concerned just about the economics, but the politics. And the politics started to work its way through when we started to realize that Bradley-Gephardt would stay with us and we had the support of the President and we had the support of the Treasury secretary.

This comment is important because it speaks to a key element in the 1986 tax reform efforts: appropriate signalling. During this time frame, there were a number of signals in place that demonstrated that compromise across the political spectrum was possible and would not carry grave political consequences, or be exploited by the opposition. Reagan signalled in his discourse that he wanted simplification and low tax rates; Democrats, such as Gephardt and Bradley, signalled they would not abandon Republican efforts; and, Republicans such as Jack Kemp were also willing to work across the aisle for the good of the entire tax code. As will be discussed later in this research, such political signalling engenders trust, particularly when it is public, and proves to be a necessary element for any true bipartisan tax reform. Heavily partisan bills have been passed since the 1986 legislation, but they lacked this broad support, and of course, also lacked appropriate signalling.

Bob Mueller, drafter of the Kemp alternative, continued to discuss Republican strategy (Miller Center, 2014: 13:00-14:00):

Jack was already talking as early as early '83 about the next step in Reaganomics. There was an effort in each year after Kemp-Roth (a 1981 tax bill) to have a tax increase of some sort, there was an '83 bill, and an '84, and the idea I think on the supply-siders part was to have a countermove to get the rates down with a base-broadening approach and to head off tax increases

which would otherwise be inevitable. And so the idea was that Jack should wildcat with dissident democrats like Bill Bradley, and as Bradley mentioned, it seemed like a live option that he would be able to sell the democrats on the idea for the 1984 campaign, and so the Republicans should have their own version of it.

The version mentioned above, which the Republicans ultimately produced, was the Fair and Simple Tax Act of 1984. This was the result of several prior legislative efforts, as well as strategy sessions and informal discussions between members of both parties. Many of the major tenets of the Fair and Simple Tax Act or “FAST” would later be incorporated into the Tax Reform Act, either wholly, or partially. Some of the most important features proposed in FAST included (Miller Center, 2011: 5):

- cutting the top marginal tax rate in half, dropping it down from 50% to 25%, expanding personal allowances, and fixing a flat rate of tax at 25%;
  - doubling the personal exemption for each taxpayer, and expanding “zero-rate” brackets for low-income taxpayers so Americans near or below the poverty level would no longer pay income tax;
  - broadening the tax base by eliminating most tax preferences, but retaining major deductions for mortgage interest, charitable contributions, real property taxes and catastrophic medical expenses;
  - retaining tax treatment of IRA's, Keoghs, Social Security and veterans' benefits;
  - indexing for inflation, including capital gains for the first time;
  - cutting the corporate marginal tax rate from 46% to 30%, with a reduced 15% rate for small businesses, and reducing corporate capital gains tax from 28% to 20%;
  - maintaining revenue neutrality, retaining average tax rates, but reducing marginal rates;
- and

- reducing disparity between types of investment in property for tax purposes, such as depreciation.

Jack Kemp also had much to say himself about tax reform, despite his own sponsorship and reform efforts falling short of a major breakthrough. In a 1985 statement in support of bipartisan tax reform, Kemp announced the introduction of a Republican version of tax reform, and urged immediate passage of a comprehensive tax bill that reformed, equalized, and simplified the code (Kemp, 1985: 3):

The American people know that the current system is in disarray. The President strongly supports tax reform and Congressmen of both Parties understand the popular yearning for change. To symbolize the spirit of bi-partisan support for tax simplification, Senator Bradley and Congressman Gephardt are also introducing their tax reform plan in Congress on this same day. As Senator Kasten and I have said on many occasions, we welcome the contribution that Senator Bradley and Congressman Gephardt have made to lower marginal tax rates, increase investment incentives, and simplify the tax code. This kind of support from our Democratic colleagues signals Congress and the Administration that the movement for comprehensive tax reform is building undeniable momentum and strength.

The bipartisan support in Congress simply reflects the public's overwhelming support for tax simplification, lower tax rates, and fairness. According to a New York Times poll, almost 95% of the American public feel that the present tax system is unfair to the ordinary working man or woman. By almost 2 to 1, the public favors proposals to simplify the tax system by reducing the tax rate and the number of special tax preferences. According to a Washington Post/ABC News poll, over 60% of the public believe that tax rates are just too high.

Though this reform effort would ultimately fail, as did Bradley-Gephardt, the groundwork was in place for tax reform. Kemp stressed that the public wanted reform, and that Congress needed to act to deliver the fundamental change the American people needed. However, despite the synergies in place that would ease the process of changing the tax code, the current system of political tit-for-tat was hard-wired into life on Capitol Hill. Individual politicians had made promises to their home districts and to significant campaign donors. Committee Chairs, such as Bob Packwood, Senate Finance Chair during the legislative process associated with the Tax Reform Act of 1986, could demand compliance from their committee members using political favour as leverage. It would become increasingly clear that changing individual provisions in the tax code was simple. However, arranging support from a wide range of special interests for tax reform and the sacrifice of sovereignty it required would be far more difficult.

#### *Balanced Budget and Emergency Deficit Control Act of 1985*

Another important step which paved the way for the Tax Reform Act of 1986's successful passage was the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act of 1985. This bill was designed to cut the deficit to zero by 1990 by way of a sequestration process. If the results of the annual budget exceeded agreed-upon thresholds, across-the-board sequestration percentages were applied evenly across the entire budget (Library of Congress: 2014). The specific provision that enacts sequestration is described in the bill as follows (US House of Representatives, 1985: 30):

Each automatic spending increase shall be reduced

- 1) to zero (a uniform percentage reduction of 100 percent), or

- 2) by a uniform percentage reduction of less than 100 percent calculated in a manner to reduce total outlays for the fiscal year by one-half of the deficit excess, in such case fiscal year 1986, if the elimination of all such increases would reduce the total outlays for the fiscal year by more than one-half of the deficit excess (or the adjusted deficit excess, in the case of fiscal year 1986) for the fiscal year.

Gramm-Hollings was significant in that it was a serious attempt to tackle budget deficits that had grown significantly since 1981. It was supported almost unanimously by House and Senate Republicans, while receiving mixed support among Democrats (UC Berkeley: 2014). President Reagan's administration was also only tacitly supportive, primarily due to the fact that the sequestration provisions in the bill would directly and materially impact defense spending, a Republican priority (University of California-Berkeley: 2014). Ultimately, the Supreme Court would find Gramm-Hollings unconstitutional; Congress would pass a second version, with modifications to the sequestration provisions, just two years later (University of California-Berkeley: 2014).

Gramm-Hollings was also important because it was part of the "perfect storm" that helped lead the nation toward truly landmark tax legislation in 1986. The Tax Reform Act of 1986 succeeded partly out of the need for the political establishment on both sides of the aisle to take on the rising budget deficit in a manner that was palatable. President Reagan's administration had begun to run large deficits by 1982, and these deficits had reached all-time highs by 1986 (Bloch: 2014). By contrast, President Jimmy Carter's administration had maintained a small budget surplus all the way into the final year of his presidency (Bloch: 2014). The Reagan-era deficits between 1981 and 1986 were rooted in a number of significant causes,

including Reagan's tax cuts, dramatic and unexpected drops in inflation, and general economic malaise in the United States (American Enterprise Institute: 2012).

#### **4.10 The House of Representatives' Debate of H.R. 3838**

The principal architect of the House's version of the Tax Reform Act of 1986 was Representative Dan Rostenkowski (Democrat, represented the state of Illinois). As Chairman of the House of Representatives' Ways and Means Committee, Rostenkowski had great power to author and shape bills involving budgetary expenditures. This is a hallmark of the American legislative system: bills involving monetary outlay must originate in the House of Representatives. Though the House is considered to be the "weaker" and more transient of the two legislative bodies, the framers of the United States Constitution felt that empowering the House of Representatives with initial control over spending kept this key power close to the electorate. Rostenkowski was generally accepted to be one of the most powerful Congressmen ever to wield the position of House Ways and Means Committee chair.

On May, 28, 1986, President Ronald Reagan delivered a speech in support of tax reform, to which Rostenkowski was selected by House Speaker Tip O'Neill as the appropriate Democratic respondent (Mitchell: 2013). Rostenkowski's speech was a call for support for tax reform, and he suggested that the root goals of the legislation transcended party politics. Interestingly, while flavoured by party affiliation, it was an expression of support for Reagan's core ideals as well (Mitchell, 2013: 1):

Trying to tax people fairly: That's been the historic Democratic commitment. Our roots lie with working families all over the country, like the Polish neighborhood I grew up in on the northwest side of Chicago. Most of the people in my neighborhood worked hard in breweries, steel mills,

packing houses; proud families who lived on their salaries. My parents and grandparents didn't like to pay taxes. Who does? But like most Americans they were willing to pay their fair share as the price for a free country where everyone could make their own breaks.

Every year politicians promise to make the tax code fair and simple, but every year we seem to slip further behind. Now most of us pay taxes with bitterness and frustration. Working families file their tax forms with the nagging feeling that they're the biggest suckers and chumps in the world. Their taxes are withheld at work, while the elite have enormous freedom to move their income from one tax shelter to another. That bitterness is about to boil over. And it's time it did.

But this time there's a difference in the push for tax reform. This time, it's a Republican president who's bucking his party's tradition as protectors of big business and the wealthy. His words and feelings go back to Roosevelt and Truman and Kennedy. But the commitment comes from Ronald Reagan and that's so important and so welcome.

Because, if the President's plan is everything he says it is, he'll have a great deal of Democratic support. That's the real difference this time. A Republican president has joined the Democrats in Congress to try to redeem this long-standing commitment to a tax system that's simple and fair. If we work together with good faith and determination, this time the people may win. This time I really think we can get tax reform.

This speech was a strong signal that it was acceptable for Reagan to proceed with tax reform, with symbolic support from the Democratic side of the aisle (Mitchell: 2013). Even more fascinating, Rostenkowski closed the speech with a request for letters of support from the public (Mitchell, 2013: 2):

Even if you can't spell Rostenkowski, put down what they used to call my father and grandfather—Rosty. Just address it to R-0-S-T-Y, Washington, D.C. The post office will get it to me. Better yet, write your representative and your senator. And stand up for fairness and lower taxes.

Thousands of letters poured in in response. The public reception of Rostenkowski's response was energetic and positive, a surprise given Rostenkowski's reputation as an awkward speechmaker (Mitchell: 2013). This conciliatory and populist tone set the stage for legislators to make real change. Some of the ideological impediments to reform had been removed, and this freed up the political players, including President Reagan, Rostenkowski, and Senator Bob Packwood, to pursue the bill with few reservations. Further, it is important to note that the most important personalities in the legislative process were known to be "dealers", more than willing to bargain and "make political sausage" without dishonesty. This "honourable wheeler-dealer" mentality was a unique aspect of 1980s politics. The politics of compromise was widely accepted as the way policy was done, and no one excelled at this more than Rostenkowski (Citizens for Tax Justice: 2000). Ironically, a number of political figures associated with the Tax Reform Act of 1986 were later damaged by criminal and ethics probes, most notably Dan Rostenkowski himself.

#### **4.11 Senate Debate**

The Senate Finance Committee debated H.R. 3838 beginning on September 27, 1986. The session, televised on the network C-SPAN, contained nearly 16 hours of debate and discussion. The key themes of this debate centered on several areas: the expression of solid

support for the overall legislation, despite known flaws; recognition that the effort was not just a tax bill, but true reform; and criticism and concern over transition rules.

Senator Slade Gorton (Republican, represented the state of Washington) opened the discussion, expressing strongly the context which gave rise to the bill (CSPAN: 1986, mm 49:00-50:00):

Congress has increasingly come to view the tax code not simply as a revenue raising system, but as a tool for achieving all sorts of social goals, not always successfully. In recent years the tax code has become so complex and confusing, that even the smartest and most sophisticated taxpayers are frustrated by the task of filling out a tax return. Perhaps the most dramatic symptom of this is the industry of tax avoidance that has grown up around the tax code.

He also expressed a number of common concerns around the proposed legislation, including the proposed repeal of the investment tax credit and favourable capital gains tax rates, as well as lack of consideration for indexation of inflation.

Positives associated with the bill were its dramatic simplification and lowering of the tax rates, as well as removal of over 6 million poor and very low-income residents from the tax rolls. The increases in personal exemptions and standard deductions also levelled the tax scheme, to place a greater burden on top earners, and reduce the burden on low-income taxpayers. Gordon spoke further in support of the bill, stating “After reviewing the testimony, I am convinced that the long-run impact on our economy will be positive. The deterioration of our current tax system cannot continue. We have the chance to stop it now.” (CSPAN, 1986: mm 55:40-56:30).

Senator Alan Dixon also (Democrat, represented the state of Illinois) spoke, in support of the bill (CSPAN, 1986: mm 1:34:30-1:35:20).

I think that almost every member in either house would agree that this is truly a historic moment in the Congress, but I think anyone who has been here for a while appreciates the fact that this is landmark legislation. Mr. President, this is truly is a fundamental reform of the entire Internal Revenue Code of this country.

Dixon went on to address concerns about the economic impact of the bill, a concern with any large-scale tax reform effort (CSPAN, 1986: mm1:36:00-1:37:00):

Some have expressed concern about what this might do to the economy. But I would argue that any bill that takes fourteen brackets, with a high of 50%, and reduces it to 15 and 28%, reduces the corporate tax rate from 46 to 34%, and takes 6 million working poor off the tax rolls, ultimately has to be in my view a benefit to the economy. Now there are some things about this bill I don't like. I was one of those who led the fight in the Senate to retain deductibility of the sales tax if you itemize on the return. My state of Illinois, and many other states in this union that rely on sales tax for major sources of revenue, take some exception to the fact that you can't deduct the sales tax if you itemize.

Dixon also complained about the loss of IRA deductibility in the Senate conference report and the harshness of the transition rules with respect to real estate investments. However, he was positive with respect to the bill "taking 120 billion dollars in tax liability off the back of individual American citizens." (CSPAN, 1986: mm 1:38:00-1:38:45).

Texas Senator Lloyd Bentsen, a democrat, and known friend of "big oil" also referred to the legislation as imperfect but worthwhile, stating "As I've looked at this bill and worked on this bill, I've certainly come to the conclusion that we've got a mixed bag on our hands. But don't we always have that when we're talking about a major reform piece of legislation?"

(CSPAN: 1986, mm 1:44:40-1:45:00). The “mixed bag” metaphor was a common theme during the Senate Debate. Whether this was an expression of political cover from the Senate floor, or an expression of political reality, was unclear. However, this theme emerged strongly from the debate: the bill was not perfect, but as legislation goes, it was widely considered to be a very good bill.

Bentsen continued to discuss the bill’s reduction in loopholes, and shed significant light on precisely why they needed to be cut from the law. Interestingly, Bentsen was known to be a supporter of tax breaks for the oil industry, being a Senator from Texas, which he readily acknowledges in his speech as reproduced below. He was considered one of the most reluctant reformers on the committee as well, though he would later take on the Chairmanship due to the election results in November of 1986 (Birnbaum & Murray: 1986). However, his comments represented well the broader view of why the sheer volume of special tax breaks needed to be reduced (CSPAN, 1986, mm1:46:20-1:47:00).

I just happen to think the private sector is more efficient in that regard, and that’s what we ought to pursue. And this gets rid of a lot of those incentives. Well then, why would I vote for that bill? The reason I would is because each of those incentives was put in at a time and place in history when it serves what we deem to be a worthwhile purpose for our country. Some economic objective we think ought to be achieved. But time passes, economic conditions change, and we never go back and revisit the problem. Because we’re going to take something away from some special interest group. And one piles on top of another. And finally you’ve got the darndest mishmash in the way of a tax system you can imagine. And finally you don’t just make an economic decision, you make a tax decision. And then you end up with a very unfair tax system.

Bentsen's speech revealed a key element that provided impetus for change in H.R. 3838. There was a broad and growing sense that the tax code, including both individual and corporate provisions, had reached a tipping point. These historical "piles" of nuances, exceptions, and carve-outs Bentsen referred to had become too large for the average taxpayer to handle, and for even Congress to begin to broach. These particularities in the code often lacked logical or economic consistency, and usually benefited those most who could best navigate them with legal counsel, lobbying efforts, or campaign contributions (Birnbaum & Murray: 1986).

#### **4.12 Transition Rules: The Cost of Compromise**

Any attempt to simplify a major piece of tax legislation must allow for an orderly transition period for the new rules to take effect, ostensibly helping alleviate a catastrophic or disparate impact to taxpayers affected by the changes mid-stream. Transition rules were a major point of contention with respect to the Tax Reform Act of 1986, with over 80% of Senators and 50% of Congressmen receiving at least one instance of transition benefits (Klott: 1986). However, in this particular piece of legislation, over 1,000 requests for transition relief were denied, and even a number of staunch opponents of the bill received transition relief (Klott: 1986). However, those in charge of administering the transition aid, such as Senator Bob Packwood, viewed transition dollars as a cost of doing business and a key tool to get legislation passed. According to columnist David Rosenbaum, "One of the most powerful clubs available to the chairman of a tax-writing committee is his capacity to do small favors, called 'transition rules', for the lawmakers who support him and to withhold favors from those who do not." (Rosenbaum, 1986: 1). This was true of Bob Packwood, who used the privilege as chairman of the Senate Finance Committee to gain compliance from wavering committee members. These

transition amounts were handed out in a bi-partisan fashion, intended to smooth bumps on both sides of the political aisle.

The relief rules associated with the Tax Reform Act of 1986 were implemented as part of a discretionary lump-sum under the control of Senator Bob Packwood (Republican, represented the state of Oregon). This process raised questions among the Congress. These transition rules were, by their nature, intended to benefit particular individuals. In *US v. Kjellstrom*, the order referred to the original intent of the 1986 Act, stating “Transition rules were intended to provide limited exemptions for certain taxpayers who would be affected adversely by a new law because they had relied on the old law to their detriment.” (*US v. Kjellstrom*, 1996: No. 95-C-0091-C). Further, the court opinion in *Apache Bend Apartments*, describes transition rules as “specified exemptions from designated provisions of the new tax laws to a very, very few specified favored taxpayers.” (*Apache Bend Apartments v. United States*, 1993: 987 F.2d 1174). However, despite clear understanding that there would be winners and losers in any transition effort, a number of members of the Senate expressed reservations.

The transition rules constituted a list of hundreds of projects that would receive specific legislative protection amidst the storm of legal changes in the Act (Redburn: 1986). These items were not contained in the Act itself, but were referenced and cited in the associated Conference report, often covertly. H.R. 3838’s summary, as passed by the Senate, contains the following reference: “Transition rules. It is the sense of the Senate that the conference report on this bill contains the names of all persons receiving transitional relief as well as the costs and reasons for such relief.”

Several major industries received significant relief, along with numerous “pet” projects associated with particular Senators and House members. General Motors, Chrysler, Phillips Petroleum, and numerous civic projects such as stadiums and infrastructure were included (Klott: 1986). While the transition rules associated with major industries were difficult to conceal, the smaller rules associated with particular taxpayers or projects were often written so as to shield the beneficiary, and their Congressional sponsor, from the public eye. These became commonly known as “rifle-shot” transition rules (Evans: 1988). These rifle-shot rules were employed despite the statement in the bill’s summary which promised to specify the beneficiaries and reasons for the transition relief.

One instance of a transition rule that covertly protects the beneficiary is highlighted in Sec. 2656 of the 1986 Tax Reform Act:

For purposes of section 2656(b)(8) of the Internal Revenue Code of 1986, an individual who receives an interest in a charitable remainder unitrust shall be deemed to be the only noncharitable beneficiary of such trust if the interest in the trust passed to the individual under the will of a decedent who resided in Tarrant County, Texas, and died on October 28, 1983, at the age of 75, with a gross estate not exceeding \$12.5 million, and the individual is the decedent's surviving spouse.

It is clear in reading the legislation that this instance of relief targets one particular individual. There are numerous examples throughout the transition rules of this sort of arrangement. Not surprisingly, such deals and carve-outs angered a number of Senate and House members. However, Senator Packwood made it clear that anyone who did not vote for the bill in

conference would receive no transition aid. Of course, every member of the committee ultimately voted in favour, and every member accepted transition aid (Rosenbaum: 1986).

In Senate Committee hearings televised on C-SPAN, Senators aired their complaints about the transition rules built into the Tax Reform Act. The major criticism was the extensive discretionary power to hand out transition benefits granted to Senator Bob Packwood. In addition, a number of Senators expressed discontent at the politically tainted process of phasing out transition aid. Many of the beneficiaries of transition aid were also major sources of lobby: insurance companies, banks, and high-profile individual taxpayers. Accordingly, the lobby and hallway outside the Congressional committee room became known as “Gucci Gulch” for the nice shoes of the well-heeled lobbyist who lurked there (Birnbaum & Murray: 1992).

Senator Howard Metzenbaum (Democrat, represented the state of Ohio) was an outspoken critic in his speech on the Committee Report. Metzenbaum had previously contended that he would have accepted any transition rule as long as the rule was made public and the beneficiary was clear (CSPAN, 1986: mm 1:12:00-1:13:00).

I don't think any two men or women in this Congress have the right to parcel out 3.3 B dollars over and above that which the Congress has seen fit to include in the legislation, and at the same time you withdrew 250 M dollars from the farmers of this country of benefits they have by reason of income averaging...I guess what I am trying to say is that the managers of the bill have truly made a strong enough case for their having parceled out this 3.3 B dollars... (but) some of those positions were purely political.

Metzenbaum went on to point out that for 3.3 B dollars “foster care could be provided for every child in America for the next ten years” in response to Sen. Bob Packwood's defense that in the

scheme of things, the transition rule discretionary funding allocated by Packwood was a small amount of money. “How can we determine whether we are for them or against them if we don’t know what they are? They are one-liners. They don’t tell you the whole story.” (CSPAN, 1986: mm 1:24:00-1:25:30). Metzenbaum went on to say “What concerns me is that when you shroud the legislative process in secrecy, you contribute to the views of the average American that tax bills hurt the average American, and that only those with clout get taken care of.” (CSPAN, 1986: 1:24:30-1:25:00). Further, Metzenbaum contended “If they knew it fully, they’d say ‘I appreciate the thrust of the tax bill and that it moves in the right direction, and I think it is going to help me as a middle-class American. But why did they give away so much money?’” (CSPAN, 1986: 1:25:15-1:25:40).

Senator Metzenbaum stressed repeatedly that the transition rules were too opaque and gave too much discretionary authority to Senator Bob Packwood. Packwood’s defense was simple: when the legislation was coming down to a deadline, he did whatever he needed to do to get the legislation passed (Redburn: 1986). Further, when pressed by reporters whether he could explain to them precisely how he leveraged transition rules to get the legislation passed, he stated that though he could, he didn’t plan to (Rosenbaum, 1986). In the legislative process, the finished product is often more palatable than the sometimes distasteful steps that created it. Ironically, some political favouritism and special provisions were ultimately required to pass large-scale tax reform legislation that was designed to limit special deals. Though Metzenbaum pushed for a more perfect version of the bill and its transition rules, Packwood clearly did not want to allow perfection to slow down a bill he believed to be good enough.

#### **4.13 Success Despite Opposition**

While the Tax Reform Act of 1986 garnered broad support, it was also opposed by political action groups, individual politicians, and a portion of the voting public. The Tax Reform Act of 1986 was perceived as threatening to those who benefited from the existing political process, particularly those who were able to deliver “pork” or specific projects earmarked to their home districts. Other staunch opponents were lobbyists who were paid well to lean on Washington politicians on behalf of their corporate and wealthy individual clients. However, despite representing an existential threat to powerful Washington lobbyists, one of the most important surprises associated with the Tax Reform Act of 1986 is that these disparate opposing forces were never able to galvanize into a single bloc capable of taking down the bill (Birnbaum & Murray: 1992). Numerous theories have been conjectured as to why this was the case: the individual lobby groups’ focus on narrow exemptions; unwillingness to stand in the way of tax reform; lack of communication between “common enemies” of tax reform; and, broad public support (Birnbaum & Murray: 1992).

In part, the bill’s lackluster opposition was a product of the neutral political nature of the bill itself. The bill was supported and moved along by members of both major political parties, and offered few favours to any particular group. Well-known Republican supporters included President Ronald Reagan, Senator Bob Packwood, Jack Kemp, and future presidential candidate Bob Dole. Democratic supporters included Ways and Means Chairman Dan Rostenkowski, Dick Gephardt, and Bill Bradley, also a future presidential candidate. These individuals were from a broad range of the political spectrum, and this diversified base of support helped the Tax Reform Act of 1986 weather criticism and opposition at varying points in the process (Birnbaum & Murray: 1992). Along similar lines, Randall Weiss, Managing Director of Economic Research at The Conference Board in New York City provided testimony in 2010 as to why he believed this

Act was successful where others had failed. He listed four key provisions in the Act that made it “stick” despite political difficulty: a substantial reduction in tax rates; moving the tax base closer to actual income; revenue neutrality; and, de-emphasis on distribution by income class (Weiss: 2010). The Tax Reform Act of 1986 contained these universal, unifying elements that helped consolidate its support and diffuse its opposition. It is nearly impossible to argue against these principles without appearing to be an out-of-touch Washington insider, or a lobbyist with a personal stake in the outcome.

In 2010, Representative Dick Gephardt (Democrat, represented the state of Missouri) was called to testify before a Congressional commission called “*Tax Reform: Lessons from the Tax Reform Act of 1986*” (Senate Finance Committee: 2010). Gephardt recalled the circumstances that contributed to the Act’s success, particularly the Fair Tax Act. He also observed some of the key circumstances which allowed the Tax Reform Act of 1986 to progress (Senate Finance Committee, 2010: 1-2):

In 1982, Senator Bill Bradley (Democrat, represented the state of New Jersey) and I introduced the Fair Tax Act which reflected our view that the tax code needed to be dramatically simplified to restore public faith, and trust that the code’s intentions were to promote sound economic growth for all, and not just narrow, short-sighted, and often counter-productive benefits for a few.

Super Dairy Cows were a prime example of that. There were substantial benefits to taxpayers to invest in dairy cows that could produce higher quantities of milk. Yet, due to dairy programs in the Farm Bill, there was already a glut of milk on the market. There was so much milk in fact, that cheese was literally spoiling in federal warehouses, with no appropriate consumer for the product. Schools, nutrition programs and other users already had their fill. Yet, millions and

millions of dollars were invested in these tax shelters – with the federal taxpayer underwriting the benefits – because of some talented lawyers who helped arrange the tax dodge.

Gephardt reflected that by 1986, the Internal Revenue Code had become a playground for special interest groups, attorneys, and lobbyists. Special deductions, subsidies, and carve-outs were rampant, and these exceptions altered the behaviour of the participants in the political process. Politicians delivered “pork” to their constituencies, including both individuals and corporations, and lobbyists helped make sure that everyone who wanted a seat at the table had one. While this process of political favour-trading has not changed substantially in United States politics, the 1980s was a particularly dark period in this regard.

Gephardt’s “Super Dairy Cows” example drove home the point that particularities in the tax code could drive irrational consumer behaviour in unexpected and undesirable ways. Further, special interest lobbying and complexity in tax law are closely correlated: a specific deduction or subsidy requires the creation of a particular code section to allow it under the law. Gephardt’s point was that specific tax subsidies, while helping in a particular policy objective, can run counter to overall goals of sound tax and economic policy. Also, the passive activity rules, which were enacted as part of the 1986 Act, also helped combat the distortion of economic activity by tax policy. Many of the passive investments the new law targeted had little economic substance: their real economic value was the paper losses they generated on the personal income tax returns of their owners (Wilkie, Young, & Nutter: 1986).

Gephardt also pointed out that a deep analysis of the issues, without prejudice or scope limitation, was critical to the success of the 1986 Act. Specifically, Congress was given time to explore deeply the alternatives, strengths, and weaknesses of various tax paradigms. This

resulted in the conclusion to continue with the current approach to the income tax, rather than gutting it for other alternatives such as a national sales tax (Senate Finance Committee, 2010: 2)

But, it wasn't until President Reagan embraced the idea of tax reform that real action started. The President had commissioned a number of extensive studies by the Treasury Department to look at various options – such as sales taxes and the VAT. After full analysis, President Reagan came to the same conclusion that I did – that the best approach was to reform the current income tax system rather than abandon it.

House Ways & Means Chairman Dan Rostenkowski began comprehensive hearings that helped establish a thorough and fair understanding of the provisions in the tax code at that time, how the code might be altered and what the implications of each change would be. It was critical for members of Congress to come to a complete understanding of the interaction of the thousands of individual tax provisions. Without this level of understanding of the complex issues involved we could never have reached the bipartisan consensus that in the end passed the bill.

Gephardt's point was about how long it takes to truly understand the impact of tax legislation of the magnitude of H.R. 3838. In this sense, it was not a surprise that the 1986 effort had begun as early as 1982 with Gephardt-Bradley. The political players needed time to understand what their reforms really meant, beyond the impact of a single provision that might apply to their home jurisdiction. Large-scale reform meant that each participant had to become a bigger stakeholder in the process, meaning many politicians would be "learning while legislating." The understanding required for members of Congress to make such important policy shifts could not have occurred in a short time frame.

