Political Arenas of Federal Tax Policy

by

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Abstract

Federal tax policy is the product of a complicated political process. There are three distinct types of tax policy: distributive, regulatory, and redistributive. Each type of tax policy is made in a different political arena, by different political actors—and for different purposes. Furthermore, each arena is characterized by its own distinctive pattern of politics, decisionmaking, and interaction among the relevant participants. In this respect, political scientist Theodore Lowi was correct: the nature of the tax policy “causes” the politics. At the same time, much as an institutionalist approach would suggest, the “rules of the game” of each political arena structure the policymaking there. The institutional architecture of Congress facilitates distributive tax policymaking, just as the rules and norms of the professional tax bureaucracy are reflected in regulatory tax policymaking. Likewise, national electoral contests and shifting majoritarian coalitions produce an erratic redistributive tax policy—especially, with respect to the rate structure of the federal income tax. In the end, both an institutionalist approach and a policy-centered analysis are needed to explain the complex development of U.S. tax policy over the past century.
In studying the relationship between political institutions and policymaking, social scientists confront two seemingly diametrically opposed analytical perspectives: one (the institutionalist view) holding that policy outcomes are “structured” by the architecture of the political institutions within which they are made, and the other asserting that the nature of a particular policy determines the politics and policymaking associated with it. To be sure, these are very different views of how political institutions interact with the policymaking process. But are they necessarily mutually exclusive? When approaching a specific policy, must we choose between an institutionalist or a policy-oriented analysis? Or is it possible that these perspectives explain different aspects of the same policymaking process? Arguably, political institutions structure politics by influencing the behavior of policymakers with respect to a particular policy, and at the same time, different kinds of public policies generate their own distinct patterns of politics and policymaking. In this study, I explore this dynamic relationship with respect to one specific public policy: federal taxation. In doing so, the goal is to shed light on the broader question of how political institutions structure public policy and vice versa.

Political Institutions and Public Policy

One of the fundamental tenets of the so-called new institutionalism, an analytic approach advanced in recent years by an eclectic group of social scientists, is that political institutions (by which is meant the “rules of the game” that define the processes and procedures through which public policy is made in a given political system) play an important role in shaping decisionmaking and ultimately, policy outcomes.¹ To be sure, political institutions do not determine specific policy

¹ The seminal statement of the principles of the “new institutionalism” in political science was James G. March and Johan P. Olsen, “The New Institutionalism: Organizational Factors in Political Life,” *American Political Science Review* 78 (September 1984): 734. For a general survey of the new institutionalism as it pertains to the social sciences, see B. Guy Peters, *Institutional Theory in Political Science: The ’New Institutionalism’* (New York:}
outcomes; the connection is more tenuous. With respect to the outcome on any particular issue, political culture, individual action (“agency”), and a host of other variables influence policymaking and may very well be determinative. Political institutions function more as “structuring variables.” They establish a framework of incentives and disincentives within which policymakers act. Individual political actors make their decisions within the context of these institutions, which broadly define the parameters for decisionmaking. Consequently, a particular configuration of political institutions generates a distinctive pattern of policy outcomes over time, while alternate configurations generate other patterns. As Sven Steinmo has put it: “Institutions are important both because they are the focal points of much political activity and because they provide incentives and constraints for political actors and thus structure that activity. Rather than being neutral boxes in which political fights take place, institutions actually structure the political

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2 The “rules of the game” may also work to exclude certain decisions from the political agenda. The seminal discussion of “nondecision-making” is Peter Bachrach and Morton S. Baratz, “Decisions and Nondecision: An Analytical Framework,” *American Political Science Review* 57 (September 1963): 632: “When the dominant values, the accepted rules of the game, the existing power relations among groups, and the instruments of force, singly or in combination, effectively prevent certain grievances from developing into full-fledged issues which call for decisions, it can be said that a nondecision-making situation exists.”

3 Rational choice theorists emphasize the importance of strategic decisionmaking. From this perspective, institutions define the parameters of economic decisionmaking. North has stressed the importance of institutions in affecting patterns of national economic growth, arguing that seemingly minor differences in institutions can explain disparate outcomes in long-term economic development—for instance, the profound differences between England and Spain that emerged in the seventeenth century. Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990), 115–16.

4 Steinmo has argued that the different tax systems in Sweden, Britain, and the United States reflect underlying differences in the design of their political institutions (e.g., constitutions, electoral systems, representative bodies, etc.). Sven Steinmo, *Taxation and Democracy: Swedish, British, and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993), 10. Historical institutionalists such as Steinmo stress that initial policy choices establish institutionalized commitments that influence the course of future decisionmaking. For instance, once the United States made the decision to tax income, it became exceedingly difficult (if not impossible) to switch to a system of taxation based on personal consumption—even though most economists consider the latter a more efficient system. This is the underlying premise of so-called path dependence theory, which holds that initial decisions have a critical impact on subsequent development. See, e.g., Paul Pierson, “Increasing Returns, Path Dependence, and the Study of Politics,” *American Political Science Review* 94 (June 2000): 251.
struggle itself.”

To the extent institutions structure the political struggle, they shape policy outcomes.

This fundamental insight of the new institutionalism is important although not entirely novel. The significance of political institutions was certainly understood by earlier generations of political scientists—in particular, practitioners of what is often referred to as the “old institutionalism” or “formalistic” political science of the early twentieth century. That analytic approach has been justly criticized for overemphasizing the role of the formal (i.e., constitutional) design of political institutions in organizing the political system. The problem is, much of American politics is conducted through extra-constitutional political institutions not provided for in the U.S. Constitution—institutional innovations such as political parties, electoral competition, a professional bureaucracy, and (for better or worse) the complex web of organized interest groups that exert influence over the policymaking process. Moreover, a good deal of American politics is conducted through informal networks, procedures, and processes. A formalistic approach is too narrow to the extent it focuses excessively on the formal rules of the game while slighting the informal. The new institutionalists avoid that shortcoming by expanding the analysis to include both formal and informal networks and processes.

That makes sense, but institutionalists face two major hurdles in their analysis. First, explaining in concrete terms precisely how institutions influence decisionmaking is problematic. Given that the relationship is indirect and mediated, such connections are difficult to discern. They are even more difficult to prove. Moreover, institutionalists must come to grips with an alternate

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6 The criticism of much of early political science as overly “formalistic” is misdirected at times. For example, Woodrow Wilson perceptively urged students of American national politics to look beyond the formal constitutional model and focus instead on the “actual practices of the government at Washington”—which he saw as dominated and controlled by Congress and its committees. Woodrow Wilson, Congressional Government: A Study in American Politics (Boston: Houghton, Mifflin & Company, 1885), 6–7.
understanding of the causal relationship between political institutions and policymaking—namely, the notion that different types of public policy generate their own distinct modes of policymaking. Put another way, the nature of a public policy determines the structure of political institutions.

Theodore J. Lowi first advanced this provocative thesis in a seminal review article more than forty-five years ago. In making his case, Lowi identified three distinct types of public policies—distributive, redistributive, and regulatory—each of which generates its own unique “arena of power” for policymaking. An arena of power is characterized by a distinctive pattern of decisionmaking and interaction among participants in the policymaking process (political elites as well as interest groups). Each type of public policy generates its own associated politics and political institutions (i.e., arena of power). As Lowi famously put it, “policy causes politics.”

The politics generated by distributive policies is characterized by log-rolling and vote-trading, the objective of which is to provide special benefits to constituents and favored interest groups. This is the traditional politics of Congress and its committees, which has dominated the national political arena for more than two centuries. Representatives support subsidies, earmarks, and other forms of “pork-barrel” legislation (a less flattering term for distributive policy) for the constituents of fellow congressmen as reciprocity for favorable votes on legislation that secures

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8 Lowi originally borrowed the term “arena of power” from Harold Lasswell. He recently elaborated on the analysis recently in *Arenas of Power* (Boulder: Paradigm Publishers, 2009). Over the years, the conceptual framework has been subject to considerable criticism. Useful modifications were suggested in James Q. Wilson, “The Politics of Regulation,” in *The Politics of Regulation*, ed. James Q. Wilson (New York: Basic Books, 1980), 364–72 (emphasizing the distribution of costs and benefits to the relevant political actors); see also Robert J. Spitzer, “Promoting Policy Theory: Revising the Arenas of Power,” *Policy Studies Journal* 30 (1987): 675 (noting that particular policies possess the traits of more than one policy type).


10 “Each arena tends to develop its own characteristic political structure, political process, elites, and group relations.” Lowi, “American Business,” 689–90.

benefits for their own constituents. This politics of log-rolling and vote-trading favors incumbents in their efforts to secure reelection, which is the primary objective of congressional policymakers. Coalitions of convenience form among the various interests affected by specific policies and legislation, but these groups have little organizational connection among themselves and no overarching ideological affinities that bind them. Consequently, distributive policies are, as Lowi put it, not so much public policies as “highly individualized decisions that only by accumulation can be called a policy.” 12 There are few, if any, coherent policies or principles behind the sort of public law generated by such a political process. 13 For instance, the “accumulation” of the countless votes in Congress on rivers and harbors projects throughout the nineteenth century is what amounted to “public policy.” Much the same can be said for nineteenth-century tariff policy, which was little more than a long succession of bills bestowing preferred rates on favored industries and sectors. 14

As opposed to distributive policy, regulatory policy is specific and narrow, and most important, has a negative impact on those groups or industries targeted by regulators. Rather than bestowing economic benefits, regulatory policies impose costs on targeted groups, which accordingly have a strong interest in organizing to oppose them. Affected interests can be disaggregated to the sector level, where the political opposition coalesces in response. Coalitions


13 The incoherence, or lack of a unifying principle, of legislation produced by interest-group politics (or “interest-group liberalism”) is one of the central themes of Lowi’s influential study, The End of Liberalism: Ideology, Policy, and the Crisis of Public Authority (New York: Norton, 1969).