In his 2010 testimony which reflected on H.R. 3838, Representative Dick Gephardt went on to describe what he believed were precipitating factors that made the 1986 Act the right

legislation at the right time. What begins to emerge from his account is a “recipe” or list of conditions that make it conducive for passage of major tax reform such as the 1986 Tax Reform Act. First, the presence of a national crisis was critical. In the 1980s the United States was emerging from a deep recession and unprecedented energy shortages. This was exacerbated by high unemployment and competition in trade from other countries (Gephardt: 2010). The presence of a “crisis” was important because it galvanized individuals to make their voices heard and pressed politicians to make sacrifices and compromises necessary to generate tangible results. Second, limited trust in government by the American citizenry and a desire for change contributed key pressure to the cause of reform. Gephardt explained “Taxes remain the principal point of contact between the average citizen and the Federal Government, and during tight budget times, the American people want to make certain that their tax dollars are not only fairly spent, but also fairly collected.” (Senate Finance Committee, 2010: 2). Finally, parity in leadership, including charismatic leaders who were also willing to compromise, helped usher in the Tax Reform Act of 1986. Gephardt (2010: 3) described this phenomenon:

In 1986 we had the benefit of a strong desire for change in Washington, and across America. We had leaders in both parties, like President Reagan, who were willing to negotiate in good faith, and debate when needed, and not just block anything and everything from getting done. These were leaders who were true champions of their respective philosophies as conservatives and progressives, but who were not hamstrung by partisan extremists who question every opponent’s patriotism, vilify compromise, and who have more in common with the Know-Nothings than with our Founding Fathers.

Gephardt’s testimony suggested that in order to produce broad-based tax reform, certain political and social conditions needed to be present. While changes to the tax law have occurred

continuously throughout the history of the United States, on just a few occasions could the changes be referred to as “landmark.” The Tax Reform Act of 1986 was a landmark piece of legislation, and accordingly it fit the profile suggested by Dick Gephardt. However, perhaps the most important aspect by which one can measure any significant piece of tax legislation is its historical legacy.

#### **4.14 Conclusion**

With the passage of the Tax Reform Act of 1986, real compromise and material tax reforms appeared to have been achieved. In many ways, the Act represented the best of American politics. This chapter highlighted the strengths of the 1986 Act, the personalities who shaped it, and the behind-the-scenes efforts which laid its foundations. Perhaps most importantly, in examining this Act, four important lessons emerged as to how to best foster substantive tax reform. As later chapters will discuss, many of these lessons in fact predicate any real effort at tax reform.

First, partisanship creates dire consequences for reform efforts. When party leaders and voting constituencies make narrow, specific demands on politicians, it erodes their individual ability to compromise and make government function properly. This impedes progress of any kind, and prevents efforts at change that could be considered “across-the-board.” The result is a self-fulfilling prophecy: the only change that is possible is narrow in scope, not substantive, or responds piecemeal to special interest groups or particular jurisdictions.

Second, certain political elements in the environment are critical. The history of the 1986 Act shows that tax reform is most likely when no single party has effective control of the legislative and executive branch. This balance of power appears to create ideal conditions for compromise. If this balance is not present, the minority party may be inclined to take more extreme positions or seek leverage by mechanical or administrative means.

Third, highly visible, vocal support from top political leaders makes reform more likely to succeed. President Reagan's openness to compromise set a tone within his own party, a tone that was reciprocated by the opposition. With political consequences out of the way, politicians could go to work making a deal that could pass Congress.

Last, pursuit of a good bill, as opposed to a perfect one, is the best attitude for creating tax reform. By focusing on making some progress, as opposed to accomplishing every political goal, legislators can appease a large enough voting bloc to pass key pieces of legislation. In seeking tax reform, this is a key consideration: creating a piece of legislation that is substantively better than the alternative.

The 1986 Tax Reform Act succeeded for several reasons: Reagan's very public leadership; Packwood and Rostenkowski's willingness to set a tone of compromise; the efforts of Jack Kemp and Bill Bradley to lay the groundwork for reform; and, the political landscape which allowed for a proper balance of power. The story of the Tax Reform Act of 1986 is colourful and complex. It is still regarded as one of the most important and comprehensive attempts to change American taxation in the nation's history. Though imperfect, it was largely recognized as a leap forward in the United States' tax system. However, perhaps its most memorable contribution to our understanding of history and taxation is that it provided a blueprint for cultivating

substantive tax reform. But questions remain: Did the Act accomplish what it appeared to? Would it last? A 1992 study examined retrospectively public opinion around the 1986 Tax Reform Act. Surprisingly, public opinion became increasingly negative of the Act itself over time, while public opinion of the tax system improved (Scholtz, McGraw & Steenbergen: 1992). Perhaps the lesson is a universal one in the political process by which tax laws are forged: the average voter dislikes the political process, even when the results of that process are healthy and beneficial. However, it is clear that the Internal Revenue Code and the American system of taxation itself improved in the eyes of the public with the passage of the Tax Reform Act of 1986. This in itself should be considered a major victory for any piece of tax legislation.

Metaphorically speaking, the 1986 Act helped make many more taxpayers accountable, and helped encourage many more taxpayers to buy in to the tax reporting process. It also left little room, other than conflict over transition rules, for any particular group to claim either aggrieved or superior status. It ironed out many differences between classes of taxpayers, types of transactions, and levels of income. To the average taxpayer, it made more sense than any tax code before, and had a great deal of face validity. The Tax Reform Act of 1986 reduced the citizen's need to wonder whether their neighbors, co-workers, or business competitors were getting a better tax deal than they were. While some of the accomplishments in the Act would be undone by later legislation, the Act was important and memorable. While a future Congress might roll back its provisions, it would not be able to alter its legacy: the Act accomplished a difficult task during complicated circumstances, to the surprise of its critics; and, in taxation, as in life, sometimes we surprise ourselves most of all.

## CHAPTER 5

### The Omnibus Budget Reconciliation Act of 1993

#### 5.1 Introduction

As the decade of the 1980s came to a close, optimism, economic growth, and financial prosperity in the United States were on the decline. The United States endured significant reductions in business growth and investment, and steep declines in real estate values, beginning in the late 1980s and proceeding into the first term of President George Bush (Kamery: 2004). Ironically, it has been posited that many of the law changes in the Tax Reform Act of 1986 may have contributed to these economic woes (Entin: 1991). For example, passive loss limitations passed in the Tax Reform Act of 1986 possibly contributed to the slide in real estate values, and the repeal of the investment tax credit arguably discouraged business expansion and spending (Entin: 1991). Coupled with the resoundingly negative outlook on the economy expressed by most Americans, the nation teetered on the brink of a deep recession (Kamery: 2004).

Further, despite extensive tax reform efforts in 1986, the incidence of tax expenditures continued to rise (General Accounting Office: 1993). In its report entitled “Tax Expenditures Deserve More Scrutiny”, the General Accounting Office stated that in 1993 special preferences “applied to 124 separate exemptions and exclusions of income, deductions, credits, deferrals, and preferential tax rates.” (General Accounting Office: 1993). This was an all-time high, the result of a steady climb up from just 74 instances in 1974 (General Accounting Office: 1993). These tax preference items continued to be an area of concern because they circumvent traditional

budgeting processes, and result in artificially high tax rates in order to equalize budget outlay (General Accounting Office: 1993).

Many of these widespread economic challenges served to boost the presidential candidacy of Arkansas Governor Bill Clinton, challenger to Republican incumbent George Bush for the Presidency in 1992. Clinton ran aggressively against Bush on a platform of economic change (American Presidency Project: 2015a). Clinton laid out his economic and tax philosophy in a series of presidential debates in late 1992, including the final debate before the November election, on October 19<sup>th</sup>. Clinton sought to incentivize economic investment to spur growth, as well as increase the share of the tax burden borne by the wealthy (American Presidency Project, 2015a: 1):

I propose an American version of what works in other countries. I think we can do it better: invest and grow. I believe we can increase investment and reduce the deficit at the same time if we not only ask the wealthiest Americans and foreign corporations to pay their fair share, we also provide over \$100 billion in tax relief in terms of incentives for new plants, new small businesses, new technologies, new housing, and for middle class families, and we have \$140 billion of spending cuts. Invest and grow: raise some more money; spend the money on tax incentives to have growth in the private sector; take the money from the defense cuts and reinvest it in new transportation and communications and environmental cleanup systems. This will work.

Clinton would go on to win the Presidency in a rout, despite the unusually strong presence of 3<sup>rd</sup> party candidate Ross Perot, who garnered nearly 20% of the vote (FEC: 1993). However, after his election in 1992, President Clinton needed to deliver on his promises to relieve the United States' economic malaise and boost the morale of a dispirited public.

Clinton's budget challenges were substantial. In its report filed in January of 1993, the Congressional Budget office projected a \$310 billion budget deficit, marking the fourth year in a row the United States would tally a record-setting deficit (Congressional Budget Office: 1993). The long-term budget outlook was also poor, with reports projecting a deficit of \$357 billion by 1998 (Congressional Budget Office: 1993). These bleak projections made a strong case for immediate deficit reduction steps, and President Bill Clinton made it his legislative priority to attack both the deficit and the lagging economy.

Tax policy would ultimately play a critical role in these efforts, with the passage of the Omnibus Budget Reconciliation Act of 1993. The 1993 Act would become a defining piece of legislation for the Clinton administration. The measure was part of a very active first-term legislative agenda in the Clinton White House. Though Clinton would be nagged by scandal in his second term, by 1994, the budget deficit had fallen to just under \$300 billion, and by 1999, the deficit would turn into a \$124 billion surplus (Miller Center: 2015). In 1998, President Clinton generated the first balanced Federal budget in the United States since 1969, with a key element of the reduction funded by tax increases on the wealthiest Americans (Miller Center: 2015). Clinton's aggressive deficit-reduction policies, spearheaded by the Omnibus Budget Reconciliation Act of 1993, made the difference (Miller Center: 2015).

## **5.2 Background**

In his State of the Union address on February 17<sup>th</sup>, 1993, President Bill Clinton explained his plan to close the budget deficit, a plan which would again significantly alter the tax landscape (Washington Post, 1993: 9).

For the wealthiest – those earning more than 180,000 dollars per year, I ask you to raise the top rate for federal income taxes from 31 percent to 36 percent. Our plan recommends a ten percent surtax on incomes over 250,000 dollars a year. And we will close the loopholes that let some get away without paying any tax at all. For businesses with taxable incomes over ten million dollars, we will raise the corporate tax rate to 36 percent. And we will cut the deduction for business entertainment. Our plan attacks tax subsidies that reward companies that ship jobs overseas. And we will ensure that, through effective tax enforcement, foreign corporations who make money in America pay the taxes they owe to America.

It is clear that budget reform should ideally be accomplished through compromise between factions. However, compromise does not always occur in a timely or efficient manner. As a result, prior budget reform efforts in the United States have relied on process mechanisms, such as sequestration, to enforce specific budget limitations. Sequestration is process by which an “automatic” and targeted budget cut is instituted when legislative compromise cannot be reached. It is primarily intended to be a severe and unpalatable option for all parties to the debate, in order to encourage them to compromise (White House: 2015). In its 1993 report, the Congressional Budget Office instead proposed a different approach to deficit reduction (Congressional Budget Office, 1993:119):

The past indicates that efforts to reduce the deficit are most likely to be successful if the President and the Congress first agree on policy actions and then set up processes to enforce them: deficit reduction does not work as well if the process changes precede the policy actions.

The Congressional Budget Office’s report suggested that such mechanisms are a poor substitute for compromise in situations where the political will to find common ground is limited. Rather

than working first toward policy solutions for budget deficits, politicians have tended to resort to enforcement as an artificial means to gain agreement. The Congressional Budget Office specifically advised against this approach (Congressional Budget Office, 1993:119):

If agreement exists on policy actions, many of the major process changes (such as the balanced budget amendment, the line-item veto, and mandatory caps) that have been advocated are superfluous. The Congress and the President should avoid any temptation to substitute process for policy, but should recognize the importance of process in ensuring that policy changes are realized.

Successful tax reform bills, such as the Tax Reform Act of 1986, were achieved through extensive personal effort and substantial compromise, including very public support by key leadership figures in both Congress and the White House. As discussed earlier in this research, Dan Rostenkowski and Bob Packwood made great examples of this approach to establishing policy. They spent long hours in backrooms and endured great personal sacrifice to ensure the passage of the Tax Reform Act of 1986. They also benefited from the very public support of President Ronald Reagan and his commitment to similar policy outcomes. In the end, the legislative deal was made around *how* to make policy, not *whether* particular policies should be made.

However, the legislative history of Omnibus Budget Reconciliation Act of 1993 was entirely different. The bill would ultimately be passed without a single Republican vote in either chamber of Congress (Rosenbaum: 1993). In fact, the bill struggled through both committee and the final vote in the Senate, with vice-President Al Gore forced to add a tie-breaking vote to pass the measure in both cases (Rosenbaum: 1993). This is surprising, given that many of the key

architects of the Tax Reform Act of 1986 were also directly involved in the Omnibus Budget Reconciliation Act of 1993. Bob Packwood, Dan Rostenkowski, Max Baucus, and Bob Dole were all members of the Joint Committee on Taxation which took up the work of creating and passing the 1993 Act (Joint Committee on Taxation, 1993: iii).

### **5.3 Major Provisions of the Omnibus Budget Reconciliation Act of 1993**

The Omnibus Budget Reconciliation Act of 1993 was originally sponsored by Congressman Martin Sabo (Democrat, represented the state of Minnesota) and was first introduced on May 25th, 1993 (GovTrack: 2015b). The tax changes in the bill were designed to accomplish several major economic policy goals: budget deficit reduction; an increase in the share of tax burden borne by corporations and wealthy individuals; increased aid to working families with low incomes; and, rollback in “posh” business deductions such as lobbying and meals and entertainment expenses (Tax Policy Center: 2015a). The most critical provisions of the Omnibus Budget Reconciliation Act were as follows (Tax Policy Center: 2015a; Hall: 1993):

- increased individual income tax rates on top earners, creating higher tax brackets of 36 percent and 39.6 percent;
- permanently extended the itemized deduction limitation and the personal exemptions associated with individual income taxes;
- increased by 4.3 cents per gallon the gasoline tax, and dedicated those funds specifically to deficit reduction;
- increased the corporate tax rate to 35% on income above \$10 million;
- reduced deductions for business meals, entertainment, club dues, and lobbying expenses;

- increased both tax rates and exemption amounts under the Alternative Minimum Tax System;
- expanded the taxable portion of Social Security benefits from 50 percent to 85 percent for taxpayers with joint income of \$44,000, or \$34,000 for single filers; and
- expanded the Earned Income Tax Credit program for low income taxpayers.

#### **5.4 Timeline**

The timeline of the Omnibus Budget Reconciliation Act of 1993, and its movement through the legislative process, is outlined below (Votesmart.org: 2015).

- May 25, 1993 introduced
- May 27, 1993 House version passed
- June 25, 1993 Senate version passed
- August 5<sup>th</sup>, 1993 House Conference report adopted
- August 6<sup>th</sup>, 1993 Senate Conference report adopted
- August 10, 1993 signed by the President into law.

#### **5.5 Key Figures in the Omnibus Budget Reconciliation Act of 1993**

Several individuals played critical roles in the evolution of the Omnibus Budget Reconciliation Act of 1993. Bill Clinton, inheriting an ailing U.S. economy and significant budget deficits, determined that significant tax action was required to close the budget gaps and restore the economy. With the help of Martin Sabo, and over the objections of Republicans Newt Gingrich and John Kasich, the 1993 Act passed with almost no Republican support.

### *Bill Clinton*

Bill Clinton was a Yale-educated attorney, Rhodes Scholar, and two-term president of the United States. Clinton was born in 1946 in Hope, Arkansas, and ultimately served as Governor of the state for 12 years before being elected president in 1992. He was also the first Democrat elected to consecutive terms in office since Franklin Delano Roosevelt in 1936. Clinton was well-known as a centrist Democrat who supported international trade, economic change and deficit reduction, and public education (Clinton Presidential Library: 2015). He pushed for economic change as the primary plank of his 1992 campaign platform against incumbent George Bush, and would become the primary force behind the Omnibus Budget Reconciliation Act of 1993. The Act would form the centerpiece of Clinton's domestic agenda. Though his second term would be marred by allegations of misconduct in office, Clinton's legacy would be one of popularity and strength on economic issues (Clinton Presidential Library: 2015).

### *Martin Sabo*

Martin Sabo was a member of the U.S. House of Representatives from 1979-2007, having been elected fourteen times prior to his announced retirement in 2006 (Biographical Directory of the US Congress: 2015). Sabo represented Minneapolis, Minnesota, a heavily democratic district. Sabo chaired the House Budget Committee, and was also a member of the House Appropriations Committee (Biographical Directory of the US Congress: 2015). Despite being known as a quiet, reserved man he was well known for managing the Democratic baseball team in the annual Congressional game against the Republicans (Biographical Directory of the US Congress: 2015). Sabo was the primary architect and champion for the Omnibus Budget Reconciliation Act of 1993.

### *Daniel Patrick Moynihan*

Moynihan was a Senator from the state of New York, Fulbright fellow, and graduate of Tufts University. Moynihan was a lawyer and sociologist, with a background in urban studies. He was a professor at Syracuse University and during the 1990s, was a member of the Senate Committee on Finance (Biographical Directory of the US Congress: 2015c). Moynihan had a peculiar, witty, manner of speaking for which he was well known. He was a proponent of political compromise and “subsidiarity” or the idea that small, community organizations play an important role in filling the void between big government and the individual citizen (Katz: 2015).

### *Newt Gingrich*

Gingrich is a conservative Republican from the state of Georgia, and graduate of Emory University in Atlanta. Gingrich was known for being plainspoken and direct. He became the first Republican Speaker of the House in 40 years with his election in 1994, having served in the House since 1979 (Biographical Director of the US Congress: 2015b). Gingrich ran for president in 2012, unsuccessfully. He was known to be a philosophical “foil” for President Clinton. Gingrich authored the famous “Contract with America” and ushered in what is known as the Republican Revolution, a mid-1990s movement which overturned Democratic control of both Congressional bodies.

### *John Kasich*

John Kasich is currently the Governor of Ohio, and a former member of the United States House of Representatives, as well as the Congressional Budget Committee. Kasich is a fiscal conservative, with a long record of supporting defense initiatives and low taxes. He is also a

former investment banker with the blue-chip firm Lehman Brothers. Kasich ultimately voted against Clinton's 1993 Omnibus Budget Reconciliation Act, but was an outspoken and charismatic representative of the conservative side. Still active in politics, Kasich is currently a 2016 presidential candidate (Kasich: 2013). Kasich authored the Kasich Substitute, a proposed alternative to Clinton's budget plan which was defeated by a 2 to 1 margin in a House vote (CSPAN: 1993j).

## **5.6 Bill Clinton on Taxes and the Budget Deficit**

Bill Clinton faced several significant challenges in his first term as president, most of them economic. For these reasons, tax policy and tax legislation would be extremely important to his presidential agenda. Since 1981, the amount of the Federal debt held by the public had quadrupled, and as a percentage of the total economy, had increased from 26 percent to 48 percent of Gross Domestic Product (Jeffrey: 2015). In his State of the Union Address on February 17<sup>th</sup>, 1993, Clinton laid out his vision for tax reform, with deficit reduction in mind. Clinton opened by highlighting the major moves his administration planned (Washington Post, 1993: 2).

Our plan has four fundamental components: First, it reverses our economic decline, by jump-starting the economy in the short term and investing in our people, their jobs and their incomes in the long term. Second, it changes the rhetoric of the past into the actions of the present, by honoring work and families in every part of our lives. Third, it substantially reduces the federal deficit, honestly and credibly. Finally, it earns the trust of the American people by paying for these plans first with cuts in government waste and inefficiency -- cuts, not gimmicks, in government spending -- and by fairness, for a change, in the way the burden is borne.

Clinton introduced the theme of “fairness in the way the burden is borne” in laying out his economic plans with respect to taxes. This particular paradigm of fairness would become a recurring theme in the life of the 1993 Act. Clinton, as well as several Democratic party leaders, would begin to frame the “fairness” narrative around the idea that fairness is achieved by urging that the wealthy pay proportionally higher taxes, while those with middle and low incomes pay proportionally less. It is clear that Clinton’s view of “tax fairness” was at least, in part, a political view, not a purely philosophical view (Miller Center, 2015: 5).

Our economic plan is ambitious, but it is necessary for the continued greatness of our country. And it will be paid for fairly -- by cutting government, by asking the most of those who benefited most in the past -- by asking more Americans to contribute today so that all Americans can do better tomorrow. For the wealthiest -- those earning more than 180,000 dollars per year, I ask you to raise the top rate for federal income taxes from 31 percent to 36 percent. Our plan recommends a ten percent surtax on incomes over 250,000 dollars a year. And we will close the loopholes that let some get away without paying any tax at all. For businesses with taxable incomes over ten million dollars, we will raise the corporate tax rate to 36 percent. And we will cut the deduction for business entertainment. Our plan attacks tax subsidies that reward companies that ship jobs overseas. And we will ensure that, through effective tax enforcement, foreign corporations who make money in America pay the taxes they owe to America. Middle-class Americans should know: You're not going alone anymore; you're not going first; and you're no longer going to pay more and get less. Ninety-eight point eight percent of America's families will have no increase in their income tax rates. Only the wealthiest one point two percent will see their rates rise.

Clinton’s remarks, while no doubt easy for many to agree with, represented a step back toward partisanship and use of the tax code for political ends. This is not to suggest that this was immoral conduct; few would disagree with the proposition that those in need could benefit from

economic assistance from those who could most afford to assist them. However, the distinction lies in the manner in which the tax code was used to achieve nontax goals. Recall Max Baucus' testimony on the evolution of the post-1986 Internal Revenue Code (US Congress, 2010:1):

The 1986 tax reform leveled the playing field. No longer could a wealthy individual escape taxes by buying into a shelter. No longer could a clever investment strategy get investors out of paying their fair share. No longer could businesses participate in notorious tax shelters. Similar taxpayers paid similar taxes. But since 1986, Congress has made more than 15,000 changes to the code. Congress made these changes with the best intentions; some to collect revenue, some to stabilize the economy, others to further certain social objectives, all made for legitimate reasons. But each change created additional complexity, and each change created the potential for exploitation.

One can observe that the bipartisan nature of the 1986 Act, by comparison, was much more than merely an agreement between political parties and a practical compromise. Rather, it was a grand agreement to begin to limit the number of political inequities and preferences in the code, irrespective of political affiliation.

The Clinton budget proposals, on the other hand, appeared to move the tax code back to a pre-1986 paradigm, and toward increasing complexity and more prevalent use of tax preferences. For example, the creation of two new high-rate individual tax brackets at 30% and 36% suggests that the effective tax rate, across all tax brackets, might not have been high enough to sustain new spending levels for low-income individuals. Stated differently, new tax benefits at lower income levels must be paid for by new revenue at higher income levels, if all other variables are held constant. Accordingly, it is important to clarify that actions generally accepted to be good or "correct," such as a tax bill that helps the poor, may also be unfair. While it may have been

morally correct to redistribute wealth in this manner, it was a departure from the 1986 Tax Reform Act's efforts at simplification and consistency.

Despite the trend toward "unfairness" through greater use of the tax code as a political tool, the 1993 Act did improve fairness by taking on the lobbying industry associated with the tax code, in particular deductions associated with lobbying efforts. Bill Clinton called for an "end to the tax deduction for special interest lobbying" and implored the government to "use the money to help clean up the political system... and we should quickly enact legislation to force lobbyists to disclose their activities." (Washington Post: 1993). The push toward transparency in the political process was a major goal of President Clinton's, and he was able to achieve it. The specific changes enacted in the 1993 Omnibus Budget Reconciliation Act of 1993 as highlighted in the Conference committee report, were as follows (DeLuca: 1993):

- limited deductions for costs incurred in any attempt to influence legislation through communication with a member or employee of a legislative body or with any other government official or employee (regardless of rank) who may participate in the formulation of legislation; and
- costs incurred in connection with "direct communication with covered executive branch employees" in an "attempt to influence official actions or positions of such official" are non-deductible.

The Conference report also requested guidance in several key areas, including how third parties might distinguish attempts to influence legislation from simple monitoring of legislation. It is easy to see how these two activities could overlap. For example, if a firm was in the process of "monitoring" a legislative development, and the legislation ultimately took a negative turn,

monitoring efforts could seamlessly transform into lobbying activities without a clear indication that a boundary had been crossed (DeLuca: 1993).

## **5.7 House and Senate Committee Discussion**

Committee discussion of the Omnibus Budget Reconciliation Act of 1993 began on July 15<sup>th</sup> of that year. On the afternoon of the 15<sup>th</sup>, prior to the closed door conference session which would consider the Act, Representative Martin Sabo (Democrat, represented the state of Minnesota) spoke in a public meeting in favour of the proposal. Sabo was the author of the original proposal for the Omnibus Budget Reconciliation Act of 1993. In his remarks he defended the budget reconciliation efforts as a move that would increase “tax fairness” (CSPAN: 1993a, 3:00-7:00):

As we approach conference, the House and Senate versions are 80-95% alike. Each achieves \$500 billion in deficit reduction. Each features tax fairness as a cornerstone. Under either plan at least 75% of the new revenues raised will be paid by the wealthiest 6% of all Americans. Tax fairness is applied to the other end of the income equation as well, for expansion of the earned income tax credit taxes of full-time working Americans will be effectively reduced and such workers will no longer be forced to live in poverty. Both versions also include significant spending reductions. Over five years, for example, the House version includes \$250 billion in spending reductions, and will cap discretionary spending at 1993 levels for each of the next five years.

It is notable that Sabo couched the Act as a step toward greater tax fairness. As with all tax reform proposals, it is important to consider what political figures mean when they use the term tax “fairness.” According to Heritage Foundation researcher William Beach, tax fairness is a concept that is easily misunderstood and subject to interpretation (Beach: 2005). Beach testified “As I observed, nearly every major tax bill is challenged to prove that it is fair. Fairness, however, can (and probably does) mean something different to each person who thinks about it. I imagine there are differences on this subject even on this committee.” (Beach, 2005: 2). Beach instead referred the Committee to more transparent tests of tax fairness, such as vertical and horizontal equity (Beach: 2005). Vertical equity means that taxpayers bear a similar proportion of taxes as one moves up or down the income continuum (Cordes: 1999). Horizontal equity means that taxpayers with the same income pay the same amount of tax, regardless of their differing circumstances (Cordes: 1999). Accordingly, using these definitions, one can reasonably interpret tax fairness to mean a tax applied without politically-motivated tax preferences. Beach suggests this is a persistent problem in evaluating the fairness of any piece of tax legislation (Beach: 2005):

However, our current tax policy is, if anything, one of targets, not of equal treatment. That is, Congress has decided to use the tax system to achieve specific social and economic goals, which has resulted in a significant decay in vertical equity. To illustrate this point, I have provided in my full testimony a wonderful graph prepared by Kevin Hassett of the American Enterprise Institute, a tax economist well known to this committee. Dr. Hassett compares the current tax code to tax law in 1986 and 1988 and how tax policy has affected the marginal income tax rates faced by a family of four. While this graphic shows many things, its single most important message is how targeting tax relief has produced significant equity distortions in the code.

Sabo argued that the Omnibus Budget Reconciliation Act of 1993 would increase fairness by increasing the share of tax burden borne by top earners, while subsidizing and expanding benefits to low-income taxpayers. Sabo's interpretation of fairness is based on targeted political goals: he believed it would increase fairness because the legislation addressed his goals of reducing the tax burden of low-income taxpayers. This approach was a departure from the broad-base, low rate approach championed in prior proposals by Bill Bradley and Dick Gephardt (Gephardt Collection: 2014).

It is also noteworthy that the Omnibus Budget Reconciliation Act of 1993, while in line politically with Democratic, progressive economic goals, was out of line with the principles of fair taxation. Stated differently, Representative Dick Gephardt and Representative Martin Sabo would have likely agreed on the political principle that lower-income individuals should receive some tax relief, given that both Gephardt and Sabo were progressive Democrats. However, Gephardt may have considered Sabo's bill to be on shaky ground in the way it specifically targeted its tax relief to achieve political goals, and likewise focused the tax burden of those goals on high-income taxpayers. Gephardt was a strong proponent of tax fairness and was opposed to targeted tax legislation (Gephardt Collection: 2014).

Senator Jim Sasser (Democrat, represented the state of Tennessee) spoke following Representative Sabo's remarks. Sasser lauded the bill for its dramatic effect on the deficit, as well as its fairness (CSPAN: 1993a, 8:00-12:00). Like Representative Sabo, Sasser characterized the Omnibus Budget Reconciliation Act as "fair and balanced." (CSPAN: 1993a, 8:00-12:00).

Both the House Bill and the Senate Bill in my judgment are tough in regard to deficit reduction, but they are fair, and they are balanced. Both bills, coupled with the discretionary spending cuts

which will be enforced in each version, will provide for a record 5-year deficit reduction. As Chairman Sabo said, our calculation is \$498 billion in deficit reduction in the Senate bill, and \$503 billion in deficit reduction in the House bill, and I say to my colleagues: that is unprecedented in American history, or perhaps unprecedented in any country in the world, to have a deficit reduction package of that substance. Now, both of these bills will produce entitlement spending cuts, and will offer a serious down payment for healthcare reform, for which the American people are demanding, and which is coming down the pike in the not-too-distant future.

Senator Sasser also stressed the fact that there had been significant partisan rhetoric around the bill, and that Republicans were trying to raise fears about the legislation. Sasser reiterated the fact that the “average American” did not need to be concerned about its effects (CSPAN: 1993a, 8:00-12:00).

Of course, there’s been a lot of talk, a lot of discussion across the country about taxes. There’s been an effort to frighten many Americans when they really have nothing whatsoever to fear from this bill. As Chairman Sabo said, fully 79% of the tax increases in the revenue portion of this plan will fall on people who have incomes in excess of \$200,000 per year. Now what about the other Americans, will their taxes be raised? Well, middle class Americans, and by that I mean people making between \$30,000 and \$100,000 will not see their taxes raised at all.

As was the case with Representative Sabo, Sasser portrayed the bill as “fair” in the sense that it relieved the tax burden of middle-income and low-income Americans, with wealthier taxpayers bearing the balance. As discussed later in this research, Democratic proponents purported the bill to be fair, while criticizing opponents’ objections as fear-mongering and disinformation.

The Joint Tax Conference for the proposed Omnibus Budget Reconciliation Act of 1993 began in earnest on the evening of July 15<sup>th</sup>, 1993. The Conference included both the House of Representatives Ways and Means Committee and the Senate Finance Committees. Chairman Dan Rostenkowski (Democrat, represented the state of Illinois) opened with a statement that outlined clearly the difficulties that lay ahead in getting the legislation passed. In particular, Rostenkowski stressed the political frailty of the bill. He also made clear the primary purpose of the legislation was to reduce the deficit in an aggressive fashion (CSPAN: 1993a, mm 3:30-6:00).

Back in May, at the urging of our President, we set an ambitious task for ourselves: cut the deficit by \$500 billion dollars over the next five years. This afternoon, we are in the home stretch, on the verge of achieving that goal, and in the final stages of the first real test for the 103<sup>rd</sup> Congress. I hope that we can measure up. I welcome the opportunity to be here this afternoon. I have no illusions about the difficulty of the job ahead of us. We face an enormous task. But we, members of Congress, on both sides of the aisle, cannot afford to fail. This country and this Congress faces (sic) no bigger problem than the crushing debt that we are amassing, as the inheritance of our children and grandchildren. In large measure, the credibility of this Congress rests on our ability to accomplish this task. That will not be easy. I know how fragile support for this Conference Report could be, and how fragile the House and Senate support was achieving it. Representatives, and those of us that are obligated, have a tremendous burden. I know that for each of us, the bills before this conference are far from perfect. There is much we would prefer not to do. Tough choices that we would prefer not to make. Changes we would like to suggest. Ultimately, the secret to a successful conference is a combination of patience and flexibility. I believe that both will be tested in the weeks ahead.

The Omnibus Budget Reconciliation Act of 1993 carried with it divided support nearly from start to finish, narrowly passing through even the conference stage of the legislative process (Tumulty & Eaton: 1993). That same day, in the public meeting prior to the closed door session, Rep. John Kasich expressed his concerns over the heavy partisanship associated with the bill (CSPAN: 1993a, 14:00-18:00).

I think it is a terrible mistake, the business of this Congress trying to pass the largest tax increase in history, behind closed doors, without Republican involvement at all in either the Senate or the House. And there is one thing we heard a lot about in this campaign, and that is the issue of gridlock. I want to tell you that the Republicans feel particularly gridlocked especially in the House of Representatives, because at every turn of the bend we tried to fix the package, we tried to improve the package, we spent ten and a half hours in the budget committee when we originally wrote this broad outline, we spent ten and half hours offering 40 amendments offering to replace tax increases with specific spending reductions. We were defeated on every single effort along a party line vote.

Kasich stressed that the bill was forced through without any Republican input, and would negatively impact jobs, while slowing the economy (CSPAN: 1993a). He also warned about the nature of spending cuts in Washington (CSPAN: 1993a, 14:00-15:00).

In addition, there's been an argument made that somehow that this package, this is a budget that is very tight fisted. Over the next five years domestic spending will increase by 15%. We should also realize, especially the American people, that we live in a fantasy land here in Washington, D.C. when we talk about the concept of cuts. We don't cut anything in Washington. We cut below a baseline. A baseline is the increase in spending that should occur the next year in Federal programs, established by some bureaucrat. See, where I come from in Ohio, a cut is a cut, a

freeze is a freeze, an increase is an increase. We don't have any real cuts except in the area of national security in this proposal.

Kasich's comments reflected well the overall Republican position on the Clinton budget proposals: the increase in taxes would slow the economy, and would only result in greater propensity to continue an upward trajectory in spending. In addition, the increase in domestic spending came at the expense of Defense Department spending, a sharp turn away from the spending policies of the Reagan Administration. With the military being a traditionally conservative voting bloc, this was of particular concern to conservatives in Congress.

With Republicans pushing hard for spending reductions to offset new spending, and Democrats pushing for revenue increases to fund additional domestic spending, there was seemingly little room for compromise. Speaking from "Gucci Gulch," the same hallway in the Russell Senate Office Building where numerous deals had been cut in drafting the Tax Reform Act of 1986, Sen. Daniel Patrick Moynihan (Democrat, represented the state of New York.) spoke with candor about the chances of reform: "There are three numbers here: the total deficit reduction, the ratio of spending cuts to revenue increases, and the gasoline tax. You can fix any two of those numbers, and the other falls out from them. In your high school math classes, they would call that a dependent variable." (CSPAN: 1993b, mm 2:00-3:00). Of those three variables cited by Senator Moynihan, the gasoline tax provision would prove to be most controversial.

## **5.8 Gasoline Tax Provision**

The additional 4.3 cents per gallon gasoline tax provision in the Omnibus Budget Reconciliation Act of 1993 was arguably unfair, regressive, and punitive to low-income taxpayers: (Federal Highway Tax Administration: 2013). The increase in the gasoline tax in both

1990 and 1993 was unprecedented, primarily because the United States' gasoline tax had been traditionally administered as a type of "user fee." Theoretically, those who purchased gasoline and availed themselves of the United States' highway system would ultimately pay higher gasoline taxes. In principle, Federal gasoline tax proceeds would fund a single trust account, which was to be used to improve and maintain transportation infrastructure. However, in 1993, the 4.3 cent tax increase, representing a 30% increase in the overall rate of tax, was used entirely to decrease the budget deficit (Thorndike: 2013). This was seen by many as a "raiding" of a public trust fund, and it has been proposed that this has resulted in public distrust of special levies such as fuel taxes (Thorndike: 2013). Rep. John Kyl, in an interview with CSPAN on July 30th, 1993, reacted to the 4.3 cent proposed gas increase: (CSPAN: 1993c, mm 4:00-6:00)

It's pernicious in three specific ways. First of all, it costs people who have to drive their cars. Secondly, the costs are added to the cost of goods and services, particularly the products that are brought across country that are delivered throughout the United States, primarily through trucks. And third, the effect on state gas tax revenues is a negative effect, because as people buy less gasoline because of a higher cost due to the Federal increase in taxes, the state gasoline tax doesn't bring in as much revenue, so then the state legislatures usually raise the state tax, and you have kind of a vicious cycle created where the consumer always ends up paying more and revenues to the treasury are never quite as much as predicted in the first instance.

Kyl's sentiments on the gasoline tax were echoed by Sen. Dennis DeConcini (Democrat, represented the state of Arizona). DeConcini was unique because he was a Democrat who, at that point in time, had chosen to oppose the bill. In a speech given on July 30<sup>th</sup>, 1993, he gave two primary reasons for his opposition: the gasoline tax increase, and the bill's lack of impact on the Federal budget deficit. As with Kyl, DeConcini's home state of Arizona was one in which

gasoline tax would have a direct impact. Similar to most Western states in the United States, the population is spread between a few large urban areas and many sparsely populated areas. This requires significant commuting and transportation times, and accordingly, a higher incidence of gasoline tax on the individual resident. DeConcini was also concerned about the impact of low ceilings on the Social Security tax on individual taxpayers (CSPAN: 1993d). This was likely a key concern for DeConcini because of the relatively high rate of retired individuals in Arizona.

In taking up the progressive viewpoint, media member Clarence Page of the Chicago Tribune discussed how the makeup of the United States Senate could play a role in swaying the negotiation toward opposition to the gasoline tax (CSPAN: 1993e). Page seemed to refer to the fact that each state's two allocated Senators represent their home state without regard to population. As a result, under the United States Constitution, individual Senators have great power to lobby for their own state's interests (CSPAN: 1993e, 9:00-10:00)

The real issue here is the politics as well as the nature of American culture. We are a car country, a big car nation as has been said. Britain has a much better public transportation system than the US because that's the way we have shifted this country. But what the real politics of it - are such that - what is revealed here is a great imbalance on the part of the clout of Senators from Oklahoma and Nevada, and other states where you've got to drive a long way to work or to get to where you are going. And, uh, being someone from the industrial Northeast I find this to be a great imbalance.

The gasoline tax was ultimately passed as part of Clinton's budget, and brought the nationwide total tax per gallon to 18.4 cents. All of it was allocated to deficit reduction, despite calls to redirect it to the Highway Trust Fund. Nonetheless, the tax remained an important part of the President's budget package, representing approximately \$30 billion of the \$500 billion dollar

deficit-reduction package. In 1997, the gasoline tax was in fact redirected to the Highway Trust Fund as part of the Taxpayer Relief Act of 1997 (Federal Highway Tax Administration: 2015).

## **5.9 Senate Debate**

Given the bill's divided support, many members of Congress painted the 1993 Act in stark, apocalyptic terms, reflecting the depth of the divide over the legislation. Democrats voted unanimously for the bill, though some centrist Democrats had reservations. Senator Bob Kerrey (Democrat, represented the state of Nebraska) voiced these concerns, but was unwilling to vote against the bill because he did not want to damage President Clinton's credibility, stating "I could not, and should not, cast a vote that brings down your presidency. I do not trust 44 Republicans enough to say no to this bill." (Tumulty & Eaton, 1993:2). Kerrey was the last holdout on the Democratic side of the aisle, with all other participants casting votes strictly along party lines (Tumulty & Eaton: 1993).

Republicans staunchly opposed the bill. Sen. Charles E. Grassley, (Republican, represented the state of Iowa) stated that the bill was a "blivet--five pounds of manure pounded into a four-pound sack. The point is, if you vote for this package, you're voting for deep doo-doo." (Tumulty & Eaton, 1993: 3). Bill Archer, a conservative Republican from the state of Texas, also made sarcastic comments that symbolized these stark differences in the Conference debate (CSPAN: 1993a 12:00-13:00)

It was stated over and over again this was an historic occasion. I will admit it is an occasion for the record books, because we are gathered here to consider the largest tax increase in history. It was also said that it was historic because this is the largest deficit reduction activity in the history of the United States. And that was said over and over again. And I say to the American people,

we don't know if that's true. We have every reason to believe it is not true. The deficit reduction package of the 1990 budget agreement was officially scored by the CBO as one that would reduce the deficit by \$497 billion dollars. And that is a matter of record.

In his remarks, Archer expressed lingering doubts about the accuracy of the proposed deficit reduction efforts in the 1993 bill, based on his claim that the 1990 budget estimates were also inaccurate. This appeared to be mostly political posturing; if the 1990 budget estimates were wrong, then Archer wanted his colleagues to believe the 1993 estimates were wrong as well. However, estimating the budget impact of any bill, including the 1990 Congressional Budget Office forecast, is tricky business. While Archer's claim that the budget reduction efforts in 1990 were not as effective as expected is technically correct, it glossed over the point that almost all of the measures in the bill reduced the deficit (General Accounting Office: 1993). Further, a poor economy, which underperformed substantially below forecasts, was the primary reason the deficit reduction efforts in the 1990 Omnibus Budget Reconciliation Act were less effective (General Accounting Office: 1993). These doubts were emblematic of Republican criticism of the 1993 Act.

Senate Republican Leader Bob Dole (Republican, represented the state of Kansas) also spoke about the bill, expressing concerns about its expanding revenue provisions, as well as the fact that it guaranteed no spending cuts. His sentiments echoed those of Bill Archer's. Dole also expressed his willingness to work with the Democrats to forge a compromise, but he tempered his enthusiasm when it came to spending. Dole made it clear that the Republicans' willingness to participate in a "deal" to pass the Omnibus Budget Reconciliation Act of 1993 would increase if Democrats offered up spending cuts at the same time (CSPAN, 1993a: 19:00-22:00).

Maybe it's not necessary to raise taxes as much, and maybe other things could be accommodated that I know would be very difficult items for the conferees to deal with. And I would just underscore what's been said, we do have a different view. Republicans have a different view. Our view is not adopted. Some liked our view, position, our package, others did not, and I think everything is based on what will happen in the future. Except the American people understand that taxes are going to happen. They also understand that spending (cuts) may not happen, and they've seen this happen time after time after time. I guess that's why there is some cynicism in America about Congress and taxes. We always seem to stick with the taxes but we never, or not always, come up with the spending cuts whether it's Republican or Democratic administration.

Throughout the legislative process, one of the most common themes among Democratic party members was that Republicans were circulating false information and raising fears about the bill among the general public. Democratic political consultant Bob Shrum indicated that the strong opposition by conservatives was unprecedented (CSPAN: 1993f, 1:00-2:00).

By a 3-2 margin the people understand that the lockstep Republican opposition, unprecedented by the way, and I've checked and there isn't a single major piece of economic legislation since Franklin Roosevelt that passed without any vote from the other party. I think that kind of lockstep opposition has come through to the people and they know how partisan this Republican opposition was.

Shrum's comments are no surprise. The debate and discussion around the bill began and ended along stark party lines, a huge shift from the politics of compromise that were the hallmark of tax legislation in the 1980s. In this one-hour segment, Shrum and conservative consultant Glen Bolger also discussed, rather sharply, the manner in which both parties contributed to "gridlock"

in Washington (CSPAN: 1993f). Shrum cast the Republicans as threatening moderates in their own party if they supported Clinton's efforts at passing the budget, while Bolger indicated that Democrats had cast aside their own home states and constituencies to get into lockstep with President Clinton (CSPAN: 1993f). Bolger also suggested that this was the same way Democrats had tried to attack the Presidency of George Bush in the early 1990s (CSPAN: 1993f).

In both cases, the common thread was that the parties had moved away from any semblance of real compromise. Democrats and Republicans alike alienated members of the opposition party. This created high-risk public relations stakes when the other side waffled in their positions, or showed weakness. Further, each party had clearly begun policing its own membership internally, an allegation made by Shrum against the Republicans. However, it is clear that both parties participated in this given the nearly unanimous, partisan nature of the votes for and against the Omnibus Budget Reconciliation Act of 1993.

Conservative political consultant Glen Bolger responded to Shrum's allegations (CSPAN: 1993f, 20:00-21:30).

I think when people see a plan that is a bad idea, I think they are going to vote against it. I don't see anything wrong with the party being unified. Democrats were certainly unified in successfully bringing down the Bush presidency by not allowing him to put forth any policies and programs that had any chance in passing.

Both parties, as reflected in the words of each of these political consultants, had begun to polarize away from the opposition. This bitterness highlights a dramatic difference between the compromises that forged the Tax Reform Act of 1986 and the political climate in 1993. What had previously been considered good political work and a moderate approach to solving

problems had become signs of political weakness and infidelity to the party. This change raised the stakes for individual politicians who might consider political compromise. Those who did risked alienation from their own party, as well as the opposition. The result was the beginning of political gridlock and the beginning of death throes for moderation in political work in Washington.

### **5.10 House Debate**

House Republicans were predictably and staunchly opposed to the President's budget plan. In response, earlier in the summer, Rep. John Kasich had floated an alternative plan that would theoretically reduce the deficit without relying on tax increases. This plan called for \$495 billion in deficit reduction, slightly less than the Congressional committee's request (U.S. Congress: 2015). In Kasich's amendment, also known as House Amendment 20 to House Continuing Resolution 64, domestic spending cuts amounted to \$290 billion; \$145 billion were achieved by government savings; and, \$60 billion were achieved by defense cuts (U.S. Congress: 2015).

In budget debate on May 28<sup>th</sup>, 1993, Representative John Kyl of Arizona opened discussion of Representative John Kasich's (Republican, represented the state of Ohio) budget proposal (CSPAN: 1993j, mm1:00-6:00).

Unlike the President's budget, the Kasich substitute is based on the premise that spending cuts should come first, which is exactly what the American people have been demanding. First year savings alone, again according to CBO, amount to 86 billion dollars under Kasich, all from spending cuts. CBO scores the President's plan at zero net spending cuts for the first two years.

Kasich strikes the President's retroactive income tax increases, his energy tax, his increased tax on Social Security, and his increased Medicare payroll tax.

Democrat Charles Schumer, of New York, vehemently opposed the Kasich amendment. In response to Kasich's plan, he spoke on May 28<sup>th</sup>, 1993 (CSPAN: 1993j, mm 8:00-10:00).

On the Kasich budget, you know, I respect the gentleman from Ohio. He has tried to put together an honest plan. The problem is, that the kind of cuts that are in this plan are unpalatable to the American people. And I ask my colleagues on this side of the aisle, you want to freeze the COALUS for military retirees between 55 and 62, vote for Kasich. You want to vote to eliminate college assistance? Vote for Kasich. You want to vote to eliminate programs you care about? Vote for Kasich. But you don't have enough votes even on your side to pass this recessionary budget.

Representative Dick Gephardt (Democrat, represented the state of Missouri) also spoke. Gephardt played a key role in shaping the Tax Reform Act of 1986 (CSPAN: 1993j, mm 53:00-54:00).

Tonight, we must act. Many of the members have said to me, this bill has got difficulties in it, pain in it, things that are not politically attractive. When you're trying to honestly reduce a deficit that has built now to 4 trillion dollars, take our deficit from 5% of GDP to 2.5, there is no way that that piece of legislation can be politically attractive.

Gephardt's comments called attention to Congress' duty to take action to solve a practical problem, knowing the problem would be painful. This is a dramatically different tone than those members of the House who spoke only in terms of what their constituents specifically needed, or who spoke in opposition to Clinton's plan without considering middle ground (CSPAN: 1993j, mm 54:30-55:00).

In my view the Kasich plan is deficient, it doesn't cut the deficit enough, it is not fair in my view, because it does not ask the people at the top to pay their fair share, and it doesn't give the people stuck at the bottom the incentive that the earned income credit gives the people to get out of welfare and get into a job, something that all of us desperately want to do. The Clinton plan is better. It is fair and comprehensive.

Gephardt couched the need for deficit reduction in terms of the future of America's children. He referred to ignoring the debt as irresponsible and potentially fatal to the American economy (CSPAN: 1993j).

Republican and Minority Whip Newt Gingrich (Republican, represented the state of Georgia) closed the House debate for the Republican side. Gingrich's comments represented well the Republican position: conservatives cast their opposition to Clinton's budget in terms of principles, rather than of pragmatism (CSPAN: 1993j, mm 1:13:00-1:13:50).

What we face is a genuine, historic, legitimate, difference of principle. These next votes are about our vision of the future, our understanding of America, and our belief in the lessons of history. The Clinton plan, which I respect, props up the past. It raises \$325 billion in new taxes to pay for a bigger welfare state. It starts \$40 billion dollars in new entitlements, as it should, because it believes in the welfare state. But the simple fact is, the welfare state has failed.

Tom Foley (Democrat, represented the state of Washington) as Speaker of the House, closed the debate on the Kasich amendment as is custom. Foley (CSPAN: 1993j, mm 1:19:00-1:22:00):

We seldom do important, valuable and lasting things by taking easy votes, comfortable votes, politically popular votes. I can remember when President Reagan came and asked for his economic program to be adopted. It was a program that called for giving back to people, taxes. Encouraging them to vote for tax reductions. And, it came with a promise that if only those deep

reductions could be accomplished, a balanced budget would be achieved. A distinguished member of the other body, Senator Baker, called it at the time a riverboat gamble. It was a gamble that many members made, and it was a gamble that the country lost. A recession, sharp increases in defense spending, a falloff in revenues, year by year, not reducing deficits but rising deficits, multiplying anything that had been seen in previous years, and a burgeoning national debt that is now an all-too-sad factor of our national life.

The House ultimately voted on Kasich's amendment, and resoundingly rejected it at a nearly 2 to 1 margin. Clinton's budget plan, supported almost exclusively by tax increases, would go on to succeed, but without any measurable support from the Republican side.

### **5.11 Deficit Reduction**

While deficit reduction was the primary driving force behind the Omnibus Budget Reconciliation Act of 1993, economists debated the effectiveness of the "tax increase" approach in the context of the effects on the overall economy. During a forum before the House Republican Conference on August 11<sup>th</sup>, 1993, the day after President Clinton signed the Act into law, Harvard economist William Niskanen spoke about the potential effects of the revenue provisions in the Act (CSPAN: 1993i, mm 46:00-50:00).

I want to make a point that deficit reductions are not all equal. A deficit reduction that is achieved primarily by tax increases has very different effects than one that is achieved by spending reductions. Now, I am a deficit hawk, I think that it is very important to reduce the deficit, but I have come to conclude that it is also especially important, maybe even more important how it is done... a deficit reduction that is achieved primarily by tax increases, as is the case in the Clinton budget, would not have a significant effect on private investment, and that should be the primary objective of a deficit reduction exercise.

Further, Niskanen went on to discuss the tax effects of attempting to close the deficit with revenue increases (CSPAN: 1993i, mm 46:00-50:00).

It is not clear to me that higher taxes would reduce the deficit. Because, in the absence of some independent control on Federal spending, higher taxes, that Congress may not change, higher taxes are very likely to increase spending in future years. Most governments appear to act like a person who spends all of his earnings, plus the remaining limit on his credit card. If you look at the fiscal records of about 19 OECD countries for example you find a very strong relationship between the level of taxes and level of spending. But, you find no relation between the level of taxes and the amount of government borrowing. So, the marginal effect of additional revenues on spending for this sample of OECD countries is one.

Despite some criticism of the approach taken by the Clinton Administration, the economic effects, including the effect on the budget deficit, would prove to be positive (White House: 2015b). By 2000, Federal debt had reached its lowest levels of the decade in terms of percentage of GDP, to a low of 31.4 percent in 2001 (White House: 2015b). Further, by 2000 the economy had transitioned slowly into a budget surplus, reaching 2.3% of GDP and \$296 million in constant dollars. In 1993, these figures were a 3.8% deficit and \$255 million deficit (White House: 2015b:32-33). In pure economic terms, the Clinton administration's tax policy had been effective in closing the budget deficit, despite reservations and political obstacles to its implementation.

## **5.12 Constitutional Objections to Retroactive Taxation**

One element of the 1993 Omnibus Budget Reconciliation Act considered to be extremely controversial was the retroactive nature of some of the elements of the plan. The budget

proposed by Clinton sought to levy taxes on income earned prior to the first introduction of the bill in April of 1993 (CSPAN: 1993h, mm 3:00-6:00). Senator Slade Gorton (Republican, represented the state of Washington) spoke in a press conference about the unfairness of the retroactive nature of portions of the tax bill.

The outrage of the American people at the retroactive nature of this tax literally knows no bounds. In my office, and in many others, callers are almost speechless over the fact that this tax looks all the way back to January 1<sup>st</sup>. The constitutional point of order, which Senator McCain will raise, which I will argue however, is more narrowly limited, because we want to operate within the parameters of the Constitution as it has been interpreted. And it will claim unconstitutionality of this law only for that portion of the taxes which will be levied on income prior to April 8<sup>th</sup> of this year. April 8<sup>th</sup> is the date on which the President submitted a budget with the specific recommendation that this tax be retroactive. The Supreme Court of the United States has said, in this case in 1938, that ‘harsh and oppressive’ retroactive taxation violates the Due Process clause of the 5<sup>th</sup> amendment. Nothing can be more harsh and oppressive than the retroactive nature of this tax on both the living and on the dead.

In citing a Supreme Court case related to the Tax Reform Act of 1986, Gorton went on to highlight what he considered to be the two tests to determine whether Due Process considerations were intact with respect to the taxpayers of the United States (CSPAN 1993h, mm 3:00-6:00).

Retroactive taxation has got to meet two tests. First, that the taxpayer has actual or constructive notice that the statute will be retroactively amended. And, second that the taxpayer relied to his detriment on the pre-amendment tax statute, and was such reliance reasonable. In this case, of course, the taxpayers had no such notice before April 8, 1993, and we are being generous in that

respect. In June of this year, Senator Mitchell asked a question whether these taxes would be retroactive, said no, unconditionally, no.

Gorton's argument hinged upon the fact that taxpayers did not receive actual or constructive notice of the change. However, constructive notice is defined in Black's Law Dictionary as either "knowledge that can be acquired by normal means or news about court actions that is sufficient for all parties involved." (Black's Law Dictionary: 2015). This appears to be a rather loose definition, in that if a reasonably informed taxpayer followed the legislation, they would be aware of the possibility of a pending change. Further, the definition suggests that constructive notice might be achieved if an individual citizen has at least a chance to influence or lobby for a desired outcome within the bounds of the democratic process.

A Bloomberg article penned by Craig Roberts on August 29, 1993 lamented the retroactive provisions as well. The piece, written from a Conservative perspective, focused on the possible precedent set by use of retroactive legislation (Roberts: 1993, 1).

Clinton's tax increase, for which only Democrats voted, may be challenged and overturned in the courts. If not, a dangerous new precedent will have been established. Clinton's next deficit-reduction plan can be made retroactive two years, and after that a government desperate for revenues can use retroactive tax laws to confiscate wealth. Clinton's tax increase won't reduce any deficit, but it may signal the end of our Constitutional protection against ex post facto laws.

Despite these appeals, the bill passed in August of 1993, with the retroactive provisions intact. Ultimately, the Supreme Court would receive a petition to address these complaints in *US v. Carlton (1994)*. The taxing provisions allowing for retroactive tax were originally overturned by the US Court of Appeals, prior to the appeal to the Supreme Court. However, the appellate court

ruling would be reversed by the Supreme Court. The Supreme Court held that the tax was not “wholly new” and that the tax itself had a very limited retroactive effect, making the Omnibus Budget Reconciliation Act provisions materially consistent with the Due Process Clause (US v. Carlton: 1994). In its reasoning, the Court cited that the lack of advance notice was not compelling, primarily because the taxing scheme was not new or surprising.

### **5.13 Clinton’s Reflections**

President Clinton’s remarks upon signing Omnibus Budget Reconciliation Act 1993 expressed clearly his dismay at the partisan nature of the deal that had been forged. While happy with the tangible results, Clinton recognized that the political victory had taken a more divisive path than he desired (American Presidency Project, 2015b:1):

Today we come here for more than a bill signing. We come here to begin a new direction for our Nation. We are taking steps necessary and long overdue to revive our economy, to renew our American dream, to restore confidence in our own ability to take charge of our own affairs. This was clearly not an easy fight. When I presented this program to Congress, I had hoped for something quite different: I had hoped that it would spark a genuine, open, honest, bipartisan national debate about the serious choices before us, about the world economy we face as we move toward the 21st century, about the problems we have here at home and all the people whose lives and potential we lose and what economic consequence that has for all the rest of Americans. I had hoped that we could discuss whether and to what extent the revival of the competitive skills of our work force could raise incomes and generate jobs; how we could both reduce the deficit and increase investment in our future; whether we could escape the trap that has afflicted so many wealthy countries, that even when their economies are growing now they don't seem to be creating jobs; how we could escape the policies of the seventies and the eighties which led middle

class Americans to work longer work weeks for lower pay while they paid more for the essentials of life; whether we could bring the power of free enterprise to bear in the poor inner cities and rural areas of this country and lift people up with the force of the American dream; whether the short-term consequences of bringing the deficit down would be more than outweighed by the short-term benefits of lower interest rates and the long-term benefits of being in control of our economic destiny. These are the kinds of things that I wanted to see debated. And to be sure, to some extent, we did debate them. But for 5 months the American people heard too little about the real debate and too much from those who oversimplified and often downright misrepresented the questions of tax increases and spending cuts because they had narrow economic or political or personal reasons to do so.

Despite Clinton's dismay at the character of the debate, and the imperfect results of the legislation, the Omnibus Budget Reconciliation Act of 1993 was effective in starting a move away from the extreme deficits of the 1980s. Through Omnibus Budget Reconciliation Act of 1993 the Clinton administration was successful in beginning deficit reduction, while simultaneously increasing spending on domestic programs such as healthcare and social services (President's Report to Congress: 1994). This was done by rolling back defense spending in favour of domestic programs, and reversed a projection that previously forecast out of control deficits through the decade of the 1990s (President's Report to Congress: 1994).

The Omnibus Budget Reconciliation Act of 1993 was the second consecutive bill which sought to increase both tax revenues and spending, while closing the budget deficit. It has been established that the 1993 Act successfully accomplished the goal of measurably and substantially reducing the deficit (White House: 2015b). However, as with any policy implementation, debate remains with respect to its overall effectiveness and efficiency in accomplishing these goals. In a

1995 campaign stop, Clinton himself offhandedly stated that he may have gone too far with his 1993 budget (Purdum, 1995:1).

Probably there are people in this room still mad at me at that budget because you think I raised your taxes too much. It might surprise you to know that I think I raised them too much too.