14 This was the politics observed by Elmer Schattschneider in his account of tariff legislation in the late 1920s. He noted that the relationship among participants in the political struggle over tax legislation was based on “mutual non-interference” that resulted in the “universalization of the policy”—namely, protection for every organized interest (or as Schattschneider aptly put it, “protection all around”). E. E. Schattschneider, Politics, Pressures, and the Tariff (New York: Prentice-Hall, 1935), 86. The classic account of the politics of nineteenth-century tariff policy remains Frank W. Taussig, The Tariff History of the United States (New York: G. P. Putnam’s Sons, 1888). A more recent account of rivers and harbors legislation is John A. Ferejohn, Pork Barrel Politics: Rivers and Harbors Legislation, 1947–1968 (Stanford: Stanford University Press, 1974).
form around specific issues that affect member groups, but each is affected slightly differently. Hence, coalitions are typically unstable and short-lived.\textsuperscript{15} The political networks that coalesce are loose and informal, and the politics is conducted largely outside the view of the public. In contrast, redistributive policies affect broad social or economic classes (for example, the “haves” versus the “have-nots”) rather than narrow economic sectors and consequently, generate their own distinctive pattern of politics and decisionmaking. The politics of redistributive policies is stable over time but is responsive to major shifts in partisan affiliations or the composition of the electorate (e.g., a so-called critical election\textsuperscript{16}). Because cleavages fall along broad social or economic classes, coalition-building requires (as Lowi put it) “complex balancing on a large scale.”\textsuperscript{17} For this reason, implementing such policies requires the support of a majority coalition. Hence, the politics of redistributive policy plays out at the highest level of politics, which in the United States means electoral competition between the two major political parties. If regulatory policies are contested discreetly behind closed doors in the backrooms of Congress, the political issues raised by redistributive policies play out in full public view during national elections and on the floor of Congress. These conflicts are reflected in the highly partisan debates over such divisive issues as the adoption of major social programs (e.g., Social Security in 1935 and healthcare insurance reform in 2010) and as we shall see, the progressivity of the federal income tax.

The Federal Income Tax

When approaching federal tax policy, one of the first things we observe is that different types of tax policy are made by different groups of policymakers acting within their own separate political

\textsuperscript{15} Lowi, “American Business,” 698.
\textsuperscript{16} For an explanation of the concept of critical elections, see infra note 92 and accompanying text.
\textsuperscript{17} Lowi, “American Business,” 715.
institutions. In other words, there are *multiple* arenas of power for tax policy. Some tax policies originate in Congress; others can be traced to initiatives set in motion by nonpartisan experts and professional staff in the executive branch. Still others are blatantly partisan policies originating with the White House or the leadership of the majority party in Congress. Often these emerge as significant political issues in national elections. Whatever their origin, all tax policy proposals eventually come to the tax-writing committees of Congress (the House Ways and Means Committee and the Senate Finance Committee), where they are subject to revision, amendment, or obstruction. The approval (or acquiescence) of the majority leadership of Congress is also necessary to enact new tax policies or change existing provisions of the tax code. That said, different types of tax policy receive different treatment and are resolved through separate political processes. Simply put, not all tax policies are the same. Some are distributive; others are regulatory or redistributive. Moreover, each type of tax policy generates its own distinctive pattern of politics and policymaking. Much as Lowi anticipated, the nature of a particular tax policy (distributive, regulatory, or redistributive) structures the political arena. At the same time, the various national political institutions (Congress, political parties, the professional bureaucracy in the executive branch) generate their own specific type of tax policy.

When we talk about federal tax policy, we usually are referring to the income tax. This is because the income tax is the most important component in the robust revenue system of the national government of the United States. Early in the twentieth century, the United States moved from its traditional nineteenth-century system of revenue based on the taxation of imported goods and commodities (the tariff and various excise taxes) to a new system based on the taxation of income. Revenue from the federal income tax (corporate and individual combined) steadily increased from the insignificant $28 million raised in 1913 (the first half-year the modern income
tax was in effect) to $29 billion in 1945 at the height of the Second World War, to $561 billion in 1990, and to the historic high of $1.53 trillion collected in 2007. In 1914, the income tax provided just 9.7 percent of the total receipts of the federal government; the figure reached 55 percent by 1985. Today, the income tax is the single most important source of revenue for the national government, generating in excess of 50 percent of total federal receipts.¹⁸

Yet even these figures understate the importance of the income tax in financing the operations of the national government. The Social Security wage tax is the second most productive source of federal revenue, accounting for more than 40 percent of total federal receipts.¹⁹ But the revenue from the wage tax is dedicated to paying current beneficiaries under the Social Security and Medicare programs.²⁰ This leaves the income tax to finance virtually all the “discretionary” spending (both military and non-military) provided for in the federal budget. This includes all federal spending on education, healthcare, highways, the environment, relief from...


¹⁹ Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2011 to 2021, January 2011, Table E-3 (“Revenues by Major Source, 1971 to 2010”). The Social Security tax is imposed at a flat rate of 12.4 percent (split equally between employee and employer) on the “applicable wage base” ($106,800 in 2011); the Medicare tax is imposed at a combined rate of 2.9 percent but is not capped. The Medicare tax is scheduled to rise to 3.8 percent on income over $200,000 under Section 1402 of the Health Care and Education Reconciliation Act of 2010, Pub. L. 111-152, 124 Stat. 1029 (March 30, 2010). At the same time, under an agreement reached between congressional Republicans and the White House regarding the extension of the Bush tax cuts from 2001, the employee’s share of the Social Security wage tax was lowered 2 percentage points to 4.2 percent for calendar year 2011. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312 (December 17, 2010).

²⁰ After rates were increased and benefits reduced pursuant to the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65, the program ran annual surpluses. These were loaned to the federal government in exchange for special debt instruments issued by the U.S. Treasury. So, the wage tax has supplemented general revenue. The problem is, for the first time since 1983, program expenses exceeded revenue in 2010. This will result in future deficits, depleting the accumulated surplus of $2.3 trillion held by the Social Security Trust Fund by the year 2037. Social Security and Medicare Board of Trustees, Status of the Social Security and Medicare Programs: A Summary of the 2010 Annual Reports (August 2010). The burden on the income tax will be even greater when the Trust Fund is exhausted and as the special debt instruments reach maturity and must be repaid from general revenue.
natural disasters, law enforcement, bank bailouts, etc.—to say nothing of our sizeable military force stationed across the globe.\textsuperscript{21} The vast revenue collected under the income tax makes possible all these programs; little wonder the tax attracts so much political attention. Indeed, the modern income tax has been continually debated, amended, revised, and “reformed” since its adoption in 1913. Likewise, the scope and volume of income tax legislation and policy has exploded in recent decades.\textsuperscript{22} For decades, the rate structure of the income tax is the focus of an intense political debate. While no less politically controversial, the federal gift and estate tax (a unified tax imposed on the transfer of wealth) is simply an insignificant source of revenue compared to the income tax, raising just $18.9 billion in 2010—or 0.87 percent of total federal receipts.\textsuperscript{23} An assortment of excise taxes, custom duties, and user fees generate the rest of the revenue of the federal government—collectively amounting to 5.61 percent of federal receipts.\textsuperscript{24} Clearly, the income tax is the “golden goose” that finances the operations of the American state.\textsuperscript{25} For this reason alone, income tax policy is central to American politics.\textsuperscript{26}


\textsuperscript{23} The politics of the federal gift and estate tax is described in Michael J. Graetz and Ian Shapiro, \textit{Death by a Thousand Cuts: the Fight Over Taxing Inherited Wealth} (Princeton: Princeton University Press, 2005).

\textsuperscript{24} Figures from Congressional Budget Office, \textit{The Budget and Economic Outlook: Fiscal Years 2011 to 2021}, January 2011, Table E-3 (“Revenues by Major Source, 1971 to 2010”).

\textsuperscript{25} In recent years, the United States has required massive public borrowing to finance its operations. In the past, this was necessary only during wartime, with the accumulated debt paid off in the decades that followed. The current peacetime deficits are ominous signs for the sustained fiscal viability of the American state. Of course, the ability of the United States to sell Treasury debt obligations in international capital markets is related to its capacity to raise revenue through the federal income tax.

\textsuperscript{26} Only belatedly have political scientists come to appreciate the importance of tax policy to American politics. Some of the best studies of the politics of the federal income tax published in recent years include: John F.
Within the national government itself, the Constitution formally “assigns” the power to tax to Congress. Accordingly, all forms of federal taxation (as well as modifications, amendments, and additions to existing taxes) must be authorized through duly enacted legislation. This puts Congress at the center of the tax policymaking process. The Constitution further requires that revenue bills originate in the House of Representatives. For this reason, the Ways and Means Committee (the committee in the House with oversight over taxation) has assumed a primary role in crafting federal tax policy—with the Senate Finance Committee running a close second. Here in the tax committees of Congress, we find the “arena of power” of distributive income tax policy.

**Distributive Tax Policy**

If the federal income tax is a highly effective tool for raising revenue for the national government, it also is ideally suited for use by individual congressmen in distributing economic benefits to their constituents. This instrumental use of the income tax takes the form of enacting special rules, regulations, or statutory amendments to the tax code to shelter specific groups from the burden of the income tax. Indeed, it is now virtually expected that representatives and senators will pursue special tax provisions for organized interest groups, industries, economic sectors, and wealthy individuals located in their home districts and states. They do not always succeed, but they certainly try. Distributive revenue policy is not new in Congress; what changed is that the income tax became the primary instrument of distributive revenue policymaking. As the income tax

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27 Article I, Section 7, U.S. Constitution.

28 Under Article I, Section 7, amendments to revenue legislation may be added in the Senate. Major tax policies can be added in the Senate as amendments to relatively minor revenue bills originating in the House.
replaced the tariff as the major source of revenue of the national government in the first half of the twentieth century, the focus of distributive revenue policy shifted from providing constituents with special tariff rates to special preferences under the income tax. The seminal account of distributive tax policymaking was written more than fifty years ago, and little has changed since. Nevertheless, we need to better understand the institutional forces that encourage congressional policymakers to enact special tax preferences for their constituents. As institutionalism would suggest, specific incentives can be traced to the “rules of the game” that define the political institution wherein federal tax policy is made—namely, the Congress of the United States.