Clinton echoed this sentiment during a second fundraiser in October 1995 (Cannon, 1995:1).

In the first week I showed up in Washington, the leaders of the minority in Congress—who are now the majority leader and the Speaker of the House—told me that I would not get one Republican vote no matter what I did. As a consequence, I had to raise your taxes more and cut spending less than I wanted too, which made a lot of you furious.

Clinton went on to state how Republican leaders were eager for him to fail (Cannon, 1995: 1).

[Dole and Gingrich] were very candid. They said ‘We want to be in a position to blame you if the economy continues to go down. And if it goes up, we want to be in a position to attack you for raising taxes.’

Clinton’s comments also seemed to confuse the Republican opposition, who felt Clinton’s remarks were not representative of their sentiments, or his, at the time (Cannon: 1995). Senator Daniel Patrick Moynihan, a Democrat from New York, and ally of Clinton’s, also expressed his own confusion (Cannon, 1995: 1).

I confess to my distress at the President’s statement that we raised taxes too much. The President, in retrospect, says he made a mistake. But I think we did the right thing.

It seems likely that Clinton’s casual but public reflections were an expression of remorse for having to proceed in 1993 without any bipartisan support. Further, Clinton was actively

campaigning for his second term in office in 1995. As a result this may have contributed to his uneasiness with unilateral Democratic actions, and partisan votes, associated with the 1993 Act (Purdum: 1995).

#### **5.14 Legacy: Partisanship and Gridlock**

The evolution of the Omnibus Budget Reconciliation Act of 1993 represented a major contrast to the Tax Reform Act of 1986. While the 1986 Act exemplified political compromise, complete with all of its positive and negative implications, the 1993 Act was an extreme example of partisanship and gridlock. Senior Fellow Bruce Bartlett has conjectured that gridlock is, ironically, a result of one party's maintaining control of the Presidency and both Congressional bodies (Bartlett: 2002). Intuitively, it would seem that a party with control of the legislative and executive branches of government could impose its will on the other party. However, Bartlett conjectured that it is an American ideal to distrust any party that maintains effective control of the Federal government in this manner (Bartlett: 2002). During 1993, the Democratic Party held a 53-47 advantage over the Republicans in the Senate; a 58%-42% edge in seats in the House of Representatives; and, control of the White House (US House of Representatives: 2016). Though it seems the majority party, particularly when it controls several branches of government, can act almost unilaterally, the reality is much different. The minority party may begin to rely on more mechanical obstacles in order to maintain its sovereignty. Examples include tactics such as use of filibuster to prevent a vote on controversial legislation, as well as legal challenges to the law itself, as evidenced in *US vs. Carlton*.

Gridlock can also be explained by the concept of "representative dynamics." This is the idea that when someone is designated to represent a constituency, they are expected to do so in a

contractual sense. When they do not perform by representing the narrow interests of the constituents, they are accused of “selling out” and are punished by them (Armajani: 2012). This tends to push representatives away from compromise for fear of repercussions, furthering the gridlock. Also, supporting or opposing a policy in a public forum creates a “winning and losing” dilemma, to which neither side is willing to concede (Armajani: 2012). In order to solve gridlock, it is apparent that the paradigm must be reconceived: that it is possible for both sides to win, and both sides to lose (Armajani: 2012).

In explaining the extensive gridlock associated with the Omnibus Budget Reconciliation Act of 1993, it is apparent that many of the characteristics that generate polarity were in place. Party leaders on both sides took stark positions, allowing very little room for deviation across party lines. The political climate was perfect for gridlock: Democrats controlled both legislative bodies and the White House. Accordingly, Republicans were unwilling to negotiate, and used political tactics to oppose the bill on philosophical grounds, including challenging the constitutionality of the law itself. The result was not surprising: the Democratic majority party pushed through the 1993 Act without any tangible support from the Republicans, and the Republicans were provided political cover with their home constituencies by maintaining their vehement opposition.

In 1982, President Ronald Reagan faced a similar situation as President Bill Clinton did in 1993. In a speech supporting a significant tax increase, he said the following (Burman, 2006: 359; Reagan, 1982b: 4):

The single most important question facing us tonight is: Do we reduce deficits and interest rates by raising revenue from those who are not now paying their fair share—or do we accept bigger budget deficits, higher interest rates, and higher unemployment simply because we disagree on

certain features of a legislative package? We're within sight of a safe port of economic recovery. Do we make port, or go aground on the shoals of selfishness, partisanship and just plain bullheadedness?

Reagan's speech resounded with a tone of compromise, in sharp contrast to the political rhetoric of 1993. Tax increases were not in line with Reagan's core values, but he saw them as a necessity. Much had changed by 1993. There was no room by then for both sides to compromise, and the negotiations instead decayed into a face-saving effort.

### **5.15 Conclusion**

The Omnibus Budget Reconciliation Act of 1993 was a case study in partisanship and gridlock. However, in retrospect it appeared to be successful in stimulating the economy and closing the large deficits that had grown steadily since 1990. There is little doubt that Clinton's economic plan was largely a success. However, its success came without any tangible Republican support. Blocked at every turn by conservatives like Newt Gingrich and John Kasich, the President was forced to work unilaterally to push the bill through Congress. In that sense, the 1993 Act could not have been more different than the 1986 Act. Nonetheless, a closer look at the bill's passage, and the personalities who supported and stifled it, offers three lessons for future tax reform.

First, as evidenced in the 1986 Act, effective control of the legislative and executive branch by one party appears to be a recipe for gridlock and divisiveness. In the 1993 Act, the Republican minority was clearly threatened by the electoral mandate achieved by the Democrats, and responded by standing even more firmly against change. As outlined earlier, this seemed to allow individual legislators to save face in their home districts by opposing any proposal the

Clinton administration offered. Effectively, this meant that to the individual politician, it was not necessary to accomplish anything tangible while in Washington. Rather, the act of preventing any legislative progress was accomplishment enough.

Second, narrow interpretation of the bill along lines of “principle” rather than practicality made compromise very unlikely. When legislators approach certain elements of legislation as morally or fundamentally wrong, it leaves no room for the emergence of middle ground. While one could argue this was precisely the intent of the founders of the Constitution - to slow major legislative changes and prevent governmental institutions from turning over too quickly - this effect also makes substantive overhaul of the tax code very difficult. Instead of, as in 1986, moving change toward more broad changes that influence many taxpayers, this narrow approach to governing supported carve-outs and ideological stances that appealed to small slices of the electorate. Stated differently, when compromise is not seen as an option in the legislator’s toolkit, the overall electorate becomes much less important than the individual constituent and the home district that the legislator represents.

Last, the evolution of the 1993 Act seemed to suggest that the role of an elected Representative or Senator was changing. Were politicians elected to represent the narrow positions of their constituents, or were they elected to “do what was best” for their constituents within the framework of the nation as a whole? In 1993, it appeared that the Republicans in particular had moved toward the former position, though the Democrats also bore some responsibility for gridlock. The environment at the time was toxic for any politician who considered compromise as an option. This “toxicity” was likely the result of heavy accountability to party leadership, the home district, and special interest groups who kept scorecards as to politicians and their solidarity on particular issues. In 1993, politicians had fewer tools to work

with than in 1986, mainly as a result of this change in tone. The result was predictable: any change that occurred did so along party lines, and was limited to what the party in power could pass with its own voting strength.

As will be discussed later in this research, the United States tax code and legislative process continued to move toward bitter partisanship after 1986, with little evidence of an end in sight. The passage of the Omnibus Budget Reconciliation Act of 1993 was a significant shift in paradigm, away from the politics of compromise, and toward polarization. This sharp partisanship would become the rule rather than the exception. A new consequence-filled political environment had evolved since 1986, often devoid of substantive debate and statesmanship. Only seven years removed from one of the most hallowed political compromises in the history of U.S. taxation, the Tax Reform Act of 1986, the landscape had changed immeasurably. While “Gucci Gulch” was gone, with its environment of both personal and pork-barrel compromise, it was replaced with a rigid and unyielding Congress. The battle against “sausage-making” and deal-cutting may have been won, but the war against gridlock was just beginning.

## CHAPTER 6

### The Economic Growth and Tax Relief Reconciliation Act of 2001

#### 6.1 Introduction

The Economic Growth and Tax Relief Reconciliation Act of 2001 was the first major piece of tax legislation to take effect under the administration of President George W. Bush. Bush was elected in 2000 after a controversial and hotly-contested election in which he narrowly carried the state of Florida, thus winning the Presidential election, by only 537 votes out of tens of millions cast. His predecessor, President Bill Clinton, had served since 1993, nurturing a strengthening economy that produced solid growth and budget surpluses. However, Clinton only cut taxes once during his tenure, raising the widespread sentiment that a tax cut of some kind was in order during Bush's tenure (Cato Institute: 2006).

The 2001 Act constituted the largest tax cut in the United States since 1981, reducing the overall tax burden by 1.35 trillion dollars over 10 years (Cato: 2006). Major provisions in the Act reduced individual tax rates, increased tax credits for dependent children, temporarily repealed and phased in reductions to the estate tax, and the introduction of favourable retirement plan provisions (Cato Institute: 2006). One of the most unusual aspects of the 2001 Act was the fact that it contained numerous and complicated timing provisions, with the majority of the plan's provisions scheduled to sunset in 2010 (Cato Institute: 2006). The 2001 Act was the final step in a series of attempts by Republicans to implement tax-reduction legislation, efforts which had previously been blocked by Democratic President Bill Clinton.

## 6.2 Background

From the mid-1990s to the end of the Clinton administration in 2000, American politics was characterized by bitter partisanship and budget impasses (Los Angeles Times: 1999). The government was actually forced to temporarily shut down during the 1995-1996 fiscal year due to legislative bickering and funding shortages. Republicans had, at the same time, grown frustrated with Clinton's ability to push his agenda, while derailing their own (Los Angeles Times: 1999). Clearly, Clinton was a powerful negotiator, a relatively popular president, and a good steward of the economy. He held the political high ground. Clinton was said to have "taken credit for having ended a generation of deficit spending, having ushered in unprecedented prosperity and, in the words of one top staffer, having prevented the squandering of the surplus." (Los Angeles Times, 1999: 3).

As early as 1999, Congress had begun to deliberate an 800 billion dollar tax cut package intended to stimulate economic growth and create jobs, known as the Taxpayer Refund and Relief Act of 1999. This bill would pass late in 1999, to be taken up by the President for his signature upon return from the Congressional recess in August of that year. Business leaders in particular expressed strong support for this tax cut. In a press conference hosted by Michael Baroody of the National Association of Manufacturers, executives called for a reduction in tax burden to stimulate the economy and improve economic growth (CSPAN, 1999: 2:00-3:00).

I want to make three points briefly and preliminarily in our discussion. The first is the primacy of economic growth. The second is our long-held view at the NAM is that our Federal income tax code is an anti-growth code. And, the third point is that this tax cut, despite the spin of its critics, is not by any stretch of the imagination, too big for an economy of our size.

The National Association of Manufacturers expressed concern that then-President Bill Clinton might veto the Republican tax cut bill (CSPAN: 1999). Baroody expressed support for the tax cut bill's cost-efficiency, and refuted the argument that the tax cut bill was too big. He cited the projected growth benefits of the tax reduction (CSPAN: 1999):

Even if there were no growth over the same ten years covered by this tax bill, the GDP of the United States economy would accumulate to more than 80 trillion dollars. 800 billion dollar tax cut over 10 years, as a percentage of an 80 trillion dollar GDP over the same 10 years, amounts to 1%. In fact, if you add the increment of growth, even the conservative estimates of Federal budget analysts at the CBO and OMB, that 80 trillion dollars expands to 114 trillion dollars. Simply put, we don't believe this is too big of a tax bill. Far from it.

These fears of a presidential veto proved to be well founded, as Clinton indeed vetoed the 800 billion-dollar tax cut package. Clinton, along with many economists, supported the action because it increased the likelihood that the budget surplus might be used to instead pay down the national debt (Washington Post: 1999). The Republicans were instead forced to settle for the possibility of compromise for a potential deal that would be much smaller – closer to 300 billion dollars (Washington Post: 1999). No deal would be reached on the proposed legislation in 1999, and Clinton would also go on to veto another tax relief measure as well – the Marriage Tax Reconciliation Act of 2000. These two actions ensured that no substantial tax cuts would occur during Clinton's presidency, while laying the groundwork for President George Bush's view that tax relief should be a major policy goal (US Senate: 2016).

### **6.3 Timeline**

The timeline of the Economic Growth and Tax Relief Reconciliation Act of 2001 and its movement through the legislative process, is outlined below (Govtrack: 2015c).

- May 15<sup>th</sup>, 2001 introduced
- May 16<sup>th</sup>, 2001 House version passed
- May 23<sup>rd</sup>, 2001 Senate version passed
- May 25<sup>th</sup>, 2001 House Conference report adopted
- May 26<sup>th</sup>, 2001 Senate Conference report adopted
- June 7<sup>th</sup>, 2001 signed into law by the President.

### **6.4 Key Figures in the Economic Growth and Tax Relief Reconciliation Act of 2001**

#### *George W. Bush*

George W. Bush became the 43<sup>rd</sup> President of the United States in 2000, narrowly defeating former vice-President Al Gore. Bush is the son of former President George Bush, who was elected in 1988. George W. Bush served as governor of Texas, and was a graduate of Yale and the Harvard Business School. Bush was an executive in the energy industry, as well as an investor in a major league baseball franchise, the Texas Rangers, prior to his career in public office (White House: 2016b). Bush would serve two terms as President, focusing on tax relief, national security, and combatting terrorism. As a former business executive, Bush clearly sought to refocus the economy by re-introducing “trickle-down” principles implemented by Ronald Reagan. Bush inherited a significant surplus from the Clinton administration, though he would depart office having reversed the surplus and generated significant new budget deficits.

## *Alan Greenspan*

Alan Greenspan was the Chairman of the Federal Reserve banking system, taking office in 1987. He would serve five terms, ending his service in 2006 (Federal Reserve History: 2016). Greenspan was a graduate of New York University, and presided over a number of significant economic events in the economic history of the country, including a 1987 stock market crash, two recessions, and the 2001 9/11 terrorist attacks (Federal Reserve History, 2016: 1). Greenspan played a role in helping lay the theoretical groundwork for supporting Bush's proposed tax cuts (CSPAN: 2001).

### **6.5 Major Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001**

The most substantial provisions of the 2001 Act, from an economic impact perspective, were arguably the reductions to the individual income tax rates. The Act sought to provide some immediate economic boost, as recommended by many experts (Greenspan: 2001). The major provisions are outlined below (Joint Committee on Taxation, 2001: 2-8):

- expansion of a number of tax-preferenced retirement plans;
- created a new 10% regular individual income tax bracket for taxable income that would have been otherwise taxed at 15%;
- the 28% individual income tax bracket was reduced to 27%, falling to 25% over the next 5 years;
- the 31% individual income tax bracket was reduced to 30%, falling to 28% over the next 5 years;
- the 36% rate would also fall immediately to 35%, down to 33% over the next 5 years;

- the top tax bracket (39.6%) would be reduced immediately to 38.6%, falling to 35% over the next 5 years;
- an immediate credit was issued for the 2001 rate reduction differences, up to a maximum of \$600 in the case of a married couple;
- phased out limitations on individual tax itemized deductions, beginning in 2006, to complete over the next decade;
- correction of the so-called “marriage penalty”; this is the difference between the tax rate applied to a given tax return filed by a married couple, and the tax rate(s) applied to the same income level filed under two single taxpayer returns;
- increased the child tax credit from \$500 to \$1,000, and made it fully refundable;
- expansion of dependent care tax credit; and
- phase out of the Estate and Gift Tax, including expansion of the exemption from 1 million in fair value transferred to full repeal in 2010; this included a gradual rate reduction from 50% in 2001, down to 45% in 2010.

As will be discussed later in this research, it is notable that many of the provisions in this tax reduction plan would phase in gradually over a ten-year period. It also included a number of substantive sunset provisions that would require Congressional action beyond Bush’s terms of office. These were unconventional, and would prove to be both a catalyst for criticism, as well as a means for easing the bill’s passage.

## **6.6 The Transition to George W. Bush: Political and Economic Change**

Texas Governor, and soon to be President-elect George W. Bush, campaigned in 2000 primarily on a platform of tax relief. The United States' economy was in excellent shape and had been in a consistent state of expansion since Bill Clinton took office in 1993 (Boehne: 2000). In remarks made about the state of the economy in 2000, Philadelphia Federal Reserve Chairman Edward Boehne noted the strength of the economy (Boehne, 2000: 1):

The U.S. economy has grown at an average rate of more than 3-1/2 percent per year since 1991 when our current expansion began. Growth has accelerated since the end of 1995, averaging about 4-1/4 percent per year. The strong pace of economic growth has been matched by the strong growth of employment. Since 1991, the U.S. has added about 2.5 million workers to payrolls each year, and the unemployment rate has fallen from above 7 percent to a 29-year low of just over 4 percent.

George W. Bush's campaign against sitting vice-President and Democratic candidate Al Gore focused on putting tax revenues back in the pocket of the American taxpayer. Bush debated Al Gore in North Carolina on October 11, 2000, just prior to the November general election. The topic of taxes and the candidates' approach to the economy was a significant point of discussion. In the debate Bush outlined the major components of his tax plan (Bush, 2000a: 1).

Let's talk about my tax plan. The top 1% will pay one-third of all the federal income taxes. And in return, get one-fifth of the benefits, because most of the tax reductions go to the people at the bottom end of the economic ladder. That stands in stark contrast, by the way, to a man who is going to leave 50 million -- 50 million Americans out of tax relief. We just have a different point of view. It's a totally different point of view. He believes only the right people ought to get tax relief. I believe everybody who pays taxes ought to get tax relief.

Bush's rhetoric mirrored President Ronald Reagan's, nearly twenty years previously, in his call for an "across the board" style tax reduction. However, the political landscape was markedly different in 2000. Reagan had inherited an economy in shambles in 1980, while Bush began his term with a much more stable economy. However, opponent Al Gore criticized Bush's uniform tax cut plan by characterizing it as a gift to the wealthy (Commission on Presidential Debates: 2016).

I think that what -- I think the point of that is that anybody would have a hard time trying to make a tax cut plan that is so large, that would put us into such big deficits, that gives almost half the benefits to the wealthiest of the wealthy. I think anybody would have a hard time explaining that clearly in a way that makes sense to the average person.

Gore also sought to remind voters about the danger of returning to post-Reagan era budget deficits. He echoed these concerns again in the final debate of the 2000 election cycle, on October 17, 2000, in Missouri (Commission on Presidential Debates: 2000b). Gore reiterated concern over the deficit potential of Bush's plan, and the subsequent effect on the already burgeoning national debt. He cited the interest on the national debt as being as large, on its own, as almost any Federal program, but providing no tangible benefit to the public (Commission on Presidential Debates: 2000b). Bush defended his plan (Commission on Presidential Debates, 2000b: 66):

Let me talk about tax relief. If you pay taxes, you ought to get tax relief. The vice President believes only the right people ought to get tax relief. I don't think that's the role of the President to pick you're right and you're not right. I think if you're going to have tax relief, everybody ought to get it.

Bush's comments are interesting in that he stressed that he wanted everyone who paid taxes to have tax relief. However, the reality is that the mechanics of any proposed tax reduction or increase is far more complicated. Obviously Bush was using these comments as a rhetorical device. However, it is evident that incremental rate reductions, even when fixed as a flat rate across all tax brackets, affect different classes of taxpayers differently. Further, one cannot make political decisions of any kind without them being inherently political in nature. Notably, Bush's comments harken back, again, to Ronald Reagan's campaign to lower tax rates in the early 1980s. Bush, as did Reagan, sought to position himself on the side of the taxpayer, not the side of government (Commission on Presidential Debates, 2000b: 6):

And therefore, wealthy people are going to get it (tax reductions). But the top 1% will end up paying one-third of the taxes in America and they get one-fifth of the benefits. And that's because we structured the plan so that six million additional American families pay no taxes. If you're a family of four making \$50,000 in Missouri, you get a 50% cut in your federal income taxes. What I've done is set priorities and funded them. And there's extra money. And I believe the people who pay the bills ought to get some money back. It's a difference of opinion. He wants to grow the government and I trust you with your own money. I wish we could spend an hour talking about trusting people. It's just the right position to take.

The similarities between Bush's political playbook and Reagan's tax reform platform are striking: Bush referred to his strong belief in trusting Americans with their own money. While Bush phrased his tax cut plan in terms of "trust," Reagan framed his in terms of freedom. Though they chose different terms, clearly Bush sought to capitalize on Reagan's massive popularity with the American people by structuring his political positions parallel to Reagan's. Bush sought to drive home the point that he trusted the American people, particularly with their

own money, while vice-President Al Gore did not. The moderator of the debate pushed back and challenged Bush for clarity to which Bush responded (Commission on Presidential Debates, 2000b: 6):

Let me finish. Under my plan, if you make -- the top -- the wealthy people pay 62% of the taxes today. Afterwards they pay 64%. This is a fair plan. You know why? Because the tax code is unfair for people at the bottom end of the economic ladder. If you're a single mother making \$22,000 a year today and you're trying to raise two children, for every additional dollar you earn you pay a higher marginal rate on that dollar than someone making \$200,000, and that's not right. So I want to do something about that.

Bush would go on to defeat Gore by the narrowest of margins in the November 2000 presidential election. Bush carried the state of Florida, a state of monumental electoral importance, by just 537 votes of tens of millions of total votes cast. Numerous challenges to the electoral results ensued, including manual recounting of ballots, court challenges, and ultimately, the involvement of the US Supreme Court. Nearly a month later, the election results were still in doubt, unprecedented for an election in the United States. In *Bush v. Gore* the Supreme Court stopped the manual recounting process, effectively ending the controversy and handing the election to Bush. This was a rocky start to what would prove to be a tumultuous first year for Bush and the nation. Bush would go on to push for monumental tax reductions via the Economic Growth and Tax Relief Reconciliation Act of 2001. Would Bush's plan produce large and lasting deficits, as Reagan's plan did? Would it continue to grow the economy? Or would the United States return to a pattern of deficit spending?

## **6.7 Bush's Proposal**

Bush's plan to reduce taxes was built around the idea that economic conditions dictated the need for a tax cut; Bush touted his plan before a Joint Session of Congress on February 27, 2001 (American Presidency Project, 2016: 28-30):

I hope you will join me in standing firmly on the side of the people. You see, the growing surplus exists because taxes are too high and government is charging more than it needs. The people of America have been overcharged and, on their behalf, I am here asking for a refund. Some say my tax plan is too big. Others say it's too small. I respectfully disagree. This plan is just right. I didn't throw darts at the board to come up with a number for tax relief. I didn't take a poll or develop an arbitrary formula that might sound good. I looked at problems in the Tax Code and calculated the cost to fix them.

This simple rhetorical approach was typical of George Bush, and was one of the ways he connected so well with the general public. Bush would go on to highlight some of the specifics of his plan, including an interesting comment about the so-called "marriage penalty" (American Presidency Project, 2016: 29-30):

Our government should not tax, and thereby discourage marriage, so we reduced the marriage penalty. I want to help families rear and support their children, so we doubled the child credit to \$1,000 per child. It's not fair to tax the same earnings twice — once when you earn them, and again when you die — so we must repeal the death tax. These changes add up to significant help. A typical family with two children will save \$1,600 a year on their federal income taxes. Now, \$1,600 may not sound like a lot to some, but it means a lot to many families.

Bush would go on to highlight how his plan helps the average family, and how the surplus "is not the government's money" but the people's money (American Presidency Project, 2016: 30).

It is interesting, and absurd however, that Bush suggested that tax policy was in some way discouraging marriage, as this lacks face validity. Further, there is no evidence that this was true. Bush also pushed the fairness of his cuts, in that they were applied evenly across income brackets. However, this argument is flawed because it clearly ignores the possibility that wealthy taxpayers did not in fact need tax cuts, and assumes, perhaps erroneously, that proportional cuts are not regressive to lower-income taxpayers, or more detrimental to the budget. For example, it is entirely possible that a hypothetical 1% tax reduction for low-income taxpayers would provide more direct relief to the taxpayer, at a lower cost to the treasury, than a 1% tax cut for a high-income taxpayer. The high-income taxpayer would, arguably, be more likely to spend the cut on non-essential items, while the cut would simultaneously represent a larger outlay in tax spending.

Bush also would place great weight on Alan Greenspan's testimony about the economy in pushing his plan, while touting tax relief as patriotic, bipartisan, and urgent (American Presidency Project, 2016: 29-30):

Forty years ago, and then 20 years ago, two presidents, one Democrat, one Republican, John F. Kennedy and Ronald Reagan, advocated tax cuts to, in President Kennedy's words, get this country moving again. They knew then what we must do now. To create economic growth and opportunity, we must put money back into the hands of the people who buy goods and create jobs. We must act quickly. The Chairman of the Federal Reserve has testified before Congress that tax cuts often come too late to stimulate economic recovery. So I want to work with you to give our economy an important jump-start by making tax relief retroactive.

Ironically, the proposed retroactive approach to Bush's tax cuts would be made easier due to President Bill Clinton's successful use of retroactive tax increases in the 1990s. Bush would begin to encourage Congress to take up debate on this plan as soon as possible, again relying on

Greenspan's suggestion that tax relief typically takes too long to make a difference in economic stimulus (CSPAN: 2001).

## **6.8 Congress Takes up Bush's Tax Cuts**

As referenced by Bush in his February speech to Congress, Federal Reserve Chairman Alan Greenspan had delivered testimony on the state of the economy before the Senate Budget Committee on January 25, 2001. The economy had been performing very well throughout the Clinton administration (Boehne: 2000). However, Greenspan pointed out that projected economic growth rates had begun to fall, and he cautioned against continued creation of budget surpluses, as these had accumulated during the Clinton administration (CSPAN: 2001). Greenspan effectively called for responsible tax reductions, sooner rather than later, due to the lengthy and thorny legislative process required to implement changes to the tax code (CSPAN, 2001: 35:00-36:30):

Moreover, the greater the drain of resources from the private sector, arguably, the lower the growth potential of the economy. In contrast to most spending programs, tax reductions have downside limits, they cannot be open-ended. Lately there has been much discussion of cutting taxes to confront the evident pronounced weakening in economic performance. Such tax initiatives however have proved difficult to implement in the time frame in which recessions have developed and ended. For example, although President Ford proposed in January of 1975 that withholding rates be reduced, this easiest of tax changes was not implemented until May, when the recession was officially over, and the recovery was gathering force.

Greenspan stressed that weakening economic signals dictated that action was necessary, a position which ultimately supported Bush's designs on a tax cut (CSPAN: 2001). He also cautioned against deficit spending and the accumulation of private assets by the public sector

(CSPAN: 2001). In his words, a timely tax cut could do the economy “noticeable good.” (CSPAN, 2001: 38:00).

Congress began to debate potential tax proposals in the House on March 8, 2001. A precursor bill to the 2001 Act, H.R. 3, was considered as both sides debated the resolution. Democrats were generally critical of the proposed tax cuts, primarily citing the failure of Bush’s administration in three ways: failure to provide a budget, the allegation that Bush’s tax cuts disproportionately benefited the rich, as well as the fact that if budget projections were wrong, social programs would suffer (Congressional Record: 2001b). Republicans were generally supportive, citing the need to return surpluses to the public, and minimizing the issue of operating without a final budget for the fiscal year. Charles Rangel (Democrat, represented the state of New York) rose in opposition (Congressional Record, 2001b: 3):

This is not the tax bill that we hear the President talking about. This does not give relief to people who are married and suffer the marriage penalty. It does not take care of the estate tax. Who it takes care of politically are the top rollers in the United States.

Likewise, Congressman Matsui (Democrat, represented the state of California) of California criticized HR 3, citing the possible margin of error in the Congressional Budget Office’s projections and the associated risks. Congressman Matsui shared the fear that if budget projections were wrong, the tax cut refund could not simply be taken back. Rather, the difference would be made up using social programs such as Social Security and prescription drug benefits (Congressional Record, 2001b: 6):

Mr. Speaker, I will guarantee that we will have to make significant cuts in Social Security, if, in fact, this tax cut occurs and these numbers do not come up, and we know these numbers are just

based upon nothing but guesswork, and it is my hope that the Members will come to their senses and be very, very cautious, because the Democrats have a tax cut that basically is modest. It is about \$600 billion, which is a lot of money, but at the same time that tax cut is well within a budget framework and obviously will stay within these guesswork numbers.

The Congressman Jim Turner of Texas continued the Democratic opposition, lamenting the lack of a budget and citing the irresponsibility of approving potential tax cuts without first budgeting accurately for them (Congressional Record, 2001b: 6):

The 33 members of the Blue Dog Democrat Coalition are working hard today to send the message to all of our friends in this House that it is important to have a budget first. Democrats want the largest tax cut we can afford, but how in the world do you know how large a tax cut you can afford until you first go through a budget process? It matters not what budget I am for. It matters not what budget the President is for. It matters not what budget you are for. The process is that we all work together. We debate it out, and we vote and we have a budget. And when you do, you then know how big a tax cut you can afford.

As a member of the “Blue Dog Democrats”, Turner would have billed himself a social liberal and fiscal conservative (Bluedogdemocrats.com: 2016). Similar to the Boll Weevils who were prevalent during the Reagan years, Blue Dog democrats caucused with the Democratic party on most issues, but could sway votes toward Republicans in debates on financial matters. However, on this issue Turner toed the party line, using the lack of a budget to leverage the Democratic position.

Many Republicans spoke in support of the tax reduction efforts. In stark contrast to the Democrats, Republicans typically postured themselves as supporters of individual freedom, and stressed that taxpayers should be able to spend their own money the way they wished. Those

who rose in support of a tax reduction bill stressed that taxes raised in excess of governmental needs fundamentally belonged to the individual taxpayer, and should therefore be returned rather than used to build a surplus. Members speaking in favour of a tax cut included Congresswoman Johnson (Republican, represented the state of Connecticut) who criticized the rising surplus (Congressional Record, 2001b:7):

Let us look at what is happening to those tax dollars that they are pouring into Washington. For one thing, they are building up a surplus faster than at any time in our history. Just yesterday, our Secretary of the Treasury said that right now, this month of March, our surplus is \$75 billion. A year ago, in that economic year, at the same time, it was only \$40 billion. So in spite of the leveling off of the economy, the surplus is growing more rapidly now than it was a year ago. The surplus dollars are our taxes. They are just the fruit of the hard labor of the American people. We can reduce the debt; pay it right down. We can spend on our priorities like education and health care; and, yes, we can and must reduce people's taxes. It is their money. They deserve a portion of it back, and they deserve that today.

Congressman Portman (Republican, represented the state of Ohio), a member of the House Ways and Means Committee, also rose to speak in favour of the legislation. He continued to frame the debate around freedom, specifically that tax dollars belong to the people (Congressional Record, 2001b:8):

We are going to have some spending increases in places like education and the military, and still there is room for tax relief for the hard-working American people who created every dime of this big surplus we have. People are overtaxed. We just heard earlier people spend more on taxes now than they do on food, shelter, and clothing combined. We have the highest tax burden since World War II. Taxpayers in Ohio need some relief. I know they do. And they ought to get it.

Finally, I want to say that we need to do this for the economy, even if it did not fit in the budget so neatly, even if taxpayers were not so overburdened with taxation. Do any of us want to see us go into a recession?

Congressman Camp (Republican, represented the state of Michigan) echoed the comments about tax dollars belonging to the American people, a populist stance which epitomized the Republican stance toward tax relief. This position was vastly different than the one taken by opponents of the bill, who sought to frame the debate not as an issue of individual freedom, but one of collective governmental responsibility to balance the budget and take care of its obligations such as education and health care. Camp's comments were in strong support (Congressional Record, 2001b:8).

High taxes are not only a tax on the ability to create wealth for working people, they are a tax on opportunity itself; the opportunity for Americans to determine their own destiny, make their own choices, and keep more of what they have worked so hard to earn. These values are the essence of democracy itself. It is the people's money. They worked hard for it, and they deserve it. They deserve a refund.

H.R. 3 would pass the House narrowly, 230-198, with its provisions ultimately included in the Economic Growth and Tax Relief Reconciliation Act, which would be taken up in just a few months. H.R. 3 contained the core of the individual tax rate reductions, as well as a guarantee that major social programs would not suffer as a result of the tax cuts, in the event of a budget shortfall (Congressional Record, 2001b:20). However, the final version of the bill would find itself much further to the left, moving from a Republican-centered tax cut that benefited the

wealthy, to a tax package that included relief from the so-called “marriage penalty”, increases in child tax credits, and a future estate tax repeal (Lewandowski: 2008).

## **6.9 The Conference Report**

On May 15, 2001, House Members discussed the Conference Report, which reconciled differences between the House and Senate Versions of the Economic Growth and Tax Relief Reconciliation Act of 2001. Democrats had recently regained a majority in the Senate for the first time since 1994 after the defection of Senator Jim Jeffords of Vermont from the Republican ranks (Democracynow: 2001). Despite this development, Democrats conceded to the Republicans a majority on the Conference Committee taking up the efforts at reconciling House and Senate versions of the Bush tax cuts (Democracynow:2001). Representative Max Sandlin, of Texas, opened with remarks in support of the legislation:

Mr. Speaker, today, Congress will approve a significant tax relief package, outlining a fiscal path that promises lower taxes but creates a less certain budget picture. I believe Americans need tax relief, and I will support this tax cut bill because it is the best we can produce at this time. In many crucial respects, however, the Economic Growth and Tax Relief Act is flawed. In some cases, promised tax benefits are delayed for several years, while additional valuable tax credits for education and inducements for personal savings expire only a few years after enactment. Politics, however, is built on principled compromise between different policy positions and, in voting in favor of this bill, I will not let the friend of the perfect be the enemy of the good.

Sandlin noted some of the unique timing issues associate with the 2001 Act, including sunset provisions and expirations. Sandlin would go on to support the bill’s provisions which eliminated the estate tax, and corrected the “marriage penalty.” (Congressional Record: 2001c). The

marriage penalty was a provision of the Internal Revenue Code which resulted in a higher tax burden for the same couple, if married, than their tax burden would be if filing as single taxpayers. Though Republican support was strong, some members objected to elements of the plan. In particular, some members found objectionable the full “future” repeal of the estate tax in 2010, a measure which was included in the tax reduction package. Representative Doug Bereuter (Republican, represented the state of Nebraska) voiced this sentiment, calling for changes to the estate tax but reminding the members that estate tax reductions only benefit the “super-rich.” (Congressional Record, 2001c: 118):

Mr. Speaker, while this member enthusiastically votes for H.R. 1836 to give a tax cut to American taxpayers he continues his strong opposition to the total elimination of the estate tax on the super-rich. The reasons for this opposition has been publicly explained on numerous occasions, including statements in the Congressional Record. On the other hand, this member is strongly in favor of substantially raising the estate tax exemption level and reducing the rate of taxation on all levels of taxable estates. However, to totally eliminate the estate tax on billionaires and mega-millionaires would be a terrible idea for the American society and for continuing to foster very large charitable contributions for colleges and universities and other worthy institutions in our country. Fortunately, I believe it will never be eliminated in the year 2010.

Unfortunately for Representative Bereuter, the estate tax was in fact repealed in 2010, then retroactively re-enacted in an unusual legislative move in 2011. The lengthy deferral associated with the estate tax provision of the Economic Growth and Tax Reform Reconciliation Act of 2001 was symptomatic of its weaknesses. Many of its provisions were delayed in ways that, arguably, muted the impact of the provisions or muddled the ability of the general public to understand what they would be getting with the legislation.

Opposition to the Conference report came from expected sources, but also from those moderate members of Congress who felt the bill did not accomplish clearly enough its intended goals. California Representative Jane Harman, a Democrat who supported other provisions of the bill, declined to support it (Congressional Record, 2001c: 117).

I expect to vote for needed tax cuts in the future, including true relief from the AMT [Alternative Minimum Tax], a package of relief for small business, and a permanent research and development tax credit. But none of these important tax cuts is included in today's package. It includes some good features, such as improved pension portability, expanded IRA contributions and marriage penalty relief, but it is riddled with gimmicks and it is backloaded.

Harman opposed the bill in its amended version, as did Representative McDermott. His remarks would also prove to be prophetic, as Enron would fail spectacularly due to fraud and a flagging economy (Congressional Record, 2001c: 119):

So much for their earlier explanation that the economy was on the brink of a recession and could only be saved by this massive tax cut. I see—all the tax cut dollars will go towards paying energy bills and stimulating the profits of the big oil companies—oil companies such as Houston-based Enron and Dynegy that have reportedly seen revenues climb by 400 percent in the past two years while the Californian utilities spiraled into debt. As for the working American families who owe no federal taxes and get zero to nominal benefits from this blatant deception of a taxcut, how will we help them pay their energy bills?

Harman criticized the way the Bush administration pushed the urgency of the bill, asking Congress to act by Memorial Day to approve the cuts. Other remarks highlighted familiar criticisms of the bill: it did not fix the Alternative Minimum Tax, which had begun to creep into greater numbers of American tax returns; it did not provide immediate benefits, with its delayed

provisions hiding much of its real cost and the effects of interest; and it benefited big business (Congressional Record: 2001c).

Massachusetts Representative Barney Frank rose to point out what he felt was the odd timing provisions of the bill, as well to mock what he felt was Republican hypocrisy (Congressional Record, 2001c: 104):

This bill takes away from the people the funds that they could use to adequately fund Medicare, a prescription drug program, nursing homes, long-term care. None of those can be addressed without the revenues that this bill does away with. Now, I do understand that it sunsets the tax cuts. That is odd. When the Republicans were facing Bill Clinton as President, they said if they got in power, they would sunset the Tax Code. Apparently they misunderstood themselves, because this bill does not sunset the Tax Code, it sunsets the tax cuts.

The Conference Report would pass 240-154 on May 25, 2001. Bush signed the bill into law on July 5, 2001.

On September 5, 2001, three months after President Bush signed the 2001 Act, members of Congress discussed the budget and the future of the budget surplus on the floor of the House of Representatives. There was significant and ongoing concern about the magnitude of the cuts. Representative Tom Allen (Democrat, represented the state of Maine) was outspoken in his alarm (Congressional Record, 2001a:4):

Thanks to the President's refund and the state of our economy, the government is facing financial shortfalls. Instead of operating in a surplus and each party claiming credit, we are blaming one another for a deficit. The other party's leaders choose to ignore the advice of economists forecasting a shrinking surplus, and all indications are that the economy has begun to slow. The surplus was once expected to be about \$125 billion. The Congressional Budget Office is

estimating the present surplus is nearly zero. Things have changed over the last 3 months. The White House is spinning blame to the Congress, but it is unwilling to accept the fact that the President's tax cut has eaten up the surplus. Just like an 800-pound gorilla would go at a banana, it is all gone.

Criticism also came in September 2001 from a number of other Congressional members in public statements to the press, including Missouri Representative Dick Gephardt, North Dakota Representative Tom Daschle, and Dick Durbin of Illinois. Bush was criticized as whipping up sentiment that the economy was in trouble, and that a tax cut was needed (Inside Politics: 2001). In particular, Gephardt and Daschle suggested that the need for a sweeping tax cut bill was a self-fulfilling prophecy. Gephardt referred to Bush's leadership as irresponsible, and claimed Bush's suggestion of a slowdown was simply a tactic to force Congress to accept a tax cut (Inside Politics: 2001). Durbin provided a "doughnut hole" metaphor for Bush's negative outlook (Inside Politics, 2001: 1):

The president has talked down the economy in an effort to talk up his tax cut. It appears that when President Bush looks at the economy he doesn't see the doughnut -- he just sees the hole. We believe that there is strength in America and in our economy, and that we can recover. But the president has to change his tune.

Concerns about the tax bill continued as the economy cooled. With corporate failures such as Enron and WorldCom, there was plenty to be nervous about in the American economy. What had been a large surplus now must have certainly appeared to be a pending worst-case scenario.

Members of Congress continued to retrospectively praise, criticize, and analyse Bush's Economic Growth and Tax Relief Recovery Act of 2001. On the floor of the Senate on February

5, 2002, Senator Chuck Grassley commented in support of the bill, which was still in its infancy (Congressional Record, 2002a: 1):

I emphasize that because of all the people who say the Tax Relief Act of last year was for the wealthy. A refundable credit is helping people of the lower income tax bracket very much. For example, in the year 2001, a single mother with two children, making \$15,000, received a credit of \$500. This single mother likely now will receive a bigger tax refund check when she files her 2001 tax return by April 15. This expansion of the child credit will ensure that millions of low-income families, not rich people, will now receive the benefit of this child credit. For those people who spend so much of their income, maybe all of it in some cases, they are going to have more money to spend, and that is going to stimulate the economy.

It appears, based on the criticism, that one universal truth could be gleaned from Bush's cut. It spent more than it could possibly recover via economic growth or expansion of the tax base. Remarks made during 2001 on the floor of the House and Senate criticized giveaways to big business, the wealthiest taxpayers, the general public, and energy companies (Congressional Record: 2001c). In many ways, the debate seemed to coalesce around several ideas: that the economy faced an uncertain future; that Bush's budgeting was not sound; and, with economic slowdown a possibility it was not the time to risk destroying a surplus that could cushion future shortfalls.

Bush lauded the cuts, but any political celebration would be short-lived, as the 9/11 terrorist attacks intervened. To be fair, clearly this was an unprecedented event with enormous economic implications. However, over the next several years, Bush would continue to push his agenda of tax cuts as the engine of economic growth. He followed up the 2001 cuts with a 2003

tax bill, and as late as 2008, just before a major banking crisis and economic recession, was proposing to extend and make permanent the tax reductions (Bush, 2008:3):

We have other work to do on taxes. Unless Congress acts, most of the tax relief we've delivered over the past seven years will be taken away. Some in Washington argue that letting tax relief expire is not a tax increase. Try explaining that to 116 million American taxpayers who would see their taxes rise by an average of \$1,800. Others have said they would personally be happy to pay higher taxes. I welcome their enthusiasm. I'm pleased to report that the IRS accepts both checks and money orders. Most Americans think their taxes are high enough. With all the other pressures on their finances, American families should not have to worry about their federal government taking a bigger bite out of their paychecks. There's only one way to eliminate this uncertainty: Make the tax relief permanent. And members of Congress should know: If any bill raises taxes reaches my desk, I will veto it.

Congress would ultimately extend the cuts, under the Obama administration. As evidenced in Bush's speech to Congress, above, Bush postured that allowing a previous tax cut to expire would be a tax "increase." The political implications would become more obvious later, as politicians, up for re-election, would face the decision as to how to handle these expiring provisions.

## **6.10 Legacy**

The Economic Growth and Tax Relief Reconciliation Act of 2001 was an important turning point for the United States' economy. Most prominently, 2001 would be the last year the United States treasury would hold a budget surplus as a result of the dramatic reductions in tax revenue (Miller Center: 2016). Ultimately, Bush's dramatic tax reductions were not accompanied by commensurate reductions in government spending, resulting in deep deficits. The economic

effects of the cuts on the Federal budget were further magnified by two wars, in Iraq and Afghanistan, increased entitlement program spending, and devastating economic downturns late in Bush's second term (Miller Center: 2016). The Miller Center's Presidency Project summed up Bush's 2001 tax program (Miller Center, 2016:1):

They reduced federal revenue by an estimated \$4 trillion over a period of ten years, worsened wealth inequality in the United States, and increased the federal deficit. Meanwhile, the economy grew sporadically. In October 2007, the stock market topped 14,164, up from approximately 8,000 in 2002. Unemployment declined from 6.3 percent in 2003 to 4.7 percent by 2007. Despite these signs of progress, the United States budget remained unbalanced, and a major economic catastrophe loomed in the final months of the Bush administration.

Bush's 2001 tax program ultimately resulted in dramatically expanded government expenditures, and an explosion in the deficit (Tax Policy Center: 2015c). Bush increased the size of government, as defined by total government spending, associated with wars in Iraq and Afghanistan, as well as spending on a Medicare drug provision. As indicated in figures 3.1 and 7.4, Bush's policies had erased the budget surplus by 2002, and begun to dig alarming deficits by 2005. When President Barack Obama took office in 2009, it was clear that the United States economy was in "free fall" and the deficit had become acute, if not impossible to rationally reverse. Rapid fallout would occur, including failures of many major financial institutions, and ushering in what would be known as the "Great Recession." It is also clear that, though the use of deficit spending and trickle-down tax policy remain open for debate, the Bush administration's handling of the economy was a significant setback for its proponents. Bush's tax cut program would inherit a largely negative legacy, and would subsequently be blamed for much of the economic malaise that would continue into the term of President Barack Obama.

The Washington Post, in a 2013 article, echoed these implications, as it highlighted four major impacts the 2001 Act had on the United States for the foreseeable future. The article concluded that Bush's policies, as enacted by Congress, increased income inequality; drove the deficit; disproportionately benefited the wealthy; and, in a more positive view, increased disposable income for the middle class (Washington Post, 2013:1). However, other analysts believe these outcomes were as much a result of faulty assumptions that growth would continue, as forecast in 2001, throughout the next decade, as it was any other reason (Bartlett: 2012). Analyst Bruce Bartlett contended that, while Bush was unlucky and presumptive in his reliance on poor forecasts, President Bill Clinton had previously been fortunate in that several unexpected developments cut his way. Referring to the Clinton surplus, Bartlett wrote (Bartlett, 2012:1):

The projected surplus was primarily the result of two factors. First was a big tax increase in 1993 that every Republican in Congress voted against, saying that it would tank the economy. This belief was wrong. The economy boomed in 1994, growing 4.1 percent that year and strongly throughout the Clinton administration. The second major contributor to budget surpluses that emerged in 1998 was tough budget controls that were part of the 1990 and 1993 budget deals. The main one was a requirement that spending could not be increased or taxes cut unless offset by spending cuts or tax increases. This was known as Paygo, for pay as you go.

Bartlett would also point out that the abandonment in 2002 of the PAYGO policies, which required zero-based budgeting and offsets for each tax increase, was not necessarily Bush's creation (Bartlett: 2012). PAYGO policies had unexpectedly benefited Clinton, and helped generate a surplus, while negatively affecting Bush, helping to grow the deficit (Bartlett: 2012). Bartlett's belief is that Bush and the Republican Congress were primarily responsible for continuing poor policies for nearly a decade (Bartlett, 2012:1):

The 2001 tax cut did nothing to stimulate the economy, yet Republicans pushed for additional tax cuts in 2002, 2003, 2004, 2006 and 2008. The economy continued to languish even as the Treasury hemorrhaged revenue, which fell to 17.5 percent of the gross domestic product in 2008 from 20.6 percent in 2000. Republicans abolished Paygo in 2002, and spending rose to 20.7 percent of G.D.P. in 2008 from 18.2 percent in 2001.

It is notable that in his testimony in 2001, Alan Greenspan noted that most tax cuts do not occur fast enough to make a positive economic impact or avert a recession. This turned out to be the case with the 2001 Act as well (CSPAN: 2001). Clearly it was not enough, and not fast enough, to turn the tide.

The timing of the Bush tax provisions was also important. Their pending sunset, almost ten years after their passage, created a political quandary for politicians on both sides of the aisle. The main issue is that the sunset was scheduled to occur during a mid-term Congressional election cycle, making any serious change a political risk for those on Capitol Hill (McClatchy: 2007). To extend the cuts was accepted by most pundits as politically expedient, the path of least resistance (McClatchy: 2007). Under President Obama, most of the Bush tax cuts would remain intact.

The Bush tax reductions, as begun under the Economic Growth and Tax Relief Reconciliation Act of 2001, began a dramatic downturn for the United States' economy and arguably damaged the legacy of Reaganomics. According to the Center on Budget and Policy Priorities, the economic damage is calculable: "Just two policies dating from the Bush Administration — tax cuts and the wars in Iraq and Afghanistan — accounted for over \$500 billion of the deficit in 2009 and will account for \$6 trillion in deficits in 2009 through 2019, including the associated debt-service costs." (CBPP, 2012: 1). What is less easy to calculate is

the political damage to conservative economic ideology, namely the idea of trickle-down economics itself. Under both Reagan and Bush, deficit spending, poor forecasting, revenue decreases, and consequence-free spending clearly contributed to economic malaise. While Reagan was more fortunate in that his administration avoided substantial economic setbacks after the major tax cuts, allowing for economic growth, Bush was far less fortunate. Accordingly, it is arguable that reducing anticipated tax revenues based on projected, positive economic growth forecasts and economic responses to tax changes does not outweigh the risks that the projected growth will not materialize. The Bush tax cuts ultimately were an exemplary case of this: Bush relied on aggressive growth forecasts and a freed-up economy as justification to lower taxes, thus squandering away a substantial surplus. When the anticipated economic growth did not materialize, rates were too low to offset spending, both expected and unexpected. Ironically, the political conservative, George W. Bush, proved to be anything but a fiscal conservative.

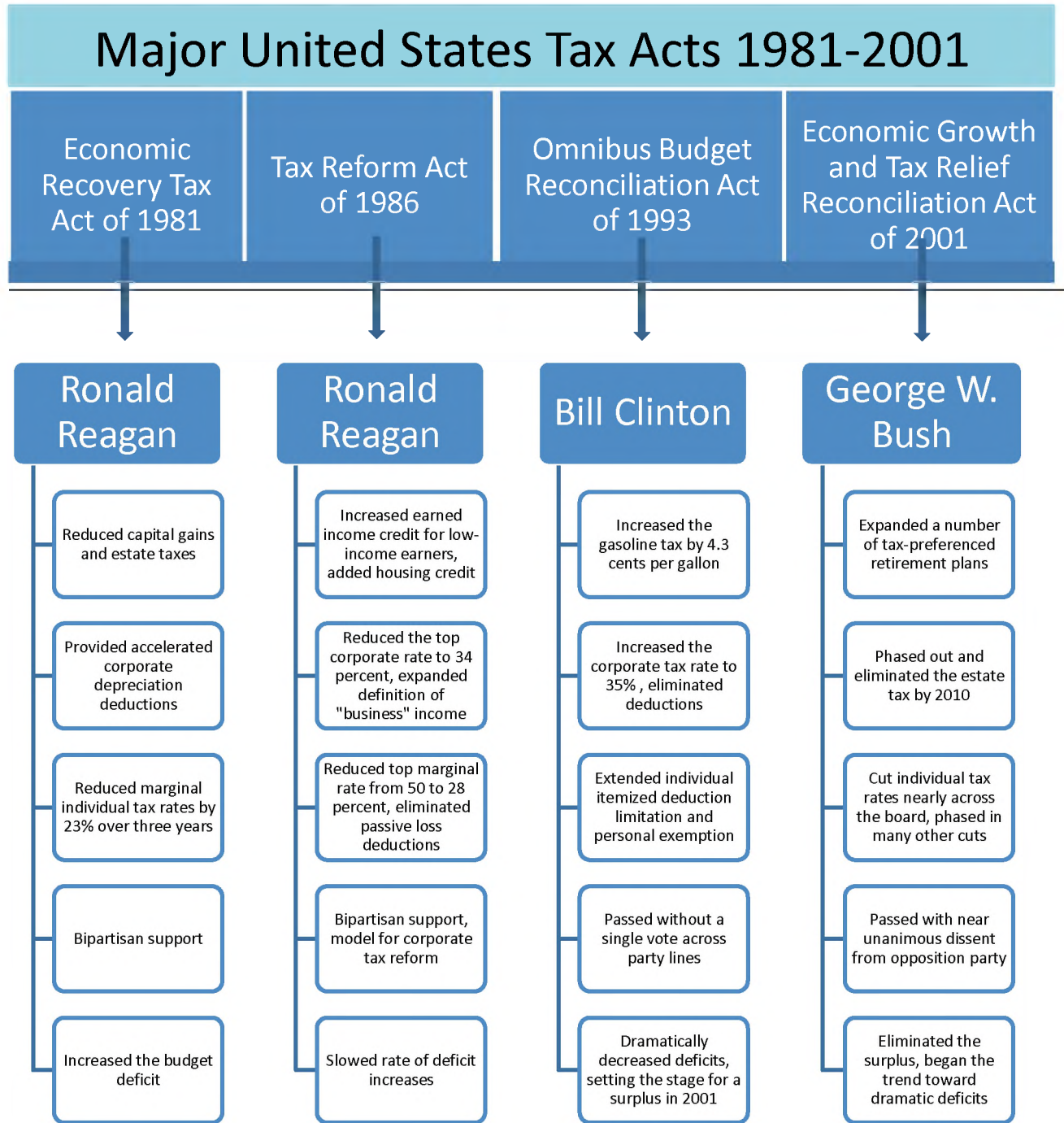
## CHAPTER 7

### Conclusions and Implications

#### 7.1 Introduction

In examining the evolution of the United States' tax code from 1981-2001, this research has chronicled the change through the lens of four seminal acts of tax legislation: The Economic Recovery Tax Act of 1981; the Tax Reform Act of 1986; The Omnibus Budget Reconciliation Act of 1993; and, The Economic Growth and Tax Relief Reconciliation Act of 2001. Figure 7.1 below summarises these four acts – the tax changes they introduced, the party support or lack of it and the main consequence of the measures introduced by the acts:

Figure 7.1: Major Tax Acts 1981-2001



These legislative developments covered or impacted the terms of six United States presidents, and were emblematic of the political forces and personalities that shaped them. While each particular act was forged under a unique set of circumstances, and influenced by the needs, hopes, and fears of those involved in the legislative process, a thorough analysis reveals a number of important themes.

This historical research has brought to light four major themes in the evolution of United States tax policy during the period under study. The first is the emergence of the budget deficit and deferred fiscal responsibility as political tools. Second, this analysis brought into sharper relief the conditions that contribute to tax reform, as well as those conditions that may hinder substantive, broad based change in the tax code, particularly partisanship. Third, this research revealed the manner in which tax increases and decreases have been cast in terms of personal liberty and social responsibility, most typically along partisan lines. Fourth, this analysis brought to light some misperceptions about presidential approaches to the budget: specifically, that the manner in which politicians cast themselves in rhetoric may be substantively different than their actual policies. Finally, and perhaps most troubling for the future of tax reform, it highlighted the manner in which partisanship has created a high-stakes environment where compromise is difficult.

## **7.2 Budget Deficits**

The emerging issue of the budget deficit was one of the most important identified in this research. The United States ran extensive deficits during World War II, obviously as a result of war expenditures (Stelsel: 2011). However, after the close of the war, budget deficits represented a very small percentage of GDP until 1975, when they first began to emerge as a material portion

of the budget, hovering just under 5% of GDP annually. This trend of annual budget deficits continued from 1975 until the present, with the only exceptions being the last few years of Bill Clinton's presidency, and the year 2001 (Stelsel: 2011). 2001 would be the last year, as of this writing, that the United States has run a budget surplus (Stelsel: 2011).

Clearly, the approach to budget deficits had changed after the Carter presidency, most notably under Ronald Reagan. While Carter had run modest deficits, in the range of 2.5%, the Reagan administration began to create deficits as a matter of routine policy. The impact of such deficits, particularly when they are recurring, is that they have a profound cumulative effect. Periodic deficits create a progressively larger financial hole, contributing to rising debt and interest payments, which can stifle the economy by requiring ever greater outlays to service them. Reagan was aware that his administration had run extensive deficits, habitually, and had done so with the hope that by leveraging a deficit and lowering taxes, he could help jumpstart the economy. However, as chronicled earlier in this research, the results of this supply-side experiment were mixed at best. According to Professor Robert Kuttner, they were mostly unsuccessful: (Kuttner, 2008: 114)

President Reagan, as well as Bush I and II, insisted that deficits didn't matter as long as the proceeds were used for tax cuts that were supposed to stimulate savings and investment. The policy failed utterly. Savings and investment rates fell, despite the lower tax rates. America became increasingly reliant for its investment capital on borrowing from abroad. But this deficits-don't-matter theology liberated Republicans from their previous stance as the fiscally responsible party.

In his farewell address to the nation, Reagan addressed the deficit: “I’ve been asked if I have any regrets. Well, I do. The deficit is one. I’ve been talking a great deal about that lately, but tonight isn’t for arguments, and I’m going to hold my tongue.” (Reagan, 1989: 3). Reagan recognized that he had helped create a generational problem, but had run out of time to fix it. However, at the same time, Reagan did not take full responsibility for the deficit, blaming what he called an “iron triangle” that drove up spending, while driving down revenue (Jeffrey, 2011: 2).

It sometimes seems to many Americans that what might be called a 'triangle of institutions' -- parts of Congress, the media and special interest groups -- is transforming and placing out of focus our constitutional balance, particularly in the areas of spending and foreign policy. Some have used the term 'iron triangle' to describe something like what I'm talking about. And with apologies to them, I'll borrow that term.

The deficits had indeed become structural, and since 1980 have become the rule rather than the exception. Bill Clinton’s administration was the only notable deviation from this trend, and when asked what his magic trick was for turning the deficit into a surplus, he famously replied “arithmetic.” (Kawa, 2013: 1). The use of deficits became more pronounced throughout the 1980s and 1990s, though President Barack Obama slowed the pace slightly beginning in 2009 (Newman: 2013). Analysis of each President’s approach to spending and taxes during this period has been conducted, and particularly revealing is the ratio of revenue increases to spending increases. This ratio reveals that only Bill Clinton and Barack Obama, as of his first term, increased revenue at a pace greater than the spending increases. President George W. Bush was considered to be the worst performer, with the percentage revenue increase just a small fraction of his spending increases (Newman: 2013).

Though some of Bush's deficit spending was unexpected, such as that required for terrorism response, other spending, such as a prescription drug benefit for seniors and across-the-board individual tax cuts, was fully anticipated and purposeful (Newman: 2013). Of all of the spending programs that contributed to the post-2010 deficit, the largest discretionary item was in fact the series of tax cuts pushed through in 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001, discussed extensively in this study. However, Bush rejected the idea that Clinton and Gore's policies had helped create the surplus that he inherited in 2001 (Brownstein: 2000, 1):

Bush flatly rejected the contention from Clinton and Gore that their economic policies, particularly the 1993 deficit-reduction package that passed Congress solely on Democratic votes, had contributed to the nation's boom times. "I think the economy has grown really in spite of government. This is an incredible period of time when productivity has been enhanced, not because of any great initiative of government, but because of the ability for entrepreneurs to stake a new claim."