Congress is a political institution that imposes its own unique framework of incentives and disincentives on those who serve in the national legislature. First and foremost, the elections mandated by the Constitution establish a critical linkage between representatives and their constituents—the so-called electoral connection. With the entire House up for reelection every two years, representatives face nearly constant pressure to satisfy the electorate—especially incumbents in marginal (“swing”) districts who feel vulnerable come election time. While U.S. senators were originally selected by the legislatures of the various states rather than through popular elections (a procedure that created its own unique set of incentives and constraints on their behavior), they too were formally subjected to the electoral connection with the ratification of the


30 In his landmark study of the U.S. Senate, Matthews explained how the values and mores of the institution influence the behavior of its members. Donald R. Matthews, U.S. Senators and Their World (Chapel Hill: University of North Carolina Press, 1960).

31 Arguably, elections are the most significant factor affecting the behavior of representatives in Congress. The classic statement of this theme is David R. Mayhew, Congress: The Electoral Connection (New Haven: Yale University Press, 1974). In a famous reformulation of the concept of democracy, the Austrian economist Joseph Schumpeter argued that elections are the chief mechanism for imposing some measure of accountability on politicians—and that the ability of the electorate to “throw out the rascals” is the fundamental prerequisite for a “democratic” polity. Joseph A. Schumpeter, Capitalism, Socialism & Democracy (New York: Harper, 1947).
Seventeenth Amendment in 1913. With that significant change to the rules of the game, senators as well as representatives are required to appeal (some would say, “pander”) to their constituents for the right to hold office. To be sure, individual politicians have their own personal political agendas and preferences that they wish to advance in office; however, reelection is the prerequisite to satisfying all other political objectives. Little is accomplished during a single term of office, and so politicians have a strong interest in reelection if they wish to have any lasting impact on public policy—to say nothing of retaining a reasonably prominent and lucrative job. As such, the electoral connection has a profound impact on the behavior of elected officials as it links them to their constituents, whose support and financial contributions are required for reelection.

Congress is a representative legislative body, but not all legislatures are organized the same way. The Congress of the United States has its own unique institutional features—in particular, the use of single-member districts to elect representatives to the House. Electing representatives from specific geographic territories magnifies the connection between congressmen and the dominant interests in the districts they represent. While not constitutionally mandated, Congress

32 By the time the direct election of senators was prescribed by the Seventeenth Amendment, a majority of the states had already adopted or experimented with procedures for the popular election of their senators. For a comprehensive account of the transformation of the selection process for senators, see William H. Riker, “The Senate and American Federalism,” American Political Science Review 49 (June 1955): 452–469.


34 Of the other democracies that employ single-member districts, most use them in conjunction with proportional representation. Canada and the United Kingdom select representatives to their national legislatures from local districts but within the context of a centralized parliamentarian system. The localizing effect of the single-member districts is partially negated there.

enacted a series of statutes beginning in 1842 requiring the states to elect their representatives from single-member districts. From 1932 to 1967, that mandate lapsed and several states experimented with electing at-large representatives to the House in winner-take-all elections. But in 1967, Congress re-enacted a statutory requirement for single-member districts, and that procedure has been the norm in all but a handful of cases. The result has been to strengthen the vital linkage between local interests and their representatives in the House. Senators represent larger and more diverse territories, and arguably, are less beholden to local parochial interests and more inclined to focus on national policy issues. Be that as it may, senators are just as zealous as representatives in protecting and assisting the dominant interests and economic sectors in their home states. They too understand that distributive policy is a highly effective means of satisfying their constituents (“constituency service”), and in doing so, improving their own political fortunes. Thus, powerful incentives established by the formal and informal rules and procedures that organize Congress as a political institution encourage senators and congressmen to use the powers of their office to distribute particularized benefits to local interests in their home states and districts.


The affinity for distributive policy is nearly universal among those who serve in Congress, even those who would prefer to focus on national political issues. Distributive policy itself takes many forms, one of which is enacting special tax preferences for the benefit of constituents. This is constituency service with a direct economic payoff. The ability of congressmen to “customize” the application of the tax code makes it a particularly efficient tool for distributing particularized economic benefits to constituents. Generally, it is easier to provide such benefits to constituents through the tax code than through direct appropriations included in the annual federal budget. An appropriations bill must first clear the relevant subcommittee with jurisdiction and pertinent technical expertise over the subject matter of the bill before it reaches the appropriations committee, whereas a provision enacted through the tax code is under the singular jurisdiction of the tax committees.38 (Earmarks are another ideal method for providing economic benefits to constituents, bypassing the regular budgetary process; however, in the current political climate, the use of earmarks has become politically suspect and restricted by the party leadership.39) Moreover, once enacted, tax preferences become permanent features of the tax code. Except in rare instances, tax preferences are not subject to annual review and scrutiny, as are budgetary appropriations.40 In addition, while economically equivalent, a tax provision that reduces taxes is often easier to “sell”


39 The political controversy over earmarks is described in David M. Herszenhorn, “Earmark Ban Exposes Rift in Both Parties,” *The New York Times*, November 17, 2010, A1. The so-called Tea party movement has campaigned hard against the use of earmarks, and in light of their success in the 2010 mid-term elections, the use of earmarks has been curtailed—at least, for now.

40 On rare occasions, tax policies are enacted on a year-by-year basis rather than as permanent provisions in the tax code. For example, in recent years Congress enacts an annual package of “tax extenders” to renew certain tax credits, deductions, and exemptions. While the package varies from year to year, it invariably includes an extender for the research and development (R&D) credit and a provision to index the alternate minimum tax to shelter middle-class taxpayers from the impact of that tax. The cost of enacting a permanent “fix” to these provisions is enormous; hence, Congress provides only one-year extensions.
politically to the electorate and colleagues in the legislature than a direct appropriation that increases the budget deficit—especially in the context of a soaring national debt.\textsuperscript{41} This is because the connection between the cost of a policy and its economic benefit is less transparent in the tax policy arena. A tax preference is easily buried in the arcane language of the tax code, while its price tag does not appear as a separate line-item in the federal budget. All this makes tax preferences a particularly attractive form of distributive policymaking for elected politicians in the national legislature.

Just as there are institutional incentives that encourage representatives to use distributive tax policymaking for political advantage, there are few disincentives. The cost of a tax preference (as well as other forms of pork barrel legislation) is widely dispersed among a very large number of taxpayers, while the subsidy is enjoyed by a small number of targeted beneficiaries. Consequently, opposition to a special tax provision is weak, diffuse, and difficult to organize, while the few beneficiaries of the provision are highly motivated to lobby (and reward) those members of Congress who control the “power of the purse”—especially those on the tax committees.\textsuperscript{42} The result is a classic politics of log-rolling and vote-trading that generates a seemingly endless supply of tax preferences for nearly every organized interest group in America. Democrats and Republicans alike pursue targeted tax preferences for their respective constituents. Distributive tax policy is nonpartisan as much as it is unprincipled.

The rise of distributive tax policy correlates with the decline of political parties and the gradual weakening of the congressional party leadership since the early twentieth century. The

\textsuperscript{41} Conservatives tend to favor tax preferences as they view economic incentives built into the tax code as a less coercive form of government intervention than direct subsidies or “command and control” type regulations.

\textsuperscript{42} While contributions to not necessarily sway the votes of representatives, the money does flow more freely to members of the more important committees— including Ways and Means. For an analysis of the relationship between campaign contributions and voting on the Ways and Means Committee, see John R. Wright, “Contributions, Lobbying, and Committee Voting in the U.S. House of Representative,” \textit{American Political Science Review} 84 (1990): 417.
trend towards decentralized power in the House intensified after World War II. As a result, individual congressmen were left relatively free to pursue special-interest provisions on behalf of their constituents. Because enacting special tax preferences is such an effective tool for satisfying the political interests of elected representatives and their constituents, this became a common practice in the postwar era. While the post-Watergate reforms of the mid-1970s (as well as the victory of House Republicans in 1994) reversed these trends to some extent, there has been no return to the kind of centralized leadership last seen in Congress prior to 1910. At the same time, one of the most significant institutional development in the legislative process for tax policy has been the weakening of control over the political agenda formerly exercised by the House Ways and Means Committee. That committee once played an important institutional role in checking the impulses of individual congressmen to introduce bills to bestow special tax treatment on their constituents—what David Mayhew referred to as “institutional maintenance.” In the past, congressmen who introduced such bills were often relying on Wilbur Mills (the powerful chair of Ways and Means from 1957 to 1975) to defend the integrity of the tax legislative process and veto

43 Following the revolt against Speaker Joseph Cannon in 1910, committee chairs played an increasingly important role in organizing the House. This decentralized system was at the expense of the party leadership and favored committee chairs from safe districts—often conservative Democrats from the South. With a strong history of unlimited debate and independence, power has always been relatively decentralized in the Senate. For an overview of changes to the organization of Congress and the committee system, see Eric Schickler, “Institutional Development of Congress,” in The Legislative Branch, ed. Paul J. Quirk and Sarah A. Binder (New York: Oxford University Press, 2005), 35–62. The classic account of the committee system in Congress remains Richard Fenno, Congressmen in Committees (Boston: Little, Brown & Company, 1973).


45 The role of the House Ways and Means Committee in the tax policymaking process is examined in Randall W. Strahan, New Ways and Means: Reform and Change in a Congressional Committee (Chapel Hill: University of North Carolina Press, 1990); see also John F. Manley, The Politics of Finance: The House Committee on Ways and Means (Boston: Little, Brown, 1970).

their own proposals. Following the fall of Chairman Mills in 1974, no one has had much interest in playing that role. In the breach, individual representatives and senators are left relatively free to use distributive tax policies to advance their own personal political objectives—in particular, reelection. The result has been an increase in distributive tax policy that is reflected in the massive omnibus revenue legislation that Congress enacts every few years, loaded up with scores of special tax provisions for constituents of both parties.

To be sure, omnibus tax legislation implements bona fide public policy as well, but the total package is mostly a hodge-podge (or “accumulation,” as Lowi put it) of unrelated tax provisions, a significant number of which distribute special preferences to favored interests. Sadly, this is what commonly passes for “tax policy” in Washington.

Tax preferences are enacted through an assortment of legislative techniques that are difficult for non-specialists to comprehend. Sometimes the class of taxpayers who benefit from a tax preference is so narrow as to consist of a single individual taxpayer or corporation—as in the case of so-called transition rules that protect specific (unnamed) taxpayers from the adverse effects of new tax legislation by grandfathering them under prior law. Even members of the

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47 The story of how Mills controlled federal tax policymaking over three decades is told in Julian E. Zelizer, Taxing America: Wilbur D. Mills, Congress, and the State, 1945–1975 (New York : Cambridge University Press, 1998). Mills restrained the use of the tax code for constituency service. Often congressmen would introduce such legislation, relying on the Mills to block what they knew to be unwise public policy. Traditionally, the Treasury Department played a vital institutional role in defending the integrity of the tax policymaking process, but in recent decades has apparently abdicated that position.

48 In October 1974, Mills was stopped by police following a minor traffic violation. He was intoxicated and in the company of an Argentinian stripper by the name of Fanne Foxe. The incident was described in Stephen Green and Margot Hornblower, “Mills Admits Being Present During Tidal Basin Scuffle,” Washington Post, October 11, 1974, A1. Mills was re-elected to his seat from Arkansas in November 1974, but following a second display of public drunkenness, he resigned his chairmanship and did not seek reelection in 1976.


congressional tax committees do not always know who is the intended beneficiary of the transition rules they adopt for a tax bill—although their staff certainly does. Tax preferences targeted to a broader class of taxpayers are typically enacted through statutory amendments or new provisions to the tax code itself. Such tax preferences take the form of deductions, credits, and exemptions designed to benefit specific groups or economic interests. These are collectively referred to as “tax expenditures” to emphasize the extent to which they are functionally equivalent (at least with respect to the net economic impact on the Treasury) to direct expenditures or outlays authorized in the budget. The concept of tax expenditures was first formally introduced to budget analysis by the Treasury Department in 1968 during Stanley Surrey’s tenure as Assistant Secretary for Tax Policy. Subsequently recognized by statute, tax expenditures are defined as “those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”

Every tax expenditure represents a discrete departure from a pure “economic” income tax as envisioned by tax professionals and academics. Tax expenditures are not “loopholes”—unintended tax benefits derived from a glitch in the tax laws or the intersection of different provisions of the tax code that produce an unanticipated tax

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In 1986, special transition rules were enacted for the Tax Reform Act that saved individual and corporate taxpayers (identified only indirectly through technical language) millions of dollars in taxes by grandfathering them under prior law. The story was told in the Philadelphia Inquirer newspaper by two investigative reporters who won a Pulitzer Prize for their reporting. Donald L. Barlett and James B. Steele, “The Great Tax Giveaway: How the Influential Win Billions in Special Tax Breaks,” Philadelphia Inquirer, April 10, 1988, A01.


advantage (i.e., a “tax shelter”) to those taxpayers with expensive legal counsel. Rather these are provisions intentionally enacted by Congress to allow specific taxpayers (individuals or corporations) who comply with the dictates of the provisions to reduce their tax liability. Among the numerous tax expenditures found in the tax code are provisions that reward taxpayers who contribute to a charity, drill for oil or gas, grow nuts or fruit, invest in research and development, purchase an automobile with a hybrid engine or energy-efficient windows, produce ethanol, pay for a dependent’s college tuition, or buy municipal bonds. The list goes on and on. Labor has its tax preferences; business has no shortage of its own. Middle-class taxpayers are the beneficiaries of significant tax preferences that cost the Treasury hundreds of billions of dollars in foregone revenue annually. Each year, the most expensive tax expenditures are those that subsidize the cost of employer-sponsored health care insurance, home-mortgage interest, and contributions to retirement accounts. These tax expenditures are claimed by so many middle-class taxpayers (many of whom are voters) that political efforts to remove them from the tax code are invariably doomed to failure. Reform proposals to eliminate tax preferences and broaden the tax base run contrary to the incentives and interests established by the political institutions within which policymakers act, and hence, are unlikely to succeed.

53 Tax loopholes are used to “shelter” liabilities arising under the income tax. Unfortunately, it is not so easy to distinguish a tax shelter from a tax expenditure. See Calvin H. Johnson, “What’s a Tax Shelter?” 68 Tax Notes 879 (August 14, 1995). Michael Gratez once defined a tax shelter as “a deal done by very smart people that, absent tax considerations, would be very stupid.” Quoted in “A Special Summary and Forecast of Federal and State Tax Developments,” Wall Street Journal, February 10, 1999, A1. The most abusive corporate tax shelters fall into this category as they entirely lack “economic substance.”


55 A November 2010 report released by the Debt Reduction Task Force of the Bipartisan Policy Center, Restoring America’s Future, proposed the elimination of most tax deductions and preferences (as well as a host of other unrealistic reform proposals). Likewise, the co-chairs of President Obama’s National Commission on Fiscal Responsibility and Reform recommended the elimination of all tax expenditures in their report of November 10, 2010. It is easy to make recommendations such as these but much harder to convince congressmen to act contrary to their own interests. The consensus is that the Tax Reform Act of 1986 was an aberration. See John F. Witte, “The Tax Reform Act of 1986: A New Era in Tax Politics?” American Politics Research 19 (1991): 438, 443.
One consequence of the growth of tax expenditures is that the revenue-raising capacity of the federal income tax has been undermined. This erosion of the tax base continues notwithstanding the great success of reformers in stripping the tax code of special-interest provisions pursuant to the Tax Reform Act of 1986. While an extraordinary number of tax expenditures were repealed pursuant to this historic legislation, the political process for making tax policy was left unchanged. Not surprisingly, the same political institutions continued to produce the same distributive tax policy in the decades that followed, and soon enough, the tax code was again loaded up with special interest provisions. Tax expenditures cost the U.S. Treasury roughly $1.2 trillion in fiscal year 2010—up from $878 billion in 2008. Because of the continual increases in tax expenditures (and the budget deficits attributable to them), Congress is under constant pressure to increase tax rates. As a result, the distinctive feature of the federal income tax in the postwar era is high marginal tax rates with an abundance of tax preferences provided to constituents by elected representatives eager to alleviate the burden of the taxes they themselves enacted. Such is the logic that prevails within the political institutions wherein tax policy is made in Congress.

56 Pub. L. No. 99-514, 100 Stat. 2085. Not surprisingly, the “sacred cow” tax preferences (e.g., the home mortgage deduction and exclusions for employer-provided healthcare and retirement contributions) were left untouched by the Tax Reform Act of 1986 (“TRA”). This historic legislation is discussed further at infra note 100 and accompanying text.

57 According to Treasury estimates, tax expenditures increased from 5.2 percent of GDP to 8.3 percent from 1976 to 1985. With TRA in 1986, the level of tax expenditures dropped to the levels of the mid-1970s and thereafter increased back to a constant 7 percent of GDP. Arguably, tax reform is cyclical, with reform efforts achieving success only after the tax code again becomes so riddled with tax expenditures following the last bout of tax reform that its revenue-raising capacity is undermined.


59 The United States ranks just behind Japan for the dubious distinction of having the highest combined federal/state corporate tax rate (39.3 percent versus Japan’s 39.5 percent). Tax Foundation, “Illinois Corporate Tax Hike Inches U.S. Closer to #1 Ranking Globally,” Fiscal Fact No. 257 (Washington, D.C.: January 14, 2011), Table 1.
Regulatory Tax Policy

No doubt, the political arena of distributive (pork-barrel) tax policy will appear familiar to many from stories in the popular press reporting on the lobbying, special interests, and “corruption” that purportedly is endemic to American politics. When it comes to tax policy, journalists regularly depict legislators as lackeys for the ubiquitous “corporate interests” and the federal income tax as a “scheme” by which the wealthy enrich themselves at the expense of middle-class Americans.60

Along similar lines, law school professors commonly portray the tax law as little more than a tool for “rent extraction.”61 Theirs is a one-sided perspective that ignores one of the most significant aspects of the tax policymaking process—namely, the times that “relatively autonomous” public officials impose their policy preferences on private economic interests.62 This is the political arena of regulatory tax policy.

Regulatory tax policy is made in political institutions distinct from those that produce distributive tax policy. This is a political arena familiar to tax professionals but largely unknown to the general public. In part, this is because regulatory tax policies are written by anonymous


62 One prominent historical institutionalist argues that the state possesses an “autonomous structure — a structure with a logic and interests of its own not necessarily equivalent to, or fused with, the interests of the dominant class in society or the full set of member groups of the polity.” Theda Skocpol, States and Social Revolutions: A Comparative Analysis of France, Russia, and China (New York: Cambridge University Press, 1979), 27. The actual degree of autonomy varies from state to state. Moreover, the state is never fully autonomous from society (but only “relatively autonomous”) as private interests and social groups always exert some influence over political elites.
bureaucrats in the Treasury Department and the Internal Revenue Service (a bureau of Treasury) and expressed through rules and regulations that are difficult for nonprofessionals to decipher due to the technical language (a dialect of legalese common to tax lawyers). Furthermore, they affect only a small number of taxpayers—mostly corporations and those with high incomes. The professional tax bureaucracy was created by Congress to administer and enforce the legislation it enacts. Perhaps not trusting its own competence or impartiality, Congress relies upon the nonpartisan tax bureaucracy to draft the volumes of rules and regulations that implement the tax laws. In addition to the staff of the tax committees, Congress created the nonpartisan staff of the Joint Committee on Taxation and Congressional Budget Office to advise them on budget and tax matters. Notwithstanding, for perfectly valid political reasons, congressmen often find it expedient to rail against the tax bureaucracy they themselves created.

The professional staff responsible for making regulatory tax policy is “relatively autonomous” to the extent it is insulated from the pressures of interest groups and lobbyists as well as the vagaries of partisan politics. Professional ethics and “academic” principles of taxation and economics guide regulators rather than political expediency. This arena of power is located in bureaucracies within the executive branch, beyond the immediate control of the congressional committee system wherein private interest groups commonly exert influence over decisionmaking.

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63 The Congressional Budget Office was created by Congress in 1974 for the purpose of providing it with an independent source of expertise to counterbalance the recommendations of the Office of Management and Budget, an agency in the Executive Office whose reputation for nonpartisanship was tainted during the Johnson and Nixon administrations.