While it is unfair to lay the emergence of deficit spending as a political tool solely at George W. Bush's feet, his administration became a case study in its negative effects, and accordingly, his presidency attracts much of the criticism. In his final State of the Union address, Bush spoke on the matter of deficits (Bush, 2008: 4):

There are two other pressing challenges that I've raised repeatedly before this body and that this body has failed to address: entitlement spending and immigration. Every member in this chamber knows that spending on entitlement programs like Social Security, Medicare, and Medicaid is growing faster than we can afford. We all know the painful choices ahead if America stays on this path: massive tax increases, sudden and drastic cuts in benefits, or crippling deficits. I've laid out

proposals to reform these programs. Now I ask members of Congress to offer your proposals and come up with a bipartisan solution to save these vital programs for our children and our grandchildren.

Bush neglected to reflect fairly on his own contribution to the matter, namely pushing massive tax cuts for individuals in 2001, and assuming the best-case scenario in budget projections for the decade. Much like Reagan, he blames Congress for not making difficult choices. In reality, the demographics of the United States and its aging population has long been common knowledge: this is one of the reasons Bush pushed for increased medical coverage for senior citizens. On January 20, 2004, Bush did exactly what he would criticize four years later: pushed for increased spending on Medicare (Bush, 2004: 1):

Tonight members of Congress can take pride in the great works of compassion and reform that skeptics had thought impossible. You're raising the standards for our public schools, and you are giving our senior citizens prescription drug coverage under Medicare.

Bush's prescription drug benefit, along with a number of other items in his political platform, were not supported by requisite tax revenue. This was emblematic of the problem: the most important conclusion is that since the Reagan administration, American politicians have begun to rely on the political expediency of the budget deficit. In the cases of Ronald Reagan and George W. Bush, it was much simpler to promise everything to everyone than make tough choices that might disappoint the electorate, or Congress. Instead they made no hard choices. Rather they provided what was demanded: massive tax cuts and increased spending on priority programs, without fiscal sacrifices. With the disappearance of PAYGO in 2002, there was nothing to administratively or mechanically prevent this behaviour. In addition, the political environment

offers few consequences: it is clear that the average American voter has been relatively unaffected by issues such as budget deficits when they cast their votes.

Deficit spending, at the root, represents a government's failure to effectively prioritize. Some unexpected spending is to be understood, if not condoned, such as war expenditures in World War II, and massive and unbudgeted costs associated with the 9/11 attack response. However, for other programs that are part of a political platform, it is clear that the political consequences of deficit spending, if any, are usually extensively delayed. By the time the consequences of deficit spending are felt, the administration is out of office, or the typical voter has forgotten where the problem originated. This phenomenon makes creating accountability for deficit spending a blurry and complex proposition. For example, Reagan and George W. Bush were elected to two terms each, despite having contributed to extensive deficits during their terms. Alternatively, individuals who have recognized that spending should be accompanied by revenue have been "punished" by the electorate.

Perhaps the best example of this "punishment" is the slate of tax increases proposed by President George H.W. Bush in his first term. In his acceptance speech for the Republican nomination in 1988, Bush spoke about his desire to cap tax revenues (Bush, 1988:5):

I'm the one who won't raise taxes. My opponent now says he'll raise them as a last resort, or a third resort. When a politician talks like that, you know that's one resort he'll be checking into. My opponent won't rule out raising taxes. But I will. The Congress will push me to raise taxes, and I'll say no, and they'll push, and I'll say no, and they'll push again, and I'll say to them, "Read my lips: no new taxes."

This was a clear promise that likely swayed voters his way in the election. Ironically, Bush would soon face the reality of the 200-billion dollar budget deficit before him soon after defeating Democrat Michael Dukakis for the presidency. To Bush's credit, he recognized that new revenue would be necessary—a hard political choice. He compromised with Democrats in Congress to close the budget gap, including provisions such as luxury taxes, which were unpopular with his own party supporters (Barber: 2014). Many believe his recasting of this promise was the primary factor in his subsequent election loss to Bill Clinton (Barber: 2014). For his political toughness in this endeavour, he would go on to receive the John F. Kennedy Profile in Courage Award for taking a stance that was not politically expedient (Barber: 2014). Unlike Reagan and his son, George W. Bush, George H.W. Bush paid the price for trying to balance the budget. His granddaughter attended the ceremony, and observed (Barber, 2014:1):

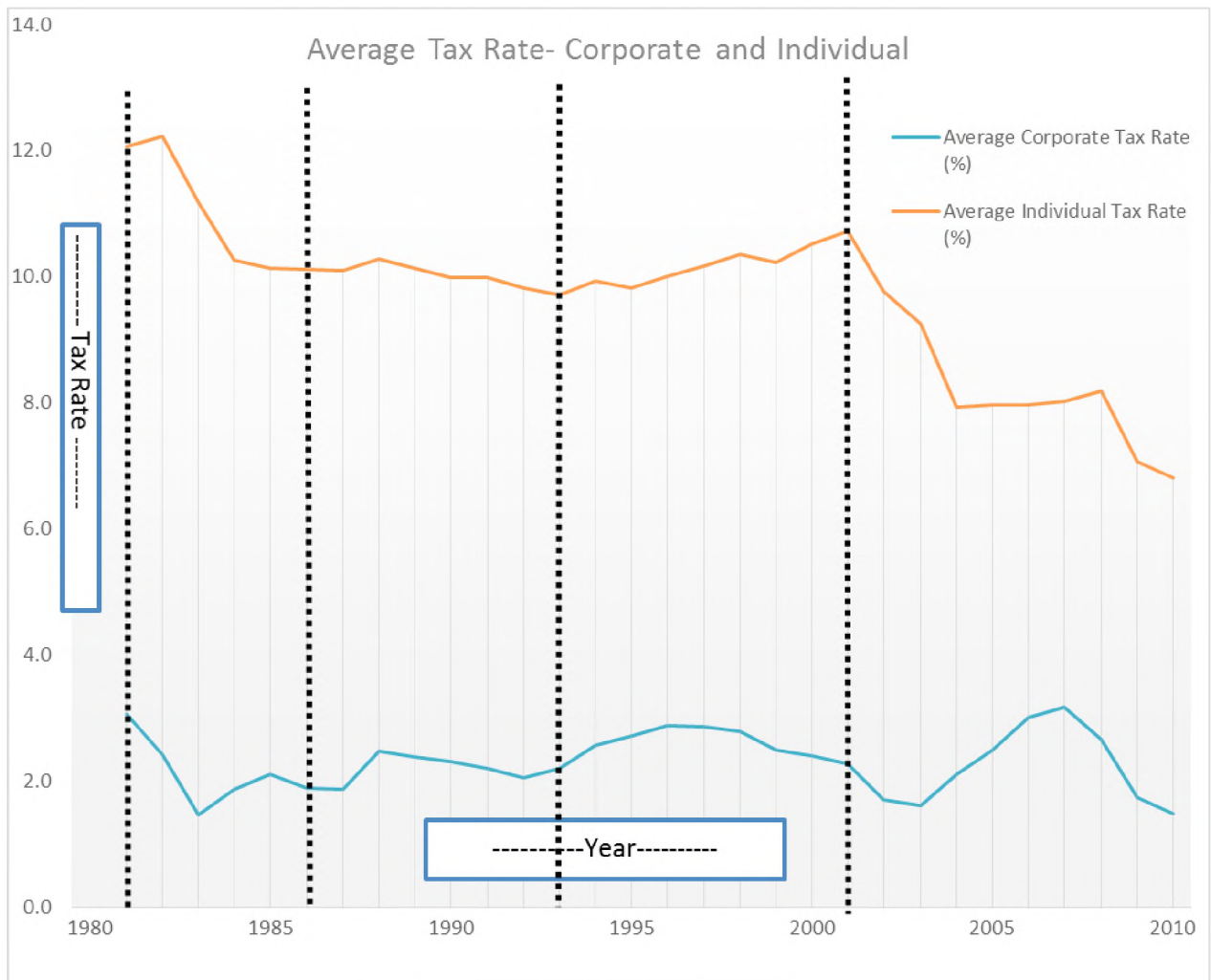
Candidly speaking, my grandfather did not want to raise taxes in 1990, but in our constitutional system of governance, Congress also gets a say - and more than that, he felt he owed the American people action and results.

This research helped illuminate this trend toward the use of budget deficits as a political tool. The lessons gleaned from deficit politics are grim: the American voter either does not recognize the issue of budget deficits as an important one, or they are unable perform the research necessary to understand the consequences of these deficits. For the politician, the lesson is that courageous steps have political consequences: it is much safer to lower tax revenue and increase spending on key programs. This approach keeps much of the electorate happy, and defers the political consequences to the future.

Figure 7.2 and 7.3, following, highlight the modest deficit growth in the 1980s, the Bill Clinton era deficit reduction, and finally, the explosion in the deficit beginning after 2001, as

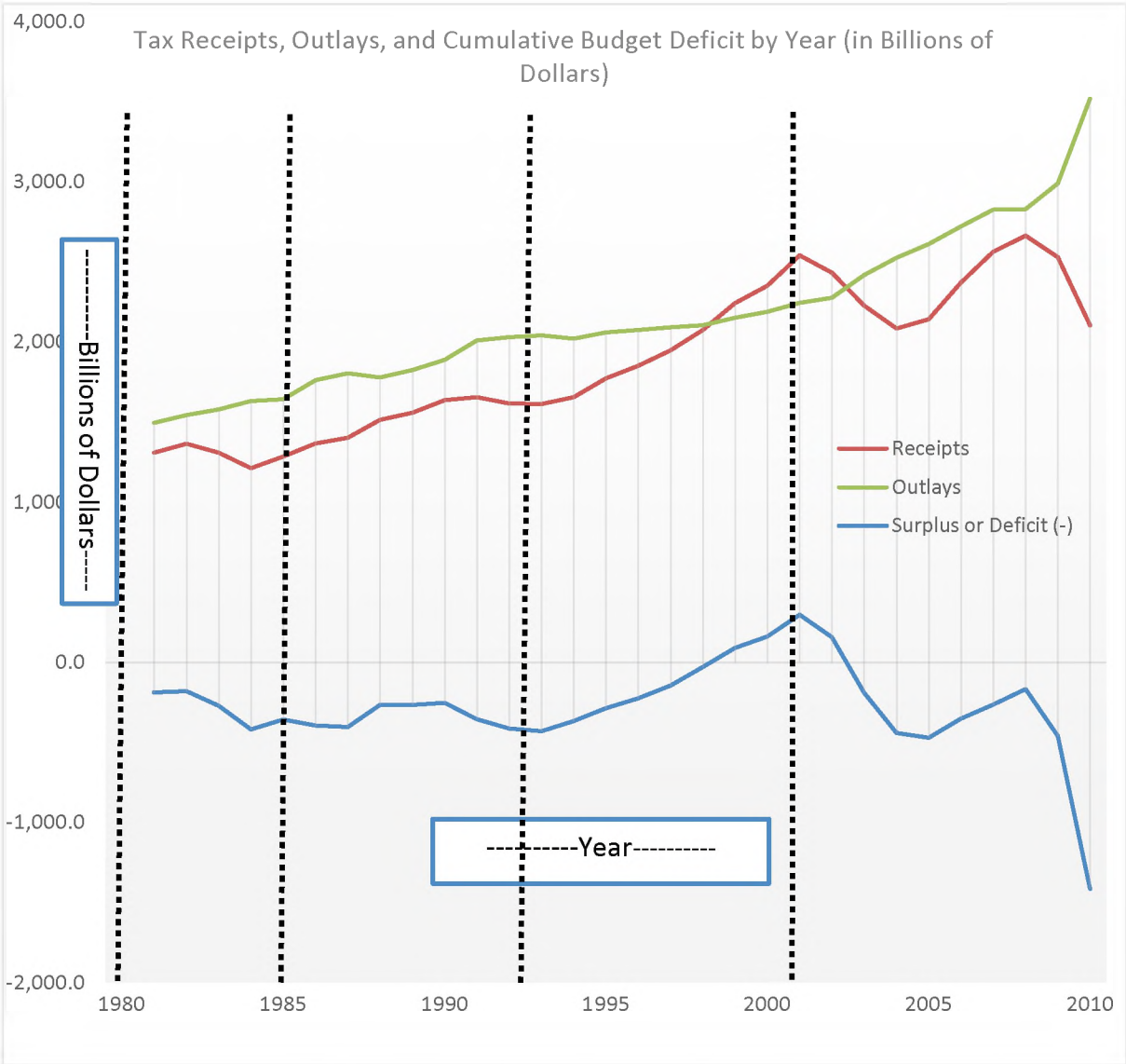
functions of tax rates and revenue generation. While expenditures and revenues drive the deficit, the association between revenues and the deficit can be seen very clearly. It is apparent that tax revenues, in general, are excellent predictors of deficit activity.

**Figure 7.2: Average Individual and Corporate Tax Rates, 1980-2010**



**(Source: Tax Policy Center: 2016a)**

**Figure 7.3: Receipts, Outlays, and Cumulative Budget Deficit by Year in Constant Dollars, 1980-2010**



(Source: Tax Policy Center, 2015c)

### **7.3 Tax Reform and Partisanship**

This research also brought into greater focus the conditions which contribute to, and hinder, the possibility of comprehensive tax reform. There are two major conditions that historically have helped set the stage for broad-based tax reform: the first is divided political leadership between the legislative and executive branches of government, and the second is solidarity between individual legislators and loyalty to their own party leadership. Conversely, unified leadership between executive and legislative branches of government, as well as practically independent, individual legislators effectively discourage comprehensive reform.

Broad-based tax reform, as was forged in 1981 and 1986, fit both of the ideal conditions. A democratic Congress was led by a powerful House Speaker, Tip O’Neill, who was able to keep individual legislators mostly in line with party expectations. There was also strong leadership continuity between both 1981 and 1986, with O’Neill and Rostenkowski establishing compromise as a baseline principle, and limiting the concerns individual members had for voting against the ideals of their home districts. In 1981 and on into the 1980s, there were also a large number of centrist legislators, known as “Blue Dog Democrats” who were willing to maintain flexible voting patterns that did not always reflect static party affiliation. This presence of a balance of power between executive and legislative branches helped both sides recognize that they needed to negotiate to accomplish anything. Alternatively, when one party is in the overwhelming minority, the minority party tends to resort to mechanical means to prevent the majority party from succeeding, such as through filibuster, bill riders, and informal means to slow down the path of legislation.

Though President Reagan was responsible for the mobilization of deficit spending, he did so with bipartisan support in 1981, and in 1986. Both the 1981 Act and the Tax Reform Act of

1986 were passed with significant investment across the aisle. Tip O'Neill and Ronald Reagan had a unique personal relationship that bridged their political differences; they cared enough about one another, and their respective offices, to work through differences. In consort with Dan Rostenkowski, the Democratic leadership accepted Reagan's mandate while working to forge an acceptable deal for their own party. This spirit of compromise and flexibility in the conduct of individual legislators during the 1980s allowed for the passage of two exceptional tax reform bills in 1981 and 1986.

Beginning with the Economic Recovery Tax Act of 1981 and culminating with the Tax Reform Act of 1986, compromise was a baseline expectation of political conduct in terms of budgets and taxes. The 1981 Act was ushered in with a spirit of compromise, with the primary catalyst being Reagan's overwhelming mandate by way of his landslide victory in the 1980 election. It is apparent that Reagan's overwhelming win encouraged the Democrats in Congress to compromise with Reagan in response to strong national sentiment. Further, the personalities involved in the legislative process during Reagan's administration were men open to the idea of principled compromise: Congressman Dan Rostenkowski; Speaker of the House Tip O'Neill; and, Reagan himself.

In contrast, this spirit of compromise began to wither in the early 1990s. George H.W. Bush's 1990 "no new taxes" compromise would be the last major tax bill to pass with significant bipartisan support. Bill Clinton's Omnibus Budget Reconciliation Act of 1993 passed without a single Republican vote; it did not need one, because Congress was Democrat-controlled. George W. Bush's 2001 Economic Growth and Tax Relief Reconciliation Act passed with minimal and begrudging bipartisan support, primarily because Bush benefited from a Republican-controlled

Congress during all but a small period of time during his presidency. Neither of these bills represented comprehensive tax reform, though Clinton's bill at least began to tackle the deficit.

Though beyond the primary scope of this research, it is important to note that this theme of bitter partisanship would continue to dominate American politics up to the time of this writing. Repeated controversies involving the national debt ceiling, attempts at budget sequestration, and use of filibuster to prevent legislative votes became the theme of budget and spending politics in the 2000s and beyond. This would culminate with the Patient Protection and Affordable Care Act of 2010, signed into law by President Barack Obama. The bill was filibustered by Republicans, and the debate around the bill was bitterly partisan. In order to pass the bill, the Democratically-controlled Congress was forced to employ seldom-used rules, known as budget reconciliation, to pass the act over the filibuster. There were also attempts made by conservatives in Congress to administratively rein in deficit spending by refusing to raise the debt ceiling; ultimately these were unsuccessful, but the level of brinksmanship involved in such a campaign served to sound an alarm to political purists.

The theme of partisanship and its effects on tax reform are clear: comprehensive, broad-based tax reform stands its best chance with a divided Congress and executive branch, strong party leadership, and centrist legislators willing to compromise without fear of electoral consequences. Divided executive and legislative branches appear to promote reconciliation, as both sides recognize the necessity of compromise. Since 1990, compromise-friendly conditions have deteriorated rapidly in American politics. An increase in polarity between both the Republican and Democratic parties, particularly in Congress, make it unlikely that the United States would be able to successfully implement broad tax reform anytime soon.

Though a number of presidential and Congressional candidates have offered tax reform as a part of their political platform since 2000, the collective political will to see such a movement through apparently does not exist. Individual legislators face retribution in their home districts when their votes in Washington compete with or deviate from home district expectations. Accordingly, they appear increasingly unwilling to be brought into the party fold at the expense of their re-election bids. Party leaders, particularly the House Speaker, have faced leadership challenges, a far cry from the solidarity achieved by Tip O’Neill in the 1980s. Tax reform, though widely desired, seems unlikely to occur in the United States unless conditions similar to those during the Reagan and George H.W. Bush administration can be replicated. The political stakes are high, and use of the deficit as a political tool allows the President and Congress to soften the electoral blow, or at least delay it.

#### **7.4 Taxes and Personal Liberty**

One critical theme that emerged in this research was the differing lenses through which presidents and Congresses viewed budget management and tax policy. Rather than view taxes and revenue through the lens of traditional budgeting, in the accounting sense, this research revealed that politicians during the period under study chose to view taxes through a politicized lens. Often this took the shape of taxes as either a usurpation of individual liberty, or as a civic duty to government. This is a critical point because it is apparent that many budgeting problems, though inherently political due to the political processes involved, are also non-political. Issues such as tax rates, population trends, the state of the economy, and demographics all impact budgets in a way that is not political. For example, one of the emerging issues in the American economy has been the effect of an aging population. The effects of such a large demographic shift are substantial: greater outlays for medical expenditures, pressure on insurance markets, and

the need for greater revenue to cover outlays under existing laws. These effects are apolitical. While politicians can argue about how to respond to them in political terms, the underlying issues themselves are beyond party lines. Accordingly, presidents during the period 1981-2001 usually viewed the response to such demographic issues as a struggle between individual liberty and collective responsibility.

For Republicans, particularly George W. Bush and Ronald Reagan, taxes were viewed as wealth that originated with the people, and therefore it inherently belonged to the people. Accordingly, tax revenues should be returned to the people when possible. George W. Bush made this particular argument strongly in pushing for tax cuts in 2001 that would cut into the surplus that had built over the decade of the 1990s (Bush, 2001: 3):

It's up to the American people; it's the American people's choice. We recognize, loud and clear, the surplus is not the Government's money. The surplus is the people's money, and we ought to trust them with their own money. This tax relief plan is principled. We cut taxes for every income-tax payer. We target nobody in; we target nobody out. And tax relief is now on the way.

In Bush's view, he made it clear that government should not hold a budget surplus or build one, because the government does not "need" the funds. Obviously Bush also intended the tax refunds created by the 2001 Act to be an economic stimulus as well, but he did not view the refunds themselves as a "use" of funds in the same way as he did if they were expended. As discussed previously in this research, such a surplus might have proven useful as a hedge against future uncertainties, such as terrorism and economic crises.

Reagan took a similar posture: he pushed for across-the-board rate reductions in individual taxes under the 1981 act, citing the fact that individual Americans knew better than the government how to spend their earnings (Reagan, 1981b: 7):

But by holding the people's tax reduction hostage to future economic events, they will eliminate the people's ability to plan ahead. Shopkeepers, farmers, and individuals will be denied the certainty they must have to begin saving or investing more of their money. And encouraging more savings and investment is precisely what we need now to rebuild our economy.

In hindsight, Reagan's comment about "holding the people's tax reduction hostage" is striking. Not only does it sum up Reagan's view of the issue – that tax reduction is a way to boost economic activity and promote individual freedom – it is a perfect parallel to Bush's positions 20 years later. It also foreshadowed Bush's miscalculation by also overlooking the government's own responsibility to "plan ahead." Though he was also unlucky in facing unprecedented economic challenges, Bush would have certainly benefited from holding a surplus as a type of emergency fund against future economic events, rather than returning it immediately to taxpayers.

Bill Clinton, as well as George H.W. Bush, took the view that paying taxes as part of a balanced budget was a collective responsibility that Americans had to the government, and to one another. This is a significantly different paradigm than Reagan and George W. Bush took on tax policy. In his 1993 speech before a Joint Session of Congress, Clinton outlined his view of this collective responsibility (Miller Center, 2015: 4):

Over the long run, all this will bring us a higher rate of economic growth, improved productivity, more high-quality jobs, and an improved economic competitive position in the world. In order to accomplish both increased investment and deficit reduction, something no American Government

has ever been called upon to do at the same time before, spending must be cut and taxes must be raised.

Clinton's view, in some sense, was that there were certain ideals that should be supported by the collective. In this case, budgetary responsibility dictated that Americans needed to pay more, because the government's fiscal health was the responsibility of all.

George H.W. Bush echoed this sentiment. Despite speaking vehemently against tax increases, Bush's pragmatic nature and collective view of government responsibility encouraged him to change his position, and perhaps compromised his potential for a second term as President (Bush, 1990: 2):

This agreement will also raise revenue. I'm not, and I know you're not, a fan of tax increases. But if there have to be tax measures, they should allow the economy to grow, they should not turn us back to higher income tax rates, and they should be fair. Everyone who can should contribute something, and no one should have to contribute beyond their fair share. Our bipartisan agreement meets these tests.

George H.W. Bush, like Clinton, viewed balancing the budget and deficit reduction as the responsibility of most, if not all Americans.

The idea of taxes as an ideological struggle between individual liberty and collective responsibility emerged strongly in the period 1981-2001. Clearly, the political party contributed to the positions of political figures: Republicans used an individual liberty argument to support tax cuts, while Democrats used a "civic duty" or collective responsibility argument to raise taxes. George H.W. Bush, as an exception, raised both arguments. When campaigning as the

Republican successor to Reagan, he pushed for lower taxes. However, as a pragmatic politician, when more revenue was required, he adopted the language of the collective view.

## **7.5 Rhetorical and Policy Differences**

This research also revealed an important trend exemplified by several U.S. presidents: they used rhetoric in a way that departed significantly from their actual policies, in terms of the role of government in tax policy. In particular, this manifested with Ronald Reagan and George W. Bush. Both Reagan and Bush touted themselves as traditional Conservatives, which would mean that in general they should traditionally support more limited government, lower taxes, and less expansive government services.

Ronald Reagan couched himself as a defender of traditional American values, individual liberty, and limited government. Primarily, this study considered “limited government” in terms of taxes and economic investment – more spending and revenue was interpreted as “more” government, while less spending and revenue was considered to be “less” government. In his first inaugural address, Reagan postured himself as believing in limited government (Reagan, 1981c: 1):

The economic ills we suffer have come upon us over several decades. They will not go away in days, weeks, or months, but they will go away. They will go away because we, as Americans, have the capacity now, as we have had in the past, to do whatever needs to be done to preserve this last and greatest bastion of freedom. In this present crisis, government is not the solution to our problem; government is the problem.

George W. Bush also ran on a plank of limited government, even going as far as to label his Democratic opponent Al Gore a “big spender” in the 2000 campaign cycle, stating: “He’s the

biggest spender we've ever had in the history of politics." (Sack, 2000: 1). In a speech to a Joint Congressional Session Bush also stated (American Presidency Project, 2016: 24):

Year after year in Washington, budget debates seem to come down to an old, tired argument: on one side, those who want more government, regardless of the cost; on the other, those who want less government, regardless of the need. We should leave those arguments to the last century, and chart a different course. Government has a role, and an important role. Yet, too much government crowds out initiative and hard work, private charity and the private economy. Our new governing vision says government should be active, but limited; engaged, but not overbearing. And my budget is based on that philosophy.

However, a number of analyses support the proposition that both Bush and Reagan expanded the government, both in terms of numbers of government employees per capita and in terms of government spending, annualized. In measures of government employees per population, George W. Bush was responsible for the largest increases in government employees per population between 1980 and 2010, at 7.4% from beginning to end of his term in office, with Reagan a close second (Patton: 2013). Bush was also the largest spender, with government spending growing at approximately 7.5% for both of his terms, with Reagan spending growth a close second, at around 6.5% across both of his terms (Ungar: 2012).

These analyses are independent of revenue decreases, such as tax rate reductions and credits. As every accountant is aware, spending can be achieved by both the use of assets and through the use of borrowed funds. Though Bush and Reagan reduced individual tax burdens and provided some corporate tax relief provisions, they did not reduce the size of government. Rather, they simply borrowed to increase the level of government services. This is ironic, given the ideological positions both men took. Despite public rhetoric to the contrary, each man relied

on government spending to achieve economic stability and growth. This covertly makes the case that the government has a critical role to play in the economy and lives of the average American, if only as a failsafe in times of catastrophe. Reagan used tax outlays to improve the economy, though with arguably mixed results. Bush used military spending, which is also governmental, to respond to 9/11 and to pursue military objectives in Afghanistan and Iraq. Later in his term, he would use astronomical sums to bail out financial institutions to prevent their failure. While these were unexpected events, when pressed both Reagan and Bush relied on government spending, and government lines of credit to accomplish major goals.

This finding is most interesting because of the “folklore” surrounding both Reagan and Bush. Both were clearly seen in popular culture as Republicans, conservatives, tax cutters, and waste-reducers. Reagan’s maintains legendary status among Conservatives. This was the image both presidents sought to cultivate. However, in examining tax outlays and expenditures across the period 1981-2001, and extending such analysis through the end of George W. Bush’s second term, a pattern emerges. It seems clear that Bush and Reagan continued to increase government spending; they simply ceased to “pay” for the spending with tax collections (Tax Policy Center: 2015c). In examining the trend line and relationship between outlays and tax collections across the time period 1981-2001, only George H.W. Bush and Bill Clinton slowed the overall increase in government spending. Coupled with their increased revenues, they achieved progress against the deficit (Tax Policy Center: 2015c). Ironically, Ronald Reagan and George W. Bush’s practical policies did not accurately reflect their rhetoric and their popular legacies. This begs the question: how can the public achieve greater understanding, or accountability for closing this rhetorical gap?

## 7.6 Conclusion

Since 1981, the United States tax code has expanded, becoming increasingly complex and nuanced. There have been few successful reform efforts that involved broad support across the political spectrum, for a common political goal. The most notable exception to this contention was the Tax Reform Act of 1986. In many ways it was the only “perfect storm” in American politics with respect to comprehensive tax reform: it relied on willing and capable party leaders; individual legislators, open to compromise; and, a president who paved the way with very public support for bipartisan efforts. It came with the requisite situational factors, including public support for reform, a pressing economic need, and a division of power in Washington that forced compromise onto the table. However, beyond the 1986 Act, there are few examples of government working to develop the tax code in a way that is pragmatic. It increasingly appears that the 1986 Tax Reform Act was a fleeting political anomaly.

Other than the 1986 Act, the trend from 1981-2001, and beyond, has instead been expansion of deficit spending, increased political polarity, and politicians’ use of inconsistent rhetoric that is out of line with actual policy. Tax increases are couched by politicians as civic duty, while tax decreases are said to be in defense of individual liberty. The budget deficit or surplus is no longer a concrete measure of responsibility, but a sinewy, vague suggestion for what ought to be done—unless the political cost is too high. The result is that over the twenty years examined, the United States has developed a complicated and inefficient tax system, a budgetary climate that shirks responsibility accounting, and an electorate that is unresponsive and minimally aware of these trends, and what they mean.

The Internal Revenue Code itself has also become a means to accomplish political ends, increasingly differentiating between groups of taxpayers and their particular activities rather than broadly generating revenue commensurate with economic activity. The Internal Revenue Code is instead built upon exceptions, with each exception creating a kind of political currency that individual legislators may use to “bring home” benefits to their constituents or respective political parties. Alternatively, the Code is used to punish political enemies or discourage undesirable activities. Constituents, increasingly, have punished their legislators when they compromise on issues, including the very notable example of George H.W. Bush and his “no new taxes” pledge. This has also extended to current issues, such as the United States’ debt ceiling, with individual legislators facing tremendous pressure to conform to their constituents’ demands, against the compromises suggested by party leaders. This divisiveness has increased the level of brinkmanship, and decreased the level of trust held between parties, colleagues in Congress, and between the American people and their government.