64 One example of Congress attacking the tax bureaucracy it created was the televised hearings conducted in September 1997 by Republicans investigating alleged “abuses” of taxpayers by the Internal Revenue Service. These televised hearings culminated in the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, the purpose of which was to rein in the purported abusive behavior of the tax authorities. Out on the campaign trail, Republicans also blamed the IRS for the excessive complexity of the tax laws (dubbed the “IRS Code”) and the burden of taxation itself—conveniently ignoring that it is Congress that writes the tax laws, not the administrative agency. The notion that Congress creates bureaucratic agencies, blames them for the failings of government, and then campaigns against them before the electorate is the central theme of Morris Fiorina’s classic study, Congress: Keystone of the Washington Establishment (New Haven: Yale University Press, 1977)
True, the highest officials in the tax bureaucracy are political appointees. These include the Secretary of Treasury, Assistant Treasury Secretary for Tax Policy, Commissioner of the Internal Revenue Service, Chief Counsel of the IRS (chief legal adviser to the IRS Commissioner), as well as the chief of staff of the Joint Committee on Taxation. But in the trenches, the tax professionals who formulate and administer the regulatory tax policies of the national government are civil servants (formally nonpartisan) rather than political appointees. Most important, none of them (including the political appointees) is required to compete in elections to retain their office.

How particular regulatory tax policies make it onto the political agenda is itself an interesting story. Some regulatory tax policies are proposed by the congressional leadership or the White House under the guise of shutting down “corporate abuses” or “corporate welfare.” Such policies may be politically motivated as they resonate well with the liberal constituency of the Democrat party. Periodically, the tax bar and accounting associations weigh in with their concerns about some abusive transaction or practice. Their recommendations are given considerable deference by the tax authorities as these groups are comprised of practitioners who are intimately familiar with what goes on in private practice. Occasionally, the news media will play a similar role in publicizing abuses—although by the time the media reports on an abusive

65 The Joint Committee on Taxation was created in 1926. The chair rotates between the chairs of the House Ways and Means Committee and the Senate Finance Committee. The staff of the committee includes lawyers and economists who advise the tax committees and individual congressmen on tax legislative proposals and provide the official revenue estimates on all proposed tax legislation. The professional staff for the tax committees functions somewhat differently as they are appointed by the majority and minority leadership to serve and advise them on revenue issues. For an account of the role of nonpartisan staff in the tax legislative process, see Michael J. Malbin, Unelected Representatives: Congressional Staff and the Future of Representative Government (New York: Basic Books, 1980), 170–187; Hedrick Smith, The Power Game: How Washington Works (New York: Random House, 1988), chapter 10 (“Shadow Government: The Power of Staff”), 270–325.


67 The Tax Section of the American Bar Association (as well as several regional associations—most prominently, Philadelphia and New York) is the main association that represents tax attorneys while the American Institute of Certified Public Accounts (“A.I.C.P.A.”) is the professional association of certified public accountants. Since 1954, both organizations have been active in lobbying government for new rules and regulations to close loopholes and abuses.
practice, invariably it is already familiar to the tax authorities and private practitioners. But most commonly, new regulatory tax policies can be traced to initiatives set in motion by the professional staff.

The professional staff proposes regulatory policies to the tax committees for the purpose of shutting down some perceived abuse of the tax law, unintended loophole, or technical glitch in the tax code. Many reform measures enacted by Congress can be traced to internal position papers drafted by the professional staff of the Treasury Department. This was the case with many of the reforms enacted pursuant to the Tax Reform Act of 1986.\(^{68}\) For example, the “passive activity loss” rules (which limit the deduction for artificial tax losses generated by tax shelter investments) were a regulatory response to widespread abusive practices among wealthy taxpayers. Likewise, the “original issue discount” rules (which require the economic accrual of interest on debt instruments sold at a discount) were originally devised by economists in the Treasury’s Office of Tax Policy in the early 1980s and subsequently enacted in omnibus tax legislation.\(^{69}\) In both cases, the regulatory tax policies were first suggested by the professional staff and subsequently included in legislation that laid out the general regulatory scheme. Thereafter, the policies were given substance and “teeth” through comprehensive regulation projects drafted by the professional staff.


\(^{69}\) The role of the Office of Tax policy is described in Ronald A. Perlman, “The Tax Legislative Process: 1972–1992,” *Tax Notes* 57 (1992): 939; Kenneth W. Gideon, “Tax Policy at the Treasury Department,” *Tax Notes* 57 (1992): 889. The original issue discount (OID) rules were introduced in the 1980s to prevent tax avoidance through deferral of the payment of tax on interest payments made on debt instruments issued at a discount. The principles were adopted under the IRC Section 1271 et seq. and Treasury regulations followed. The regulations interpreting the OID statutes are 441 pages long and use extremely complicated economic concepts. In many cases, a computer must perform the computations required under the regulations to determine an “economic accrual” of interest under an OID debt instrument. The “passive activity loss” (PAL) rules were introduced under the Tax Reform Act of 1986 as new IRC Section 469. The rules were quite effective in eliminating many forms of tax shelters marketed at individual taxpayers. Both the PAL rules and the OID rules are now a part of the regulatory landscape that every tax professional must navigate.
In contrast with regulations that merely “interpret” statutes enacted by Congress, the original issue discount regulations and passive activity loss rules are so-called legislative regulations. With these, Congress broadly delegates rule-making authority in a narrow sphere to the tax authorities. The regulations drafted by the tax professionals implementing these policies are considered to have the full force and authority of law and are afforded great deference by the federal courts.\textsuperscript{70}

Ironically, in the current budgetary climate of massive budget deficits, regulatory tax policies are also popular among legislators simply because they raise revenue. Regulatory revenue-raisers are paired in a single legislative package with legislation (distributive and redistributive) that reduces tax revenues or authorizes new spending. Regulatory tax policies are popular because they help offset the costs of tax cuts or new programs. This pairing was once formally required under the “pay-as-you-go” (or PAYGO) rule set forth in the Budget Enforcement Act of 1990.\textsuperscript{71} Under the PAYGO budget rule, any tax reduction was required to be offset by a comparable revenue increase or reduction to “direct” discretionary spending programs; net revenue losses from all new legislation had to be offset by revenue enhancement or direct spending cuts.\textsuperscript{72} Technically, PAYGO only required \textit{annual} revenue offsets, but the rule was translated by then Ways and Means Committee chairman Dan Rostenkowski and Senate Finance


\textsuperscript{72}2 U.S.C.A. secs. 633(c), (f), and 902. The Budget Enforcement Act of 1990 also provided for adjustable spending caps and caps on discretionary spending. These were easily avoided. Nevertheless, PAYGO was an effective mechanism whereby Congress was able to impose some restrictions on the impulses of its individual members to spend beyond the government’s capacity to raise revenue.
Committee chairman Lloyd Bentsen into a practice whereby any single legislative proposal resulting in a net revenue loss had to be coupled with an offsetting revenue raiser in the same bill. For years, the tax committees continued to follow this procedure even after the departures of Rostenkowski and Bentsen from Congress.

The PAYGO budget rule created a strong demand for regulatory tax policies that raise revenue. While the statute expired at the end of 2002, legislators remain under pressure to find revenue-raisers to offset the cost of new spending programs. Indeed, a version of PAYGO was introduced as a standing rule of the House of Representatives in January 2007. True, the House procedural rule has been easily avoided, as was the PAYGO statute itself. For that reason, a new statutory version of PAYGO favored by Democrats was reenacted on February 12, 2010. While this anti-deficit rule can be evaded by many of the same techniques that were used to avoid the old PAYGO statute and the House procedural rule, it keeps up the demand for regulatory tax policies that raise revenue for the Treasury. This explains why the Health Care and Education Reconciliation Act of 2010 (the so-called Obama healthcare legislation) included a number of regulatory tax provisions with no other connection to the legislation than that they helped offset the significant costs of the new program. One such revenue-raiser codified the so-called economic

73 First, the House PAYGO procedural rule does not apply to “emergency” spending (as designated by the House itself). Likewise, the rule does not apply to discretionary spending—only changes to mandatory spending. Furthermore, it does not apply to previously enacted increases to mandatory spending, such as those already scheduled for Social Security. Finally, the procedure can be waived under a rule from Ways and Means. This was the case with the Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613, which was estimated to decrease revenues by $152 billion in 2008. The $787 billion stimulus package enacted in February 2009 was exempt from the PAYGO rule under the “emergency” spending designation.

74 The Statutory Pay-As-You-Go Act of 2010 was enacted as part of Pub. L. No. 111-139 (February 12, 2010). The 2010 PAYGO statute holds that all new legislation taken as a whole that reduces taxes, fees, or mandatory expenditures, must not increase projected deficits. As with the 1990 version, the sequestration provisions are not triggered by “emergency costs” associated with legislation designated as such by Congress.
substance doctrine, purportedly shutting down certain “abusive” tax practices (e.g., bogus tax shelters) and in the process, raising revenue for the U.S. Treasury.  

The rules and regulations that implement such regulatory tax policies affect narrowly defined groups of taxpayers while leaving virtually everyone else unaffected. Rather than bestow an economic benefit (e.g., lower taxes) on a narrow class of beneficiaries (as is the case with distributive tax policies), regulatory tax policies impose an economic burden on those affected. Targeted taxpayers might be an entire industry, an economic sector, or a small number of similarly-situated firms. Those taxpayers adversely affected by a new regulatory tax policy have a strong incentive to organize and lobby against enactment. Consequently, whenever such policies appear on the policy agenda, the lobbyists and representatives for affected industries immediately swing into action. Industry and economic sectors are represented by their own legal advisers, tax professionals (lawyers and accountants), as well as lobbyists. The government’s staff may initially hear from their private-sector counterparts through comments offered at public hearings held for new regulations projects or through informal contacts, but usually the contacts and bargaining are informal. Indeed, the government’s professional staff often are personally familiar with the professionals representing taxpayers. In many cases, these “hired guns” once worked for the

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75 Pub. L. 111-152, Sec. 1409. The legislation included new IRC provision 7701(o), which codifies the economic substance doctrine applied by the federal courts. For a description of the measure, see Martin J. McMahon Jr., “Living With the Codified Economic Substance Doctrine,” Tax Notes 128 (August 16, 2010): 731.