It remains to be seen the direction the United States’ tax system will take. However, as this research has demonstrated, true reform in tax policy requires special political conditions, the right personalities, and a unifying motive. The cycle of deficit spending, much of it generated under the George W. Bush presidency, continues to trouble the U.S. economy. Interest payments on the Federal debt remained the fourth largest government program, behind only Social Security, Medicare, and the military (National Priorities Project: 2016). As in previous years, a leader or leaders with the courage to risk their own political career, as George H.W. Bush did, and to a lesser extent Bill Clinton, will be needed to bring equilibrium to the federal budget. In addition, solving this leadership crisis also demands greater responsibility and understanding by the American people of the critical nature of long-term government needs. However, the inherent

nature of the individual is to respond to the current situation, or the present crisis. This kind of long-term vision is unlikely to spawn on its own, in the electorate. Rather, perhaps through a strong president, it may be possible in the future to open the conversation. Reagan certainly accomplished this, with his rhetoric around the Tax Reform Act of 1986. President Barack Obama has also done this, slowing government spending to the lowest rates since 1981. Such efforts may reduce the ever-growing distance between governmental revenue and expenditure, and the political and economic costs that accompany budget deficits.

## **REFERENCE LIST**

AMERICAN ENTERPRISE INSTITUTE. 2012. Did Reagan's tax cuts cause those big 1980s budget deficits? Or was it Paul Volcker's inflation fighting? [Online]. Available:

<https://www.aei.org/publication/did-reagans-tax-cuts-cause-those-big-1980s-budget-deficits-or-was-it-paul-volckers-inflation-fighting/> [Accessed 06/08/2016]

AMERICAN RHETORIC. 2001. George W. Bush Speech to the Joint Session of Congress.

American Rhetoric. [Online]. Available:

<http://www.americanrhetoric.com/speeches/stateoftheunion2001.htm> [Accessed 01/06/2014]

AMERICAN PRESIDENCY PROJECT. 2015a.

<http://www.presidency.ucsb.edu/ws/index.php?pid=25958>

AMERICAN PRESIDENCY PROJECT. 2015b. Clinton Remarks on Signing the Omnibus

Budget Reconciliation Act of 1993. August 10, 1993. [Online]. Available:

<http://www.presidency.ucsb.edu/ws/?pid=46972>

AMERICAN PRESIDENCY PROJECT. 2016. Bush Address Before a Joint Session of the

Congress on Administration Goals. February 27, 2001. [Online]. Available:

<http://www.presidency.ucsb.edu/ws/?pid=29643> [Accessed 2016/20/06].

Apache Bend Apartments, Ltd. v. United States (1993). 987 F.2d 1174, 1175 (5th Cir).

ARMAJANI, B. 2012. Three Keys to Breaking Government Gridlock. [Online]. Available:

<http://www.governing.com/topics/mgmt/col-three-keys-breaking-government-gridlock.html>

[Accessed 07/08/2012]

AUERBACH, A. & SLEMROD, J. 1997. The Economic Effects of the Tax Reform Act of 1986. *Journal of Economic Literature* XXXV, 589–632.

BABBIE, E. & MOUTON, J. 2009. **The Practice of Social Research**. Cape Town: Oxford University Press Southern Africa.

BARBER, E. 2014. George H.W. Bush honored for courage with 1990 tax hikes. Reuters. [Online]. Available: <http://www.reuters.com/article/us-usa-kennedy-bush-idUSBREA4308G20140505> [Accessed 20/06/2016]

BARTLETT, B. 2011. Much Ado About Nothing. Tax Notes, October 17, 2011.

BARTLETT, B. 2012. The Fiscal Legacy of George W. Bush. [Online]. Available: [http://economix.blogs.nytimes.com/2012/06/12/the-fiscal-legacy-of-george-w-bush/?\\_r=0](http://economix.blogs.nytimes.com/2012/06/12/the-fiscal-legacy-of-george-w-bush/?_r=0) [Accessed 20/06/2016].

BARTLETT, B. 2002. Government in Gridlock. National Center for Policy Analysis. November 6, 2002. [Online}. Available: [http://www.ncpa.org/sub/dpd/index.php?Article\\_ID=5972](http://www.ncpa.org/sub/dpd/index.php?Article_ID=5972) [Accessed 09/10/2015]

BALLASY, N. 2010. IRS Commissioner: ‘I Find the Tax Code Complex, So I Use a Preparer’ [Online]. Available: <http://www.cnsnews.com/news/article/irs-commissioner-i-find-tax-code-complex-so-i-use-preparer> [Accessed 04/06/2014]

BEACH, W. 2005. Measuring the Fairness of a Tax System. Testimony Before the House Ways and Means Committee. June 8, 2005. [Online] Available: <http://www.heritage.org/research/testimony/measuring-the-fairness-of-a-tax-system>

BEDARD, P. 2010. Tip O’Neill and Ronald Reagan a Model for Breaking Partisan Gridlock. US News and World Report. [Online]. Available: <http://www.usnews.com/news/blogs/washington->

[whispers/2010/02/17/tip-oneill-and-reagan-and-model-for-breaking-partisan-gridlock](#) [Accessed 12/01/2016].

BIERMAN, H. 1987. Deferred Taxes, Income and the 1986 Tax Reform Act. *Financial Analysts Journal*, Vol. 43, No. 3 pp. 72-73

BIOGRAPHICAL DIRECTORY OF THE US CONGRESS. 2015. Martin Olav Sabo. [Online]. Available: <http://bioguide.congress.gov/scripts/biodisplay.pl?index=S000005> [Accessed 06/10/2015]

BIOGRAPHICAL DIRECTORY OF THE US CONGRESS. 2015b. Newt Gingrich. [Online]. Available: <http://bioguide.congress.gov/scripts/biodisplay.pl?index=G000225> [Accessed 06/10/2015]

BIOGRAPHICAL DIRECTORY OF THE US CONGRESS. 2015c. Daniel Patrick Moynihan. [Online]. Available: <http://bioguide.congress.gov/scripts/biodisplay.pl?index=M001054> [Accessed 06/10/2015]

BIOGRAPHICAL DIRECTORY OF THE US CONGRESS. 2015d. Thomas P. O'Neill. [Online]. Available: <http://bioguide.congress.gov/scripts/biodisplay.pl?index=o000098> [Accessed 20/01/2016].

BIRNBAUM, J. & MURRAY, A. 1992. **Showdown at Gucci Gulch**. Vintage Books. Random House.

BLACK'S LAW DICTIONARY. 2015. [Online]. Available: <http://thelawdictionary.org/> [Accessed 06/08/2015]

- BLOCH, S. 2014. US Federal Deficits, Presidents, and Congress. [Online]. Available: <http://home.adelphi.edu/sbloch/deficits.html>
- BLOOMBERG. 2004. The Real Economic Legacy of Ronald Reagan. June 20, 2004. [Online]. Available: <http://www.bloomberg.com/bw/stories/2004-06-20/the-real-economic-legacy-of-ronald-reagan> [Accessed 24/01/2016]
- BLUEDOGDEMOCRATS.COM. 2016. [Online]. Available: <http://www.bluedogdems.com/> [Accessed 27/02/2016].
- BOEHNE. 2000. Economic Forecast Breakfast. January 7, 2000. [Online]. Available: [https://www.philadelphiafed.org/publications/speeches/boehne/2000/01-19-00\\_main-line-chamber](https://www.philadelphiafed.org/publications/speeches/boehne/2000/01-19-00_main-line-chamber) [Accessed 1/2/2016]
- BRIKCI, N. 2007. A guide to using qualitative research methodology. [Online]. Available: <http://fieldresearch.msf.org/msf/bitstream/10144/84230/1/Qualitative%20research%20methodology.pdf> [Accessed 10/06/2014]
- BROWNLEE, W.E. 1996. Federal Taxation in America. A Short History. Woodrow Wilson Center Press.
- BROWNSTEIN, R. 2000. Los Angeles Times. August 13, 2000.
- BUREAU OF LABOR STATISTICS. 2015. Data Tools. Databases, Tables, and Calculators by Subject. [Online]. Available: <http://data.bls.gov/pdq/SurveyOutputServlet>
- BURMAN, L. 2006. The Tax Reform Act of 2010. Tax Notes. October 23, 2006. Page 359
- BURMAN & PHAUP. 2012. Tax Expenditures, the Size and Efficiency of Government, and Implications for Budget Reform. **Tax Policy and the Economy**. Volume 26. University of Chicago Press, 2012, 93-124.

*Burwell v. Hobby Lobby*, 2014 134 S.Ct. 2751

BUSH, G.H.W. 1988. Acceptance Speech for the Republican Nomination. August 18, 1988. [Online]. Available: <http://www.presidency.ucsb.edu/ws/?pid=25955> [Accessed 08/07/2016]

BUSH, G. H.W. 1990. Address to the Nation on the Budget. October 2, 1990. [Online]. Available: <http://millercenter.org/president/speeches/speech-3427> [Accessed 24/05/2016]

BUSH, G.W. 2001. Remarks on Signing the Economic Growth and Tax Relief Reconciliation Act of 2001. June 7, 2001. [Online] Available:

<http://millercenter.org/president/gwbush/speeches/speech-3986> [Accessed 24/05/2016]

BUSH, G.W. 2004. State of the Union Address. January 4, 2004.

BUSH, G.W. 2008. State of the Union Address to the 110<sup>th</sup> Congress. January 8, 2008.

CANNON, C. 1995. Clinton Admits Tax Mistake, but Still Blames Republicans. The Baltimore Sun. [Online]. Available: [http://articles.baltimoresun.com/1995-10-](http://articles.baltimoresun.com/1995-10-19/news/1995292099_1_newt-gingrich-clinton-raising-taxes)

[19/news/1995292099\\_1\\_newt-gingrich-clinton-raising-taxes](http://articles.baltimoresun.com/1995-10-19/news/1995292099_1_newt-gingrich-clinton-raising-taxes) [Accessed 06/10/2015]

CARON, P. 2014. The media ignore the IRS scandal. **USA Today**. [Online]. Available: <http://www.usatoday.com/story/opinion/2014/05/12/president-obama-irs-scandal-watergate-column/8968317/>. [Accessed 15/06/2014]

CARTER LIBRARY. 2014. State of the Union Address 1981. [Online]. Available: <http://www.jimmycarterlibrary.gov/documents/speeches/su81jec.phtml> [Accessed 06/06/2014]

CASTANHEIRA, M. & NICODEME, G. 2012. On the Political Economics of Tax Reforms: Survey and Empirical Assessment. 1st March 2012. European Union Seventh Framework Programme.

CATO INSTITUTE. 1991. Summit on the Reagan Tax Cuts. Reagan Supply-Side Tax Cuts After Ten Years: Economic Miracle or Voodoo Economics? [Online]. Available: <http://www.c-span.org/video/?19852-1/reagan-tax-cuts-ten-years-later> [Accessed 07/01/2016]

CATO INSTITUTE. 2006. Tax Policy Under President Bush. [Online]. Available: <http://www.cato.org/publications/commentary/tax-policy-under-president-bush> [Accessed 27/01/2016]

CBPP. 2012. Center for Budget and Policy Priorities. Downturn and Legacy of Bush Policies Drive Large Current Deficits. [Online]. Available: <http://www.cbpp.org/research/downturn-and-legacy-of-bush-policies-drive-large-current-deficits> [Accessed 26/04/2016]

CITIZENS FOR TAX JUSTICE. 2000. In Defense of the Tax Reform Act of 1986. Citizens for Tax Justice Report. [Online]. Available: [http://ctj.org/ctjreports/2000/01/in\\_defense\\_of\\_the\\_1986\\_tax\\_reform\\_act.php](http://ctj.org/ctjreports/2000/01/in_defense_of_the_1986_tax_reform_act.php) [Accessed 02/12/2014]

CLINTON PRESIDENTIAL LIBRARY. 2015. Biography of William J. Clinton. [Online]. Available: <http://www.clintonlibrary.gov/william-j.-clinton-bio.html> [Accessed 3/27/2015]

CNNMoney. 2010: Taxes: What People Forget About Reagan. [Online]. Available: [http://money.cnn.com/2010/09/08/news/economy/reagan\\_years\\_taxes/index.htm](http://money.cnn.com/2010/09/08/news/economy/reagan_years_taxes/index.htm) [Accessed 5/1/20116]

COBHAM, A. 2005. Taxation Policy and Development. Oxford Council on Good Governance. [Online]. Available: [http://www.taxjustice.net/cms/upload/pdf/OCGG - Alex Cobham - Taxation Policy and Development.pdf](http://www.taxjustice.net/cms/upload/pdf/OCGG_-_Alex_Cobham_-_Taxation_Policy_and_Development.pdf). [Accessed 26/05/2014]

COMMISSION ON PRESIDENTIAL DEBATES. 2000a. October 11, 2000 Presidential Debate. [Online]. Available: <http://www.debates.org/?page=october-11-2000-debate-transcript> [Accessed 08/02/2016]

COMMISSION ON PRESIDENTIAL DEBATES. 2000b. October 17, 2000 Presidential Debate. [Online]. Available: <http://debates.org/index.php?page=october-17-2000-debate-transcript> [Accessed 08/02/2016]

COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET. 2015. Martin Sabo. [Online]. Available: <http://crfb.org/biography/martin-sabo> [Accessed: 06/10/2015]

CONGRESSIONAL BUDGET OFFICE. 1981. Effects of the 1981 Tax Act on the Distribution of Income and Taxes Paid. [Online]. Available: <https://www.cbo.gov/publication/16332?index=6173&type=0> [Accessed 08/01/2016]

CONGRESSIONAL BUDGET OFFICE. 1986. Staff Working Paper. Effects of the 1981 Act on Income and Taxes Paid. [Online]. Available: <https://www.cbo.gov/sites/default/files/99th-congress-1985-1986/reports/doc20a-entire.pdf> [Accessed 18/06/2016]

CONGRESSIONAL BUDGET OFFICE. 1993. Economic Outlook Fiscal Years 1994-1998. [Online]. Available: <https://www.cbo.gov/sites/default/files/103rd-congress-1993-1994/reports/93doc03.pdf> [Accessed 18/06/2016]

CONGRESSIONAL RECORD. 2001a. 147 Cong. Rec. H5380-H5386 (2001). September 5, 2001. [Online] Available: <https://www.congress.gov/congressional-record/2001/9/5/house->

[section/article/h5380?q=%7B%22search%22%3A%5B%221993+budget%22%5D%7D&resultIndex=17](http://www.congress.gov/congressional-record/2001/3/8/house-section/article/h761-3?q=%7B%22search%22%3A%5B%221993+budget%22%5D%7D&resultIndex=17) [Accessed 05/02/2016]

CONGRESSIONAL RECORD. 2001b. March 15, 2001 [Online] Available:

<https://www.congress.gov/congressional-record/2001/3/8/house-section/article/h761-3?q=%7B%22search%22%3A%5B%222001+tax%22%5D%7D&resultIndex=6> [Accessed 06/02/2016]

CONGRESSIONAL RECORD. 2001c. May 25, 2001 [Online] Available:

<https://www.congress.gov/crec/2001/05/25/CREC-2001-05-25-bk2.pdf> [Accessed 05/03/2016]

CONGRESSIONAL RECORD. 2002a. February 5, 2002. [Online] Available:

<https://www.congress.gov/congressional-record/2002/2/5/senate-section/article/s316-1?q=%7B%22search%22%3A%5B%222001+tax%22%5D%7D&resultIndex=2> [Accessed 06/02/2016]

CORDES, J. 1999. Horizontal Equity. The Encyclopedia of Taxation and Tax Policy. Tax Policy Center. [Online]. Available: <http://www.taxpolicycenter.org/publications/url.cfm?ID=1000533> [Accessed 03/24/2015].

CORKER, R. et al. 1989. Tax Policy and Business Investment in the United States: Evidence from the 1980s. Staff Papers- International Monetary Fund, Vol. 36, No. 1 (Mar.1989), pp. 31-36

COWAN, D. 1981. Reagan's 3-year 25% Tax Cut Voted by Wide Margins in House and Senate. New York Times. July 30, 1981. [Online]. Available:

<http://www.nytimes.com/1981/07/30/politics/30REAG.html> [Accessed 26/01/2016]

CSPAN, 1986. Senate Session to Debate HR 3838. September 27, 1986. [Online] Available:

<http://www.c-span.org/video/?45951-1/senate-session>. [Accessed: 12/10/2015]

<http://www.c-span.org/video/?47271-1/budget-reconciliation-legislation> [Accessed 04/10/2015].

CSPAN, 1993a. Budget Reconciliation Legislation. Public Meeting Prior to Closed Door Session. July 15, 1993. [Online] Available: <http://www.c-span.org/video/?45326-1/budget-reconciliation-legislation>. [Accessed: 03/10/2015]

CSPAN, 1993b. Interview with reporters. [Online]. Available: <http://www.c-span.org/video/?47134-1/housesenate-budget-negotiations> [Accessed 04/10/2015].

CSPAN, 1993c. Interview with John Kyl. [Online]. Available:

CSPAN, 1993d. Press Conference with Dennis DeConcini. July 30, 1993. [Online] Available: <http://www.c-span.org/video/?47264-1/budget-reconciliation-legislation>. [Accessed: 03/10/2015]

CSPAN, 1993e. Interview in Live Call-in program. August 2, 1993. [Online] Available: <http://www.c-span.org/video/?47387-1/events-news> [Accessed: 03/10/2015]

CSPAN, 1993f. Interview in Live Call-in program. August 10, 1993. [Online] Available: <http://www.c-span.org/video/?48270-1/budget-reconciliation-legislation> [Accessed: 06/10/2015]

CSPAN. 1993g. House Republican Conference Forum. August 11, 1993. [Online] Available: <http://www.c-span.org/video/?48455-1/budget-reconciliation-act> [Accessed: 06/10/2015]

CSPAN. 1993h. Press Conference. August 6, 1993. [Online] Available: <http://www.c-span.org/video/?48003-1/constitutionality-retroactive-taxation> [Accessed: 06/10/2015]

CSPAN. 1993i. Economic Roundtable. [Online] Available: <http://www.c-span.org/video/?45331-1/budget-reconciliation-legislation> [Accessed: 06/10/2015]

CSPAN. 1993j. House Debate on Republican Substitute. [Online] Available: <http://www.c-span.org/video/?41206-1/budget-reconciliation-republican-substitute> [Accessed: 15/10/2015]

CSPAN. 1999. National Association of Manufacturers. [Online]. Available: <https://www.c-span.org/video/?151853-1/tax-cut-legislation> [Accessed 08/01/2016]

CSPAN. 2001. Alan Greenspan speech on tax policy. [Online]. Available: <https://www.c-span.org/video/?162141-1/fiscal-policy> [Accessed 08/01/2016]

DAVIES, D. 1986. United States Taxes and Tax Policy. Cambridge University Press.

DELUCA, M. 1993. Lobbying Allowance Provisions of the Omnibus Budget Reconciliation Act of 1993. Tax Executive. November 1<sup>st</sup> 1993. [Online]. Available: <http://www.thefreelibrary.com/Lobbying+disallowance+provisions+of+the+Omnibus+Budget+Reconciliation...-a014673624>. [Accessed 29/03/2015]

DEMOCRACYNOW. 2001. Vermont Senator Jeffords Defects from the Republican Party. [Online]. Available: [http://www.democracynow.org/2001/5/25/vermont\\_senator\\_james\\_jeffords\\_defects\\_from](http://www.democracynow.org/2001/5/25/vermont_senator_james_jeffords_defects_from) [Accessed 10/03/2016]

DUBIN, J. 2004. Criminal Investigation Enforcement Activities and Taxpayer Noncompliance. IRS Research Conference 2004. [Online]. Available: <http://www.irs.gov/pub/irs-soi/04dubin.pdf>. [Accessed 04/06/2014]

ENTIN, S. 1991. The slump: Causes and cures, The Wall Street Journal, A16. October 30, 1991.

EVANS, M. 2008. The New Rules for Limited Tax Benefits in Tax Legislation. Tax Analysts. Tax Notes Special Report. May 12, 2008. P. 597-598

EVANS, O. & KENWARD, L. 1988. Macroeconomic Effects of Tax Reform in the United States. Staff Papers - International Monetary Fund, Vol. 35, No. 1 (Mar., 1988), pp. 141-165

FEC. 1993. <http://www.fec.gov/pubrec/fe1992/federalections92.pdf>

FEDERAL HIGHWAY TAX ADMINISTRATION, 1993. Available:

<http://www.fhwa.dot.gov/infrastructure/gastax.cfm>. [Accessed 03/10/2015]

FEDERAL RESERVE HISTORY. 2016. Alan Greenspan. [Online]. Available:

<http://www.federalreservehistory.org/People/DetailView/6> [Accessed 08/01/2016]

GENERAL ACCOUNTING OFFICE, 1993. Tax Expenditures Deserve More Scrutiny. June

1994. [Online] Available: <http://www.gao.gov/products/GGD/AIMD-94-122>

GEPHARDT, R. 2010. Statement before the Senate Finance Committee. [Online]. Available:

<http://www.finance.senate.gov/imo/media/doc/92310DGTEST.pdf> [Accessed 20/06/2016].

GEPHARDT COLLECTION. 2014. The Bradley-Gephardt Fair Tax. Missouri Natural History Museum. [Online] Available:

<http://gephardt.mohistory.org/timeline/enlarge.php?image=RAG1096AM.jpg> [Accessed 17.12.2014]

GLECKMAN, H. 2009. Jack Kemp. TaxVox Tax Policy Center Blog. [Online]. Available:

<http://taxvox.taxpolicycenter.org/2009/05/03/jack-kemp/> [Accessed 10/12/2014]

GLSNE, C. 2011. **Becoming Qualitative Researchers**. Fourth Edition. Pearson Education.

GOVTRACK. 2015. S. 2817 (97th): Fair Tax Act of 1982. [Online]. Available:

<https://www.govtrack.us/congress/bills/97/s2817> [Accessed 08/01/2016]

GOVTRACK. 2015b. H.R. 4242 (97th): Economic Recovery Tax Act of 1981. [Online]. Available: <https://www.govtrack.us/congress/bills/97/hr4242> [Accessed 08/01/2016]

GOVTRACK. 2015c. H.R. 1836 (107<sup>th</sup>) Economic Growth and Tax Relief Reconciliation Act of 2001. [Online]. Available: <https://www.govtrack.us/congress/bills/107/hr1836> [Accessed 10/03/2016]

HALL, A. 1993. OBRA 1993: What Taxpayers Can Expect in 1994. Tax Foundation Special Report No. 26. [Online]. Available: <http://taxfoundation.org/article/obra-1993-what-taxpayers-can-expect-1994>

HENDERSON, R. 2006. Stuck: Why it's so hard to do new things in old organizations Massachusetts Institute of Technology. [Online]. Available: <http://video.mit.edu/watch/stuck-why-its-so-hard-to-do-new-things-in-old-organizations-9319/> [Accessed 20/01/2016].

HOFFMAN, HOELZL, & KIRCHLER 2012. Preconditions of Voluntary Tax Compliance: Knowledge and Evaluation of Taxation, Norms, Fairness, and Motivation to Cooperate. National Institutes of Health. [Online]. Available: <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3303158/> [Accessed 17/12/2015)

HOLID, D. & LABATE, L. 1985. Individual Income Tax Rates, 1985. IRS Publication. Available: [http://r.search.yahoo.com/\\_ylt=AwrBT79e\\_5RUXYEA6zBXNvoA;\\_ylu=X3oDMTBvMG04Z2o2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkAw--/RV=2/RE=1419079646/RO=10/RU=http%3a%2f%2fwww.irs.gov%2fpub%2firs-soi%2f85inintxr.pdf/RK=0/RS=HpfIHBrzG0O0JSSuH6X6e.JwxV4-](http://r.search.yahoo.com/_ylt=AwrBT79e_5RUXYEA6zBXNvoA;_ylu=X3oDMTBvMG04Z2o2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkAw--/RV=2/RE=1419079646/RO=10/RU=http%3a%2f%2fwww.irs.gov%2fpub%2firs-soi%2f85inintxr.pdf/RK=0/RS=HpfIHBrzG0O0JSSuH6X6e.JwxV4-)

INSIDE POLITICS. 2001. Democrats say Bush's comments helped bring downturn. March 15, 2001. [Online]. Available:

<http://www.cnn.com/2001/ALLPOLITICS/03/15/democrats.tax.cuts/index.html> [Accessed 06/02/2016].

INTERNAL REVENUE SERVICE. 2013a. Publication 556. [Online]. Available: <http://www.irs.gov/pub/irs-pdf/p556.pdf>. [Accessed 17/06/2014]

INTERNAL REVENUE SERVICE. 2014a. The Truth About Frivolous Tax Arguments. [Online]. Available: [http://www.irs.gov/pub/irs-utl/friv\\_tax.pdf](http://www.irs.gov/pub/irs-utl/friv_tax.pdf). [Accessed 11/06/2014]

INTERNAL REVENUE SERVICE. 2014b. Form 1040. [Online]. Available: <http://www.irs.gov/uac/Form-1040,-U.S.-Individual-Income-Tax-Return>. [Accessed 14/06/2014]

IRS TAXPAYER ADVOCATE SERVICE. 2012. Report to Congress. Volume One. [Online]. Available: <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Most-Serious-Problems-Tax-Code-Complexity.pdf> [Accessed 6/12/2014]

JACK KEMP FOUNDATION. 2014. Who Was Jack Kemp? [Online] Available: [www.jackkempfoundation.org](http://www.jackkempfoundation.org) [Accessed 15/12/2014]

JEFFREY, T. 2011. Reagan's Farewell Regret. [Online]. Available: [http://townhall.com/columnists/terryjeffrey/2011/02/09/reagans\\_farewell\\_regret\\_deficit\\_hed\\_put\\_nation\\_on\\_track\\_to\\_eliminate](http://townhall.com/columnists/terryjeffrey/2011/02/09/reagans_farewell_regret_deficit_hed_put_nation_on_track_to_eliminate) [Accessed 18/05/2016]

JEFFREY, T. 2015. Debt Headed to 103% of GDP. CNS News. [Online]. Available: <http://www.cnsnews.com/news/article/terence-p-jeffrey/> [Accessed 06/08/2016]

JOINT COMMITTEE ON TAXATION. 1986. General Explanation of the Tax Reform Act of 1986. [Online]. Available: <http://www.jct.gov/jcs-10-87.pdf> [Accessed 20/06/2016]

JOINT COMMITTEE ON TAXATION. 1993. Summary of the Revenue Provisions of the Omnibus Budget Reconciliation Act of 1993. Staff of the Joint Committee on Taxation. August 23, 1993.

JOINT COMMITTEE ON TAXATION. 2001. Summary of Provisions Contained in the Conference Agreement for H.R. 1836, the Economic Growth and Tax Relief Act of 2001. May 26, 2001. JCX-50-01

JOINT ECONOMIC COMMITTEE, 1996. The Reagan Tax Cuts: Lessons for Tax Reform. Joint Economic Committee Report. [Online]. Available:  
<http://crab.rutgers.edu/~mchugh/taxes/The%20Reagan%20Tax%20Cuts%20Lessons%20for%20Tax%20Reform.htm> [Retrieved 11/12/2015]

KAMERY, 2004. A Brief Review of the Recession of 1990-1991. Allied Academies International Conference.  
[http://www.sbaer.uca.edu/research/allied/2004\\_mauai/legal\\_ethical\\_regulatory\\_issues/14.pdf](http://www.sbaer.uca.edu/research/allied/2004_mauai/legal_ethical_regulatory_issues/14.pdf)

KASICH, J. 2013. John Kasich for America. Campaign website. [Online}. Available:  
[www.johnkasich.com](http://www.johnkasich.com) [Accessed 11/10/2015]

KATZ, B. 2015. What the US Government Can Learn from Pope Francis. Napa Valley Register. September 26, 2015. [Online]. Available: <http://napavalleyregister.com/news/opinion/editorial> [Accessed 11/10/2015].