76 This is true for regulatory tax policy as well as most other forms of regulation that impact private interests. Former SEC chief Arthur Levitt described the political environment in Washington as one in which highly organized interests wield extensive power over agendas and policy design: “During my seven and a half years in Washington . . . nothing astonished me more than witnessing the powerful special interest groups in full swing when they thought a proposed rule or a piece of legislation might hurt them, giving nary a thought to how the proposal might help the investing public. With laserlike precision, groups representing Wall Street firms, mutual fund companies, accounting firms, or corporate managers would quickly set about to defeat even minor threats. Individual investors, with no organized labor or trade association to represent their views in Washington, never knew what hit them.” Arthur Levitt, Take on the Street: How to Fight for Your Financial Future (New York: Vintage, 2002), 250.
government and left government work for more lucrative employment in the private sphere representing those they once regulated.\textsuperscript{77}

The significant costs associated with organizing and lobbying to resist regulatory tax policies is usually shared by affected taxpayers through their trade associations or new organizations created for the occasion. In rare cases, individual firms or persons have a sufficiently strong economic incentive to bear the entire cost of opposing a new regulatory tax policy. Sometimes they succeed in blocking or weakening regulatory initiatives through appeals to friendly representatives and senators in Congress; most often they do not. With all the new regulatory tax policies enacted in the past five decades, the internal revenue code and code of federal regulations have swelled, thereby contributing to a significant increase in the complexity of the federal tax laws.\textsuperscript{78}

\textbf{Redistributive Tax Policy}

Redistributive policies generate their own distinctive pattern of politics and decisionmaking. These are broad national policies that provoke intense political conflict reflecting deep-rooted cleavages based on class, wealth, and region. As such, these conflicts play out at the highest levels of American politics—on the floor of Congress and in national elections contested by the two major political parties. Ultimately, they are “resolved” only when a majoritarian coalition is strong enough to impose its will on a reluctant minority. Among such policies, few have provoked as

\textsuperscript{77} This is the negative side of the so-called revolving door between government and industry. But the revolving door swings both ways, bringing professionals from private practice into government as well vice versa. In many cases, the government first learns about abusive practices from those who came to government service from private practice. Many stories on abusive corporate tax shelters that appeared on the front page of the Wall Street Journal during the 1990s and early 2000s were based on documents leaked to reporters by tax professionals working in private firms who were shocked by the unethical behavior of their colleagues.

\textsuperscript{78} The increase in the complexity of the tax law was noted decades ago. For an account of the factors that have contributed to the increased complexity, see Stanley S. Surrey, “Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail,” \textit{Law and Contemporary Problems} 34 (1969): 673.
much controversy and acrimony as the decision whether to adopt a national income tax—in particular, an income tax with a steeply progressive rate structure. By definition, a progressive income tax has a disproportionate impact on the wealthiest citizens, and not surprisingly, those adversely affected are strongly motivated (and with sufficient resources) to organize and resist such taxes through all available political means. The more progressive the rate structure, the more intense the opposition. Without a mature party system to mediate the political conflicts triggered by redistributive tax policies, those targeted may resort to tax rebellions, protests, and in general, a more “contentious politics” disruptive to the political system.\(^\text{79}\) In the United States, the divisive issues raised by redistributive tax policy have been settled through national elections rather than recourse to “politics in the streets.”\(^\text{80}\)

The first national income tax in the United States was enacted by Congress during the Civil War. Ironically, while the political opposition came mostly from conservative Republicans representing wealthy manufacturing and financial interests in the Northeast, the Republican party itself was firmly in control of the government in Washington throughout the war.\(^\text{81}\) The powerful state created in the North by the Republican party required new sources of revenue to sustain its armies and bureaucracies, and that meant new taxes. By 1862, the fiscal shortfalls resulting from the war effort exceeded the government’s capacity to borrow, provoking an intense debate among congressional Republicans over new forms of taxation. The only real issue was, which new taxes

\(^\text{79}\) The Bourbon monarchy of eighteenth-century France and the Imperial Czars of Russia imposed high taxes on powerful social and economic classes, thereby fomenting social revolution. Theda Skocpol, States and Social Revolutions: A Comparative Analysis of France, Russia, and China (New York: Cambridge University Press, 1979). Tarrow and Tilly describe a “contentious politics” (which includes revolutions, social movements, civil wars, and violent ethnic conflicts) that occurs where the political system cannot resolve such divisive issues. Charles Tilly and Sidney Tarrow, Contentious Politics (Boulder: Paradigm Publishers, 2006).

\(^\text{80}\) This was not always the case, as tax revolts and local rebellions were common under weak national political institutions of the Articles of Confederacy (1781–1788).

to enact. A national income tax was proposed by Justin Morrill, a founder of the Republican Party in Vermont and influential member of the Ways and Means Committee, as an alternative to a proposal for a national land tax by Thaddeus Stevens of Pennsylvania, powerful Republican chairman of the House Ways and Means Committee. Despite intense opposition from conservatives within the party, the Union government’s dire need for revenue overwhelmed the objections, and an national income tax was adopted in 1862.\textsuperscript{82} A more steeply graduated rate structure (reaching 10 percent on income in excess of $10,000) was added in 1864.\textsuperscript{83} This turned out to be even more controversial than the modest 3-percent tax previously enacted by Congress. In 1864, one of the strongest critics of the new rate structure was Justin Morrill himself, who protested that progressive rates “punish men because they are rich” and amounted to “seizing the property of men for the crime of having too much.”\textsuperscript{84} Other equally intense objections were raised. But in the end, the revenue needs of the Union government attributable to the war effort overwhelmed resistance to a progressive income tax. After the war, the opposition regrouped, and the tax was allowed to expire in 1872. The national government returned to its traditional nineteenth-century sources of revenue: the tariff, excise taxes, and the sale of public land.

Support for a progressive income tax resurfaced in subsequent decades as a host of agrarian political parties embraced the idea.\textsuperscript{85} Once again, the issue provoked a national political debate.

\textsuperscript{82} An income tax was enacted on August 5, 1861, but that was never implemented. A substantially similar income tax was signed into law by President Lincoln in July 1862. Act of July 1, 1862, chap. 119, 12 Stat. 432, 469–71. The tax imposed a tax of 3 percent on the “annual gains, profits or incomes” above $600 of anyone residing in the United States, “whether derived from any kinds of property, rents, interest, dividends, salaries or from any profession, trade, employment or vocation carried on in the United States or elsewhere, or from any source whatever.”


\textsuperscript{84} Congressional Globe, 38th Cong., 1st sess. (1864), 1876.

\textsuperscript{85} In each of its platforms, the Populist Party called for a graduated income tax. The same was true of the Greenback Party in 1877 and 1878, and then again in the National Greenback Party in 1880. The Greenback Labor and Anti-Monopoly Parties adopted their own proposals in 1884, and the Union Labor Party supported a graduated income tax in its platform in 1888. Grangers, Knights of Labor, and the Farmers Alliance all supported the tax. From 1874 to 1894, no fewer than sixty-eight bills were introduced in Congress to enact a progressive income tax.
conducted on the floor of Congress. A proposal for a new national income tax gained support among Democrats and Populists. As was the case thirty years before, the nation was divided on the basis of wealth, agrarian interests versus manufacturing, and along sectional lines separating the Northeast from the South and the Midwest. In Congress, the movement for a new income tax was led by Democrats William Jennings Bryan of Nebraska and Benton McMillin of Tennessee, chairman of the Ways and Means Subcommittee on Internal Revenue. On Ways and Means, Democrats from the South and Midwest uniformly supported the plan, while all six Republican members were opposed. The House too divided along partisan and sectional lines, with a 175-to-56 vote in favor of the measure. Opposition was equally intense in the Senate, where Republican John Sherman of Ohio denounced the tax as “socialism, communism, [and] devilism.” Notwithstanding such intense objections, the measure passed and was signed into law by President Cleveland. The income tax of 1894 was imposed at a flat rate of 2 percent on the gains, profits, and income of individuals above the generous $4,000 exemption and on the “net profits” of all business conducted in the United States.

Controversy over the income tax of 1894 simmered but was rendered moot when the U.S. Supreme Court held the impost to be an unconstitutional “direct” tax in the infamous case of *Pollock v. Farmer’s Loan & Trust Co.* (1895). This judicial intervention proved a short-lived victory. In 1909, Congress approved a constitutional amendment reversing the Court’s decision in

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87 Congressional Record, 53d Cong., 2d sess. (June 22, 1894), 26, pt. 7, 6695 (Senator John Sherman of Ohio).

88 *Pollock v. Farmer’s Loan & Trust Co.*, 157 U.S. 429c (1895); 158 U.S. 601 (1995) (rehearing). The Court held that the income tax was a “direct” tax required under the Constitution to be “uniform throughout the United States.” U.S. Constitution, art. 1, sec. 8.
Pollock; this was subsequently ratified by the states in 1913. The Sixteenth Amendment granted Congress the broad authority to tax “incomes, from whatever source derived.” Pursuant to this mandate, a new national income tax was enacted. Three years later, the Supreme Court upheld the constitutionality of its progressive rate structure, which reached a maximum rate of 7 percent. With the constitutional issues resolved, a century long political battle commenced over the degree of progressivity of the federal income tax. While there have been occasional outbursts from conservatives who would repeal the federal income tax altogether (usually seeking to replace it with some sort of regressive consumption tax), the serious debate has been over marginal rates. Once the income tax replaced the tariff as the primary source of revenue for the national government, there was no going back. The American state is now dependent on the revenue from the federal income tax. The question is, who will bear the burden of the impost? This is the fundamental political issue raised by all redistributive tax policies.

Since the enactment of the modern income tax in 1913, its rate structure has reflected periodic shifts in the partisan affiliation of the electorate and the overall balance of power between the two major political parties. With the ebb and flow of majoritarian coalitions, marginal tax rates have risen and fallen. During periods of one-party hegemony, tax rates have remained relatively stable. Conservative majorities have periodically emerged in national elections and used

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89 Ironically, the amendment was proposed by Nelson W. Aldrich, Republican chairman of the Senate Finance Committee, and supported by President Taft, with the intent of deflecting the Populist campaign for a highly progressive income tax. The curious strategy is discussed in Jerold L. Waltman, Political Origins of the U.S. Income Tax (Jackson: University Press of Mississippi, 1985), 4–6.

90 U.S. Constitution, 16th Amendment.

91 Brushaber v. Union Pacific Rail Road Co., 240 U.S. 1 (1916).

their self-proclaimed “mandate” to reduce taxes; at other times, liberal-left majorities have raised
taxes on the wealthy after celebrating their own electoral victories. If politics-as-usual in
Washington is associated with distributive tax policies (i.e., tax preferences for organized
interests), majoritarian politics is associated with redistributive tax policies that affect the
progressivity of the income tax. For example, tax reduction was prominent on the political agenda
of the Republican party following World War I, when the conservative presidential candidate
Warren G. Harding campaigned on a platform for a “return to tax normalcy”—i.e., repeal of the
extraordinary wartime rates that were soared to 77 percent. Under the reign of Treasury Secretary
Andrew Mellon, the campaign pledge to lower tax rates became reality during successive pro-
business administrations when the maximum tax rate was kept below 25 percent.93 Following a
major shift in the electorate and the resulting reconstitution of the party system in 1932, a
Democratic majority provided the Roosevelt administration with its own mandate to use the tax
code as a tool for redistributive policy. The maximum marginal rate rose to 63 percent during the
first Roosevelt administration and reached 79 percent during the second. One of the most divisive
political issues of the New Deal was the rate structure for the federal income tax.94

While New Deal redistributive tax policy constituted a major wedge issue during the 1938
mid-term elections, World War II put an end to the acrimonious partisan debate. The fiscal crisis
occasioned by the war necessitated unprecedented borrowing by the national government and
extraordinary increases in taxes for all Americans.95 By 1945, the maximum rate for individuals

93 For an analysis of the Mellon tax cuts of the 1920s, see Gene Smiley and Richard H. Keehn, “Federal

94 While New Deal tax policy has been appropriately referred to as “symbolic reform,” the intensity of the
politics over the income tax was genuine. The definitive account of New Deal tax policy is Mark H. Leff, The Limits of

95 The increased capacity of the national government to borrow during the war is a central theme of
Bartholomew H. Sparrow, From the Outside In: World War II and the American State (Princeton: Princeton University
soared to an historic high of 94 percent on income in excess of $1 million. Following all prior wars in American history, wartime tax rates were reduced to something close to prewar levels after the cessation of military hostilities; however, this was not the case following World War II. With the outbreak of the Korean War and the Cold War of the 1950s and 1960s, high marginal tax rates became a permanent feature of the federal income tax. As a consequence, postwar American politics has been marked by intense partisan conflict over the rate structure of the federal income tax. This conflict has played out repeatedly in national elections, with Democrats and Republicans vying for control of the reins of redistributive tax policy.

The political conflict over marginal tax rates came to a head when the 80th Congress opened in January 1947 and a resurgent Republican party set out to roll back the wartime rates still in place. In the 1946 midterm elections, Republicans took control of both houses of Congress for the first time since 1930, with conservatives assuming most of the leadership positions and committee chairs. The Republican chair of the Ways and Means Committee introduced a proposal for a 20-percent reduction in the income tax. The Truman administration rejected that and suggested a more modest reduction to be funded through an increase in the corporate tax rate. This set off a struggle between congressional Republicans and the Democrat administration. Tax reduction was one of the main issues of contention. Three times Republicans enacted tax reduction

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legislation, with Truman vetoing each bill. The third time proved a charm, as a coalition of Republicans and conservative Southern Democrats overrode the president’s veto and enacted the Revenue Act of 1948, lowering the maximum individual income tax rate to 82.13 percent. While a victory for conservatives, this was hardly a return to the golden era of “tax normalcy” of the 1920s.

While Democratic administrations heeded the advice of their economic advisers and brought the maximum rate for individuals down to 70 percent during the 1960s, conservatives still yearned for a pre–New Deal rate structure. They were stymied by a Congress dominated by Democrats. But the struggle over marginal tax rates erupted again following an historic shift in the political balance of power. When Ronald Reagan carried 44 states and received 489 electoral votes in the 1980 presidential election, the prospects for major tax reduction looked good. During the campaign, Reagan had endorsed a 1977 proposal put forth by Senator William Roth and Representative Jack Kemp calling for a 33 percent reduction in the maximum tax rate for individuals. With Reagan in the White House, tax reduction was high on the political agenda. It helped that Republicans also took control of the Senate for the first time since 1954. While Democrats retained the House, a contingent of conservative Southern Democrats supported the new administration’s pledge to reduce taxes. By summer 1981, that pledge became reality in the Economic Recovery Tax Act of 1981 (ERTA), which lowered the maximum income tax rate for individuals to 50 percent. While the president was subsequently forced to accept some modest tax increases in the face of rising deficits attributable to the 1981 tax cuts, Reagan was largely successful in his campaign for tax reduction.

After his landslide reelection in 1984, Reagan again turned his attention to tax reform qua rate reduction. Against all expectations, a political compromise was reached between supply-
siders in the White House seeking lower marginal rates and liberal Democrats in Congress pushing for a broader tax base. The two groups came together behind a “revenue neutral” plan to lower marginal tax rates and close as many tax loopholes as possible.\textsuperscript{99} The result of this odd political coalition of convenience was the Tax Reform Act of 1986 (TRA), widely hailed as the most significant reform legislation in the history of the U.S. income tax.\textsuperscript{100} The massive bill reduced the maximum rate for individuals to 28 percent (a rate last seen in the 1920s) and repealed a host of tax preferences enacted during the postwar era. But if the Reagan administration succeeded in reducing marginal tax rates, little was done to reduce government spending. The result was massive peacetime deficits and mounting pressure to raise taxes.

In the face of rising deficits, Reagan’s successor in the White House, George H. W. Bush, was forced to accept some modest tax increases in 1990. But political pressure to raise marginal tax rates reached a crescendo with the election of Bill Clinton in 1992. The new administration immediately proposed tax increases for the wealthy. In his 1993 State of the Union address, Clinton called for an assortment of tax incentives, preferences, credits, and rate increases. The president committed to a proposal long favored by congressional Democrats—a 10 percent surtax on taxable income in excess of $250,000 (misleadingly called a “millionaire’s surtax”). Targeting those who had benefited most from the Reagan tax cuts, the entire burden of the president’s proposed tax


\textsuperscript{100} See, e.g., Witte, The Politics and Development of the Federal Income Tax, 4 (“TRA can only be viewed as a remarkable legislative accomplishment and by far the most radical example of peacetime tax reform in history”); Shaviro, “Beyond Public Choice and Public Interest,” 5 (“The 1986 Act was the all-time leading example of tax reform”). For an account of the politics behind the enactment of TRA, see Jeffrey H. Birnbaum and Alan S. Murray, Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform (New York: Vintage, 1988); Conlan, Wrightson, and Beam, Taxing Choices (1990). The compromise that led to enactment of TRA is analyzed in Amy Gutmann and Dennis Thompson, “The Mindsets of Political Compromise,” Perspectives on Politics 8 (December 2010): 1125.
increase would fall on the wealthiest American taxpayers. As the Clinton administration moved forward with its proposal, the level of partisanship and acrimony intensified.

In early 1993, the Ways and Means Committee took up consideration of the president’s tax plan. Republicans uniformly opposed the package in committee, and voting on the floor of the House followed strict party lines. The measure passed by the narrow margin of 218–216. The next day, a split vote in the Senate was decided by Vice President Al Gore in his capacity as president of the upper chamber. The Revenue Reconciliation Act of 1993 was signed into law by President Clinton on August 10, 1993. Under the legislation, a new maximum tax bracket of 36 percent was created for individuals with income above $115,000, and as promised, a 10 percent surtax was imposed on income above $250,000. Consequently, the maximum marginal tax rate for individuals reached 39.6 percent, while the corporate income tax topped off at 35 percent. Other provisions repealed or limited traditional business deductions. To say the least, the 1993 Democratic tax legislation was divisive and provoked an equally partisan response from Republicans. The antitax wing of the Republican party was revitalized. The result was a backlash against Democrats and a resurrection of the GOP in the 1994 mid-term elections. Soon after, an antitax Republican would prevail in the 2000 presidential election.

With George W. Bush eventually eking out a victory in Florida, Republicans took back the White House after an eight-year hiatus during which the maximum marginal tax rate increased 28 percent. Republicans retained a slim 221–212 majority in the House, which meant that the leadership positions and committee chairs would remain in Republican hands for at least two more years. In the Senate, Republicans and Democrats were deadlocked with 50 senators each, but Vice President Cheney would cast his vote in the event of a tie. So with Republicans in control of the 107th Congress, George Bush made good on his campaign pledge to cut taxes. Addressing a joint
session of Congress on February 27, 2001, the president revealed his plan. One week later, the House took up consideration of a major tax-reduction bill and quickly approved the bill by a 230 to 198 vote. Republicans voted unanimously for the tax cut. Ten Democrats defected from their party and supported the House bill, which would reduce income taxes by $2.2 trillion over six years, repeal the federal estate tax over ten years, grant relief from the so-called marriage tax penalty, and repeal the alternative minimum tax for individuals. The Senate postponed consideration of tax cuts until later that spring, at which time a more moderate proposal passed. A conference committee worked out a compromise bill that made 441 changes to the tax code. The Economic Growth and Tax Relief Act of 2001 enacted $1.25 trillion in tax cuts and included a new 10-percent tax bracket for low-income taxpayers, effective retroactive to January 1, 2001. The maximum tax rate was scheduled to fall to 35 percent by 2006. This was redistributive tax policy on a grand scale.