KAWA, L. 2013. How Clinton's Surplus Became a 6 Trillion Dollar Deficit. Business Insider. [Online]. Available: <http://www.businessinsider.com/how-clinton-surplus-became-a-6t-deficit-2013-1>. [Accessed 15/05/2016]

KEMP, J. 1985. Statement on the Kemp-Kasten Fair and Simple Tax. January 30, 1985. [Online] Available: <http://www.jackkempfoundation.org/kemp-legacy-project/locally-hosted-kemp-collection/?pg=5>

KLOTT, G. 1986. Tax Transition Rules Detailed. The New York Times. September 20, 1986. [Online]. Available: <http://www.nytimes.com/1986/09/20/business/tax-transition-rules-detailed.html>

KUTTNER, R. 2008. Obama's Challenge. Chelsea Green Publishing. 114

LEWANDOWSKI, M. 2008. Harvard Law School. Federal Budget Policy Seminar Paper #37. [Online]. Available: [http://www.law.harvard.edu/faculty/hjackson/2001-2003TaxCuts\\_37.pdf](http://www.law.harvard.edu/faculty/hjackson/2001-2003TaxCuts_37.pdf) [Accessed 10/03/2016]

LIBRARY OF CONGRESS. 2014. Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Control Act of 1985. Bill Summary. [Online]. Available: <http://thomas.loc.gov/cgi-bin/bdquery/z?d099:SN01702:@@@D&summ2=m&>

LOS ANGELES TIMES. 1986. Rostenkowski Vows to Keep Tax Breaks for Middle-Income Payers. Los Angeles Times. [Online] Available: [http://articles.latimes.com/1986-07-13/news/mn-20741\\_1\\_tax-rates](http://articles.latimes.com/1986-07-13/news/mn-20741_1_tax-rates) [Accessed 28.11.2014]

LOS ANGELES TIMES. 1999. Clinton Vetoes What He Calls "Bloated" GOP Tax Cut Bill. Los Angeles Times [Online] Available: <http://articles.latimes.com/1999/sep/24/news/mn-13506> [Accessed 02/02/2016]

MAHER, B, 2016. An Inside Look at the Reagan Revolution, Part I. [Online]. Available: <https://dailyreckoning.com/85145-2/> [Accessed 08/03/2017]

MALONE, J. 1983. Reagan's boll weevil friends get warning. Christian Science Monitor. January 5<sup>th</sup>, 1983. [Online]. Available: <http://www.csmonitor.com/1983/0105/010542.html> [Accessed 25/01/2016]

MANUEL, D. A History of Surpluses and Deficits in the United States. [Online]. Available <http://www.davemanuel.com/history-of-deficits-and-surpluses-in-the-united-states.php> [Accessed 14/01/2016]

MCCALED, T. 1984. Deficits and Taxes: Federal Budget and Fiscal Policy in the 1980s. Cato Institute. [Online]. Available: [www.cato.org/publications/policyanalysis/deficits-taxes-federal-budget-fiscal-policy-1980s](http://www.cato.org/publications/policyanalysis/deficits-taxes-federal-budget-fiscal-policy-1980s) [Accessed 13/10/2015]

MCCLATCHY. 2007. Expiration of Tax Cuts Sparks Battle in Congress. May 4, 2007. [Online]. Available: <http://www.mcclatchydc.com/news/politics-government/congress/article24463450.html> [Accessed 08/02/2016]

MCCLURE, C. 1988. The 1986 Act: Tax Reform's Finest Hour or Death Throes of the Income Tax? National Tax Journal 41(3), 303-315  
 MCCLURE, C. 1992. The Political Economy of Tax Reforms and Their Implications for Interdependence. **The Political Economy of Tax Reform**. NBER-EASE Volume 1. University of Chicago Press. 97-116

MCDOWELL, W.H. 2002. **Historical Research: A Guide**. Pearson Education Limited.

MCKERCHAR, M. 2008, Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation. [Online] eJournal of tax Research.p1 – 21. Available: <http://www.austlii.edu.au/au/journals/eJTR/2008/1.html> (Accessed 7/4/2014).

MILLER CENTER. 2011. Jack Kemp and the Tax Reforms of 1981 and 1986. The Jack Kemp Oral History Project. [Online] Miller Center for Public Affairs at the University of Virginia.

Available: <http://millercenter.org/conferences/2011/kempk> [Accessed 16/12/2014]

MILLER CENTER. 2015. Bill Clinton, Address Before A Joint Session of Congress. February 17, 1993. [Online] Miller Center for Public Affairs at the University of Virginia. Available:

<http://millercenter.org/president/speeches/speech-3435> [Accessed 16/10/2015]

MILLER CENTER. 2016. George W. Bush: Domestic Affairs. [Online] Miller Center for Public Affairs at the University of Virginia. Available:

<http://millercenter.org/president/biography/gwbush-domestic-affairs> [Accessed 20/04/2016]

MITCHELL, M. 2013. A Time When Politicians Tried to Coax ‘the Opposition’ to their View.

February 28, 2013. [Online] Neighborhood Effects. Mercatus Center at George Mason

University. Available: <http://neighborhoodeffects.mercatus.org/2013/02/28/a-time-when-politicians-tried-to-coax-the-opposition-to-their-view/> (Accessed 29/11/2014)

MUCENSKI-KECK, L. 2012. U.S. Corporate Tax Reform Proposals. The CPA Journal.

December 2012.

National Federation of Independent Business v. Sebelius, 2012 132 S.Ct 2566

NATIONAL PRIORITIES PROJECT. 2016. Available:

<https://www.nationalpriorities.org/budget-basics/federal-budget-101/spending/>. [Accessed 25/05/2016]

NEWMAN, R. 2013. Why A Bill Clinton Style Budget Miracle Won’t Happen Again. US News.

[Online]. Available: <http://www.usnews.com/news/blogs/rick-newman/2013/02/20/why-a-bill-clinton-style-budget-miracle-wont-happen-again> [Accessed 018/05/2016]

NEW YORK TIMES. 1981a. Conservative Democrats Urge More Budget Cuts. March 6, 1981. [Online]. Available: <http://www.nytimes.com/1981/03/06/us/conservative-democrats-urge-more-budget-cuts.html> [Accessed 26/01/2016]

NEW YORK TIMES. 1981b. The Troubles of Tip O'Neill. August 16, 1981.

NEW YORK TIMES. 1981c. Reagan Exemptions Make the Budget Fight Even Grittier. New York Times. February 15, 1981. [Online]. Available: <http://www.nytimes.com/1981/02/15/weekinreview/major-news-in-summary-reagan-exemptions-make-the-budget-fight-even-grittier.html> [Accessed 26/01/2016]

NEW YORK TIMES. 2010. Dan Schneider. Dan Rostenkowski, Lawmaker, is Dead at 82. [Online]. Available: [http://www.nytimes.com/2010/08/12/us/politics/12rostenkowski.html?\\_r=0](http://www.nytimes.com/2010/08/12/us/politics/12rostenkowski.html?_r=0) [Accessed 18/06/2016]

O'NEILL, T. 1988. Man of The House: the Life and Political Memoirs of Tip O'Neill.

O'NEILL, J. 2001. The Story of the Surplus. Hoover Institution. [Online]. Available: <http://www.hoover.org/research/story-surplus> [Accessed 07/01/2016].

O'NEILL, T. 2012. Frenemies: A love story. [Online]. Available: [http://campaignstops.blogs.nytimes.com/2012/10/05/frenemies-a-love-story/?\\_r=0](http://campaignstops.blogs.nytimes.com/2012/10/05/frenemies-a-love-story/?_r=0) [Accessed 20/01/2016]

PATTON, M. 2013. The Growth of Government: 1980-2012. Forbes. January 24, 2013. [Online]. Available: <http://www.forbes.com/sites/mikepatton/2013/01/24/the-growth-of-the-federal-government-1980-to-2012/#78f4f8c777bd> [Accessed 24/05/2016]

PATTON, M.Q. 2002. **Qualitative Research & Evaluation Methods**. Sage Publications.

PECHMAN, J. 1990. Why We Should Stick with the Income Tax. *The Brookings Review*, Vol. 8, No. 2 (Spring, 1990), pp. 9-19

PETERSON, P. 1985. The New Politics of Deficits. *Political Science Quarterly*, Vol. 100, No. 4 (Winter, 1985-1986), pp. 575-601

PETHOKOUKIS, J. 2014. Did Reagan's tax cuts cause those big 1980s budget deficits? Or was it Paul Volcker's inflation fighting? American Enterprise Institute. [Online]. Available: <http://www.aei.org/publication/did-reagans-tax-cuts-cause-those-big-1980s-budget-deficits-or-was-it-paul-volckers-inflation-fighting/> [Accessed 09/11/2014]

PEW RESEARCH, 2010. Reagan's Recession. [Online]. Available: <http://www.pewresearch.org/2010/12/14/reagans-recession> [Accessed 11/21/2015].

POLLACK, S. 1996. *The Failure of U.S. Tax Policy. Revenue and Politics*. Pennsylvania State University Press.

PPSSC. 1984. President's Cost Control Commission Discloses 424 Billion in Waste. Press Release. [Online]. Available: <http://digital.library.unt.edu/ark:/67531/metacrs9044/m1/>

PRASAD, M. 2012. The Popular Origins of Neoliberalism in the Reagan Tax Cut of 1981. *Journal of Policy History* (24, 3) 351-383

PRESIDENT'S REPORT TO CONGRESS. 1994. [Online]. Available: [http://www.presidency.ucsb.edu/economic\\_reports/1994.pdf](http://www.presidency.ucsb.edu/economic_reports/1994.pdf) [Accessed 08/01/2016]

PURDUM. 1995. Clinton Angers Friend and Foe in Tax Remark. New York Times. [Online] Available: <http://www.nytimes.com/1995/10/19/us/clinton-angers-friend-and-foe-in-tax-remark.html> [Accessed 06/10/2015]

RAHN, R. 2009. The Worst Recession? Washington Times. October 14, 2009. [Online]. Available: <http://www.cato.org/publications/commentary/worst-recession> [Accessed 20/10/2015]

RAUB, B. 2005. Recent Changes in the Estate Tax Exemption Level and Filing Population. [Online]. Available: <http://www.irs.gov/pub/irs-soi/05estate.pdf>. [Accessed 04/06/2014]

REAGAN, R. 1980. Televised Campaign Address. A Vital Economy: Jobs, Growth, and Progress for Americans. 10/24/1980. [Online}. Available: <http://www.reagan.utexas.edu/archives/reference/10.24.80.html> [Accessed 14/01/2016]

REAGAN, R. 1981. Address to the Nation on the Economy. February 5, 1981. [Online]. Available: <https://www.reagan.utexas.edu/archives/speeches/1981/20581c.htm> [Accessed 20/01/2016].

REAGAN, R. 1981b. Address on Federal Tax Reduction Legislation. July 27, 1981. [Online]. Available: <http://millercenter.org/president/reagan/speeches/speech-5676> [Accessed 24/05/2016]

REAGAN, R. 1981c. First Inaugural Address. January 7, 1981. [Online]. Available: <http://www.heritage.org/initiatives/first-principles/primary-sources/reagans-first-inaugural-government-is-not-the-solution-to-our-problem-government-is-the-problem> [Accessed 24/05/2016]

REAGAN, R. 1982. Address Before a Joint Session of the Congress Reporting on the State of the Union. January 26, 1982. [Online]. Available: <http://www.reagan.utexas.edu/archives/speeches/1982/12682c.htm> [Accessed 16/10/2014]

REAGAN, R. 1982b. Address to the Nation on Federal Tax and Budget Reconciliation Legislation. August 16, 1982. [Online]. Available:

<http://www.reagan.utexas.edu/archives/speeches/1982/81682a.htm> [Accessed 11/10/2015]

REAGAN, R. 1985. Address to the Nation on the Federal Budget and Deficit Reduction. April 24, 1985. [Online]. Available:

<http://www.reagan.utexas.edu/archives/speeches/1985/42485b.htm> [Accessed 16/10/2014]

REAGAN, R. 1986a. State of the Union Address, February 9, 1986. [Online]. Available:

<http://www.presidency.ucsb.edu/ws/index.php?pid=36646> [Accessed 05/10/2014]

REAGAN, R. 1986b. Message to the Congress Transmitting the Annual Economic Report of the President. February 6, 1986. [Online]. Available:

<http://www.reagan.utexas.edu/archives/speeches/1986/20686d.htm> [Accessed 17/10/2014]

REAGAN, R. 1989. Farewell Address to the Nation. January 11, 1989. [Online]. Available:

<http://www.presidency.ucsb.edu/ws/?pid=29650>

REAGAN, R. 1990. An American Life. pp. 232

REDBURN, T. 1986. Metzenbaum Seeks to Curb 'Transition Rules' : Exemptions in Tax Bill Under Fire. Los Angeles Times. June 16, 1986. [Online]. Available:

[http://articles.latimes.com/1986-06-16/news/mn-10849\\_1\\_tax-bill](http://articles.latimes.com/1986-06-16/news/mn-10849_1_tax-bill)

ROBERTS, C. 1993. Clinton's Budget Isn't Just Bad It's Unconstitutional. Bloomberg Business. August 29, 1993, p. 2. [Online]. Available: [www.bloomberg.com/bw/stories/1993-08-](http://www.bloomberg.com/bw/stories/1993-08-29/clintons-budget-isnt-just-bad-its-unconstitutional)

[29/clintons-budget-isnt-just-bad-its-unconstitutional](http://www.bloomberg.com/bw/stories/1993-08-29/clintons-budget-isnt-just-bad-its-unconstitutional) [Accessed 08/10/2015]

ROBERTS, S. 1981. 3 Conservative Democrats Wary on Tax Cuts. New York Times. May 17, 1981. [Online]. Available: <http://www.nytimes.com/1981/05/17/us/3-conservative-democrats-wary-on-tax-cut.html> [Accessed 26/01/2016]

ROBSON, J. 2015. Today in History: Reagan's Economic Recovery Tax Act. Rebel Media. [Online]. Available: <https://www.youtube.com/watch?v=NsR5ZkZkGAI> [Accessed 11/12/2015]

ROSENBAUM, D. 1986. The Senate Tax Plan: The Lawmakers and What They Forged; Tax Writers Discover Little Favors Mean A Lot. The New York Times. May 9, 1986.

ROSENBAUM, D. 1993. New York Times. August 7<sup>th</sup>, 1993. Available: <http://www.nytimes.com/1993/08/07/us/budget-struggle-clinton-wins-approval-his-budget-plan-gore-votes-break-senate.html> [Accessed 15/10/2015]

ROSTENKOWSKI, D. 1981. Speech to Chicago Chamber of Commerce. April 9, 1981.

SACK, K. 2000. THE 2000 CAMPAIGN: THE VICE PRESIDENT; For Limited Government? That's Me, Gore Says. The New York Times. October 25, 2000. [Online]. Available: <http://www.nytimes.com/2000/10/25/us/the-2000-campaign-the-vice-president-for-limited-government-that-s-me-gore-says.html> [Accessed 24/05/2016]

SCHOLTZ, T; MCGRAW, K. & STEENBERGEN, M. 1992. Journal of Economic Psychology. 13(4), 625–656.

SCHROEDER, P. 2004. Nothing Stuck to Teflon President. June 6, 2004. [Online]. Available [http://usatoday30.usatoday.com/news/opinion/editorials/2004-06-06-schroeder\\_x.htm](http://usatoday30.usatoday.com/news/opinion/editorials/2004-06-06-schroeder_x.htm) [Accessed 18/10/2014]

SENATE FINANCE COMMITTEE. 2010. Tax Reform: Lessons from the Tax Reform Act of 1986 Statement of Dick Gephardt, President and CEO of Gephardt Government Affairs and Former House Democratic Leader. September 23, 2010. [Online]. Available: <http://www.gephardtdc.com/articles/092310-SenateFinanceTestimony.php> [Accessed 24/11/2014]

SLEMROD, J. 1992. Do Taxes Matter? Lessons from the 1980s. The American Economic Review, Vol. 82, No. 2, Papers and Proceedings of the Hundred and Fourth Annual Meeting of the American Economic Association (May, 1992), pp. 250-256

SMITH, H. 1981. Rostenkowski: Tax Pragmatist. New York Times. June 4, 1981. [Online]. Available: <http://www.nytimes.com/1981/06/04/business/rostenkowski-tax-pragmatist.html> [Accessed 24/01/16]

STELSEL, D. 2011. 2012 U.S. Federal Budget and a History of Federal Government Outlays Since 1940. [Online]. Available: <http://www.valeofinancial.com/2011/02/2012-u-s-federal-budget-and-a-history-of-federal-government-outlays-since-1940/> [Accessed 18/05/16]

STENHOLM, C. 2015. How Ronald Reagan and Tip O'Neill Would Make this Congress Work. The Hill. [Online]. Available: <http://thehill.com/blogs/pundits-blog/lawmaker-news/235409-how-ronald-reagan-and-tip-oneill-would-make-this-congress> [Accessed 11/1/2016]

STONE, L. 2014. Inflation Indexing in the Individual Income Tax. Testimony before the Maryland House Ways and Means Committee. Tax Foundation. February 18, 2014. [Online]. Available: <http://taxfoundation.org/article/inflation-indexing-individual-income-tax> [Accessed 17/12/2014]

TAX ANALYSTS. 2006. *Tax Reform 20 Years Later: Time for Another Round?*. [Online]. Available: [http://webarchive.urban.org/UploadedPDF/411375\\_tax\\_reform.pdf](http://webarchive.urban.org/UploadedPDF/411375_tax_reform.pdf) [Accessed 05/08/2016]

TAX ANALYSTS. 2014. Tax History Project. [Online]. Available: <http://www.taxhistory.org/www/website.nsf/Web/1040TaxForms?OpenDocument>. [Accessed 12/06/2014]

TAX FOUNDATION. 1983a. Evolution of the Federal Tax System: 1954-1983. [Online]. Available: <http://www.taxfoundation.org/article/retrospective-1981-reagan-tax-cut> [Accessed 20/10/2015]

TAX FOUNDATION. 1983b. Restrospective on the 1981 Reagan Tax Cut. [Online]. Available: <http://www.taxfoundation.org/article/retrospective-1981-reagan-tax-cut> [Accessed 20/10/2015]

TAX FOUNDATION. 2013. U.S. Federal Individual Income Tax Rates History, 1862-2013. [Online]. Available: <http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets> [Accessed 08/06/2014]

TAX FOUNDATION. 2014. Inflation Indexing in the Individual Income Tax. February 18, 2014. [Online]. Available: <http://taxfoundation.org/article/inflation-indexing-individual-income-tax> [Accessed 08/06/2014]

TAX POLICY CENTER. 2011. Selected Provisions of Major Tax Legislation by Act 1981 to 2010. [Online]. Available: [http://www.taxpolicycenter.org/legislation/upload/legislation\\_by\\_act-2-28-11-4.pdf](http://www.taxpolicycenter.org/legislation/upload/legislation_by_act-2-28-11-4.pdf). [Accessed 25/05/2014]

TAX POLICY CENTER, 2015a. Summary of Major Enacted Tax Legislation, 1940-2009.

[Online] Available:

[http://www.taxpolicycenter.org/taxfacts/Content/PDF/major\\_bills\\_description.pdf](http://www.taxpolicycenter.org/taxfacts/Content/PDF/major_bills_description.pdf) [Accessed 12/03/2015]

TAX POLICY CENTER. 2015b. Summary of Major Tax Provisions by Act 1981-2006.

[Online]. Available: [www.taxpolicycenter.org/legislation/upload/ByAct\\_81\\_06-2.pdf](http://www.taxpolicycenter.org/legislation/upload/ByAct_81_06-2.pdf) [Accessed 21/12/2015]

TAX POLICY CENTER. 2015c. Historical Federal Receipt and Outlay Summary. [Online].

Available: <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=200> [Accessed 24/01/2016]

[http://r.search.yahoo.com/\\_ylt=AwrBT.Q6p3hWhDIAy8ZXNy0A;\\_ylu=X3oDMTEyZ2xzNTg4BGNvbG8DYmYxBHBvcwM3BHZ0aWODOjEzMjVfMORzZWMDc3I-/RV=2/RE=1450776506/RO=10/RU=http%3a%2f%2fwww.taxpolicycenter.org%2flegislation%2fupload%2fByAct\\_81\\_06-2.pdf/RK=0/RS=7utLvY\\_0OmaiMx0LOomALOE7JLI-](http://r.search.yahoo.com/_ylt=AwrBT.Q6p3hWhDIAy8ZXNy0A;_ylu=X3oDMTEyZ2xzNTg4BGNvbG8DYmYxBHBvcwM3BHZ0aWODOjEzMjVfMORzZWMDc3I-/RV=2/RE=1450776506/RO=10/RU=http%3a%2f%2fwww.taxpolicycenter.org%2flegislation%2fupload%2fByAct_81_06-2.pdf/RK=0/RS=7utLvY_0OmaiMx0LOomALOE7JLI-)

TAX POLICY CENTER. 2016. Historical Average Federal Tax Rates. [Online]. Available:

<http://www.taxpolicycenter.org/statistics/historical-average-federal-tax-rates-all-households>

[Accessed 5/07/2016]

TAX REFORM ACT OF 1986. Sec. 2656(b)(8)

TENENBAUM, J. 2002. Lobbying Tax Law: A Summary and Overview for Associations.

Center for Association Leadership. June 2002. [Online] Available:

<http://www.asaecenter.org/Resources/whitepaperdetail.cfm?ItemNumber=12223>

THORNDIKE, J. 2013. The Gas Tax Doesn't Work Because Politicians Broke It. Forbes. October 24<sup>th</sup>, 2013. [Online]. Available:

<http://www.forbes.com/sites/taxanalysts/2013/10/24/the-gas-tax-doesnt-work-because-politicians-broke-it/> [Accessed 28/03/2015]

TUMULTY, K. & EATON, W. 1993. Gore Casts Tie-Breaking Vote as Senate OK's Clinton Budget. Los Angeles Times. August 7<sup>th</sup>, 1993. [Online]. Available:

[http://articles.latimes.com/1993-08-07/news/mn-21221\\_1\\_tie-breaking-vote/2](http://articles.latimes.com/1993-08-07/news/mn-21221_1_tie-breaking-vote/2) [Accessed 25/03/2015]

UNGAR, R. 2012. Who Is The Smallest Government Spender Since Eisenhower? Would You Believe It's Barack Obama? Forbes. May 24, 2012. [Online}. Available:

<http://www.forbes.com/sites/rickungar/2012/05/24/who-is-the-smallest-government-spender-since-eisenhower-would-you-believe-its-barack-obama/#52c723d957ec>. [Accessed 24/05/2016]

United States vs. Kjellstrom (1996). 916 F. Supp. at 907 (W.D. Wis. 1996)

United States vs. Carlton (1994) (92-1941), 512 U.S. 26 (1994)

UNIVERSITY OF CALIFORNIA-BERKELEY. 2014. Fiscal Politics and Policy from the 1970s to the Present: Slaying the Dragon of Debt. [Online]. Available:

<http://bancroft.berkeley.edu/ROHO/projects/debt/1985grammrudmanhollings.html> [Accessed 25/03/2015]

UNIVERSITY OF CALIFORNIA-SANTA BARBARA. 2014. The American Presidency Project. [Online]. Available: <http://www.presidency.ucsb.edu/data/budget.php> [Accessed

05/10/2014]

URBAN-BROOKINGS TAX POLICY CENTER. 2002. EGTRRA: Which provisions spelled the most relief? Number 3, June 2002, [Online]. Available:

<http://www.urban.org/sites/default/files/alfresco/publication-pdfs/310510-EGTRRA-Which-Provisions-Spell-the-Most-Relief-.PDF> [Accessed 19/04/2016]

US CONGRESS. 2010. Tax Reform: Lessons from the Tax Reform Act of 1986. Hearing Before the Committee on Finance, 111<sup>th</sup> Congress. September 23, 2010. [Online]. Available:

[http://r.search.yahoo.com/\\_ylt=A0LEVwixNlxUxj8ANxhXNyoA:.\\_ylu=X3oDMTEzMWxncjY2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkA1ZJUDU0MV8x/RV=2/RE=1415358258/RO=10/RU=http%3a%2f%2fwww.finance.senate.gov%2fhearings%2fhearing%2fdownload%2f%3fid%3d54f47fb3-231f-48bf-a535-4bcd16b9a5bc/RK=0/RS=r\\_OPh5JwWVn7F1jBHVPVsBdFqKg-](http://r.search.yahoo.com/_ylt=A0LEVwixNlxUxj8ANxhXNyoA:._ylu=X3oDMTEzMWxncjY2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkA1ZJUDU0MV8x/RV=2/RE=1415358258/RO=10/RU=http%3a%2f%2fwww.finance.senate.gov%2fhearings%2fhearing%2fdownload%2f%3fid%3d54f47fb3-231f-48bf-a535-4bcd16b9a5bc/RK=0/RS=r_OPh5JwWVn7F1jBHVPVsBdFqKg-)

US CONGRESS. 2015. 103<sup>rd</sup> Congress. Legislation. [Online]. Available:

<https://www.congress.gov/amendment/103rd-Congress/house-amendment/20> [Accessed 09/10/2015]

US HOUSE OF REPRESENTATIVES. 1985. Report 99-433. Increasing the Statutory Limit on the Public Debt.

US HOUSE OF REPRESENTATIVES. 2014. The Legislative Process, US House of Representatives (2014). [Online]. Available:

[http://www.house.gov/content/learn/legislative\\_process/](http://www.house.gov/content/learn/legislative_process/) [Accessed 08/16/2014]

US HOUSE OF REPRESENTATIVES. 2016. Congress Profiles. [Online]. Available:

<http://history.house.gov/Congressional-Overview/Profiles/103rd/> [Accessed 18/06/2016]

US DEPARTMENT OF TREASURY. 1984. Tax Reform for Fairness, Simplicity, and Economic Growth (1984). [Online]. Available: <http://www.treasury.gov/resource-center/tax-policy/Pages/tax-reform-index.aspx> [Accessed 7/10/2014]

US SENATE. 2016. Clinton Vetoes. [Online]. Available: <http://www.senate.gov/reference/Legislation/Vetoes/Presidents/ClintonW.pdf> [Accessed 2/2/2016]

US SENATE FINANCE COMMITTEE. 1986. Report 99-313 on the Tax Reform Act of 1986. [Online]. Available: <http://www.finance.senate.gov/library/reports/committee/?c=99&maxrows=15> [Accessed 7/10/2014]

US TREASURY. 1984. Tax Reform for Fairness, Simplicity, and Economic Growth. [Online]. Available: <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Tax-Reform-v1-1984.pdf> [Accessed 20/06/2016]

VOTESMART.ORG. 2015. Legislative history. [Online]. Available: [www.votsmart.org](http://www.votsmart.org) [Accessed 11/10/2015]

WASHINGTON POST. 1993. 1993 State of the Union Address. [Online]. Available: <http://www.washingtonpost.com/wp-srv/politics/special/states/docs/sou93.htm> [Accessed 06/08/2016]

WASHINGTON POST. 1999. Clinton Vetoes GOP Tax Cut Bill. Washington Post. September 24, 1999. [Online]. Available: <http://www.washingtonpost.com/wp-srv/politics/special/budget/stories/veto092499.htm> [Accessed 2/2/2016]

WASHINGTON POST. 2013. The Legacy of the Bush Tax Cuts, in Four Charts. Washington Post. January 2, 2013. [Online]. Available: <https://www.washingtonpost.com/news/wonk/wp/2013/01/02/the-legacy-of-the-bush-tax-cuts-in-four-charts/> [Accessed 21/04/2016].

WEINBERG, D. 1987. The Distributional Implications of Tax Expenditures and Comprehensive Income Taxation. *National Tax Journal*, 40 (June 1987) 237-253

WEISS, R. 2010. How Did the 1986 Tax Reform Act Attract So Much Support? Testimony Before the Senate Committee on Finance. September 23, 2010.

WHITE HOUSE. 2011. Issues: Taxes. [Online]. Available: <http://www.whitehouse.gov/issues/taxes/> [Accessed 06/06/2014]

WHITE HOUSE. 2014. Presidential Biographies. [Online]. Available: <http://www.whitehouse.gov/about/presidents/ronaldreagan/> [Accessed 13/12/2014]

WHITE HOUSE. 2015. The Sequester. [Online]. Available: <http://www.whitehouse.gov/issues/sequester> [Accessed 10/03/2015]

WHITE HOUSE. 2015b. Office of Management and Budget. Historical Tables: Federal Debt at the End of Year, 1940-2020. [Online]. Available: <http://www.whitehouse.gov/omb/budget/historicals/> [Accessed 06/10/2015]

WHITE HOUSE. 2016. Office of Management and Budget. Historical Tables: SUMMARY OF RECEIPTS, OUTLAYS, AND SURPLUSES OR DEFICITS (–) AS PERCENTAGES OF GDP: 1930–2020. [Online]. Available: <https://www.whitehouse.gov/omb/budget/Historicals/> [Accessed 19/01/2016]

WHITE HOUSE. 2016b. George W. Bush Biography. [Online]. Available: <http://georgewbush-whitehouse.archives.gov/president/biography.html> [Accessed 28/03/2016]

WHITE HOUSE. 2016c. Jimmy Carter Biography. [Online]. Available: <https://www.whitehouse.gov/1600/presidents/jimmycarter> [Accessed 04/08/2016]

WILKIE, P., YOUNG, M., & NUTTER, S. 1986. Corporate Business Activity Before and After the Tax Reform Act of 1986. Internal Revenue Service. [Online]. Available: [http://r.search.yahoo.com/\\_ylt=A0LEVwrGkJVUAyQABRdXNvoA;\\_ylu=X3oDMTByMG04Z2o2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkAw--/RV=2/RE=1419116870/RO=10/RU=http%3a%2f%2fwww.irs.gov%2fpub%2firs-soi%2f86cobusact.pdf/RK=0/RS=zlPTnm2Rn6BBBWJVRBA45Cu7v08-](http://r.search.yahoo.com/_ylt=A0LEVwrGkJVUAyQABRdXNvoA;_ylu=X3oDMTByMG04Z2o2BHNIYwNzcgRwb3MDMORib2xvA2JmMOR2dGlkAw--/RV=2/RE=1419116870/RO=10/RU=http%3a%2f%2fwww.irs.gov%2fpub%2firs-soi%2f86cobusact.pdf/RK=0/RS=zlPTnm2Rn6BBBWJVRBA45Cu7v08-) [Accessed 20/12/2014]