Undoubtedly, the most peculiar feature of the legislation was a sunset provision for the tax cuts, virtually all of which were scheduled to expire at midnight on December 31, 2010.\footnote{For a description of the sunset provision, see Joint Committee on Taxation, \textit{Summary of Provisions Contained in the Conference Agreement for H.R. 1836, the Economic Growth and Tax Relief Reconciliation Act of 2001} (JCX-50-01), May 26, 2001.} This was necessary to keep the tax-reduction package from running afoul of the so-called Byrd rule in the Senate, which requires 60 votes in order to overcome a point of order raised against legislation that reduces revenue beyond the ten-year timeframe of budget resolutions.\footnote{The Byrd rule requires that any “extraneous” provision in a budget bill (i.e., one having significant revenue or spending impact) be stricken unless sixty senators vote on the floor of the Senate in favor of retaining such provision. The rule is described in Allen Schick, \textit{The Federal Budget: Politics, Policy, Process} (Washington, D.C.: Brookings Institution, 2000), 128–29. Senate Rule 22 (the cloture rule) requires a three-fifths vote of the Senate to end a filibuster. As a result of both rules, legislation that significantly impacts on the budget requires a super-majority of sixty votes to pass the Senate.} Republicans had a majority in the Senate, but not the 60 votes necessary to survive a point of order. Hence, the sunset provision. This meant from the onset that the Bush tax cuts were only \textit{temporary}. Of course, the...
expectation was that a Republican Congress would reenact the legislation sometime in the next ten years. That never happened. By the end of the decade, Republicans would lose control of both houses of Congress as well as the White House. Nevertheless, the GOP remained firmly in control of the redistributive tax policymaking process in 2003 and made the most of the opportunity.

Notwithstanding a significant decline in federal revenue and rising deficits, the Bush administration pushed for yet another round of tax cuts. Over the objections of Democrats, congressional Republicans enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003, which accelerated the effective date of the tax cuts previously adopted in 2001. The 35 percent maximum rate (previously scheduled for 2006) was made retroactive to January 2003; reduced capital gains rates were similarly accelerated. But the December 31, 2010 expiration date remained in place as Republicans still lacked the requisite 60 votes in the Senate. So when Democrats claimed a major electoral victory in 2008, it appeared as if the Bush tax cuts would be left to expire on schedule—returning the tax code pretty much to where it stood in 1993 when Bill Clinton was president. Before that happened, however, the Republican party enjoyed an improbably comeback in the 2010 midterm elections, greatly altering the political landscape. Knowing that Republicans would take control of the House and hold 47 seats in the Senate in the 112th Congress, the Obama administration reached a compromise with the Republican leadership on the expiring tax cuts. Despite protests from liberals that the president gave away too much, the lame-duck Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which was signed into law by President Obama on December 17, 2010.

103 Largely as a result of the 2001 and 2003 tax cuts, federal taxes fell to 15.8 percent of GDP in 2004, well below the average of 18.5 percent for the period from 1980 to 2003. Eric Patashnik, “Budgets and Fiscal Policy,” in The Legislative Branch, ed. Quirk and Binder, 397.

Pursuant to this compromise legislation, the Bush tax cuts were extended for another two years for all taxpayers (not just those with less than $250,000 of income, as liberal Democrats wanted). The federal estate tax, which had expired for 2010, was resurrected for 2011 with a maximum rate of 35 percent (as opposed to the 55-percent rate previously scheduled) and the exemption for the estate tax was raised to a very generous $5 million (from the $3.5 million in effect in 2009). Unemployment compensation was temporarily extended, a host of expiring tax credits were renewed, and the Social Security wage tax was cut by 2 percentage points for one year.

As so often happens with political compromises, everyone got something and no one was happy. Liberal Democrats felt betrayed, and conservative Republicans wanted more—specifically, a permanent extension of the income tax cuts and repeal of the federal estate tax. But they lacked the votes and money for that and had to settle. Even still, the legislation will cost the U.S. Treasury some $858 billion over ten years.\textsuperscript{105} Notwithstanding that hefty price tag, few were satisfied with the bill, which was the product of divided government and a fickle electorate. With neither party enjoying a clear advantage, the same divisive issues are sure to be raised again—either in two years when the compromise package expires or when one party or the other gains more decisive control over the redistributive tax policymaking process. However it plays out, there is no reason to believe that the battle over marginal tax rates will ever be “resolved.” As long as the underlying cleavages and divisions remain (as they surely will), future shifts in the electorate and the balance of power between the parties will produce new majorities, and the resulting majoritarian coalitions will enact new redistributive tax policies that change marginal tax rates to reflect the political

commitments and prevailing ideology of the majority party. Redistributive tax policy is an ongoing political drama for which there is no final act or conclusion.

Assessment

We see now that there are no fewer than three distinct political arenas of federal tax policy. Indeed, there is no single “federal tax policy” but rather three different types of tax policy, each made in a separate arena. To a large extent, these political arenas are independent of each other. For example, while the battle over marginal tax rates was waged by the two parties for more than five decades, the tax bureaucracy drafted its rules and regulations unfazed; likewise, congressmen in committees enacted ever more special tax preferences. To be sure, the separate policy streams are interconnected. This is because all tax policy ultimately must be approved by Congress, which often does so through a single legislative package that includes a mixture of distributive, regulatory, and redistributive tax policies. In such cases, the separate tax policies are combined into a single bill. But what we refer to as tax policy in the United States is really an amalgamation of the separate policy outcomes produced in their respective political arenas.

Much as Lowe suggested, each arena is characterized by its own distinctive pattern of politics, decisionmaking, and interaction among the relevant participants. In this respect, the nature of the tax policy “causes” the mode of politics. At the same time, much as the institutionalists would predict, the “rules of the game” of each political arena “structure” policymaking. The institutional architecture of Congress lends itself toward distributive tax policymaking, just as the rules and norms of the professional tax bureaucracy shape regulatory tax policymaking. Electoral contests and majoritarian politics produce a uniquely erratic pattern of
redistributive tax policy, especially with respect to the rate structure of the federal income tax. Institutions structure tax policymaking.

While confusing to outsiders, there is reason and purpose behind the segmentation of tax policymaking. While the Constitution formally “assigns” to Congress the general authority to make revenue and tax policy, as a practical matter, it is in the interest of Congress as a political institution to further delegate this authority to the tax committees—certainly with respect to distributive tax policies. The committee system that organizes Congress facilitates distributive tax policymaking. Similarly, the incentives created by the unique institutional features of Congress (e.g., elections and single-member districts) encourage congressional policymakers to exercise the power of the purse in very specific ways—namely, to impose taxes on the general public to finance governmental operations and then enact targeted tax preferences that relieve their own constituents of the burden of those taxes. This translates into an income tax with a high marginal rate and numerous exceptions. Make no mistake about it, this structure of the federal income tax serves the political interests of individual congressmen. Undoubtedly, nations with different constitutions and political institutions will generate their own distinctive patterns of tax policymaking—for instance, in the European democracies where revenue policy is largely a function of the executive. Such an assignment of the power of taxation could not but produce a different pattern of tax policymaking than one in which the authority to draft the tax laws is granted to representatives elected from single-member districts.

As we have seen, within the institutional parameters of Congress, there are significant political rewards for those who serve on the tax committees and bring home the “tax bacon” for their constituents. There are few comparable rewards for regulatory tax policy. Thus, it is not surprising that Congress as a political institution has collectively delegated the authority to make
regulatory tax policies to a nonpartisan bureaucracy of experts and professionals, sheltered from the direct pressures of interest groups and partisan elections. The professional staff in the Treasury Department has the duty to administer the tax laws, but Congress also delegates to them the authority to draft the technical rules and regulations of enforcement. This makes perfect sense from the perspective of the members of Congress: retain the power to make pork-barrel tax policies and delegate the responsibility for making regulatory tax policy. Standing before their constituents at election time, incumbents can blame the bureaucracy for the burdensome tax regulations and claim credit for all the popular tax expenditures. While morally perverse, such a course of action is entirely logical within the context of the incentives imposed on policymakers by Congress as a political institution. Of course, congressional politics does not consist only of individual members going their own separate ways. If it did, the institution would soon collapse under its own weight. To avoid this, Congress as an institution has created sub-institutions to check the perverse impulses of individual congressmen to accommodate their constituents with overly generous special tax preferences. These include the Office of Tax Policy in the Treasury Department, the Joint Committee on Taxation, and the Congressional Budget Office. At times, the Ways and Means Committee has played a similar “institutional maintenance” role in restraining the distributive tendencies of congressmen.

Congress must also approve redistributive tax policies; however, these policies are made in a different political arena, through a different political process, and by different political actors than those associated with distributive and regulatory tax policies. Log-rolling and vote-trading are effective for making distributive tax policy but not for redistributive tax policy. Likewise, while a decentralized committee system may be an ideal institutional arrangement for satisfying the interests of congressmen in distributing special tax preferences to constituents, it is not suitable for
enacting major national tax policies that redistribute wealth between economic or social classes. Such policies require the support of majoritarian coalitions backed by a “mandate” from the electorate. Redistributive tax policymakers depend on political parties to aggregate support for such divisive issues. Backing from the White House also helps. Without a strong majoritarian coalition bridging the chasm between the legislative and executive branches, a major redistributive tax policy is unlikely to be enacted, and if it is, unlikely to persist for long. Likewise, political compromises entered into by the party leadership in the absence of a strong majority are susceptible to being reversed by the next shift in the electorate. This has been the pattern for the past nine decades. The politics of redistributive tax policy is as fickle as the electorate.

Without the extra-constitutional institutional innovation of political parties, it is hard to imagine how the American political system could cope with the highly charged political issues raised by redistributive tax policies. For the past 150 years, the national party system has successfully contained the political conflicts provoked by such contentious redistributive policies as the imposition of a progressive income tax and wealth transfer taxes. But contain does not mean resolve. Such conflicts are endemic to redistributive tax policy and ultimately, American politics itself. There is no “end” to redistributive tax policymaking any more than to politics itself. Federal tax policy is the outcome of politicians making and remaking the tax laws to conform with the ideological preferences of the dominant political majority, the electorate, the interests of private groups and constituents, and the dictates of “relatively autonomous” tax regulators. The result is a complex tax code portions of which favor many different groups and interests but overall satisfies no one.