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5 The Politics of Tax Reform in the 1980s

Charles H. Stewart III

The 1980s proved to be one of the most volatile decades in American tax-reform history. In a policy area normally characterized by incremental change, the eighties witnessed two major reform efforts along with a host of lesser, yet significant adjustments. Income tax rates were slashed in 1981, resulting in the only drop in real federal tax receipts since the Great Depression that was not associated with war demobilization.[1] The tax code was again comprehensively rewritten in 1986. Payroll taxes undertook a steady upward march, bolstered by the 1983 Social Security "rescue package." By the end of the decade, revenues from Social Security taxes had not only risen well beyond those generated by corporate profits taxes, but they were beginning to challenge the income tax for preeminence among federal revenue sources.

The purpose of this paper is to examine the political and institutional foundations of this remarkable stream of events. Two general points will guide this examination. First, although the eighties coincided with exceptional volatility in the tax code, much of the debate was structured by the historic divisions that have separated the two major political parties. Taxation has usually been at the heart of partisan cleavages in the United States. Since at least the New Deal, Democrats and Republicans have differed over the progressivity of the tax code and the allocation of revenues between personal income and corporate profit taxes. The 1980 election set the stage for the imposition of a Republican-inspired tax policy in 1981. Democratic resurgence in Congress during the rest of the decade did nothing to alleviate the stalemate over the aggregate size of revenues.

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The second organizing point of this paper is that this perennial partisan battle over the form of taxation in the United States was guided in the 1980s by crucial institutional and political changes that had their impetus in the 1970s. In the United States, changes in policy outcomes can come about either because of changes in voter preferences (see Page 1987; Shapiro and Page 1988) or because of changes in the political institutions that aggregate these preferences.[2] In the years preceding the 1980 election there was an institutional revolution in the apparatus of making tax policy at the federal level. A series of institutional reforms "democratized" proceedings in the U.S. Congress, making that body more amenable to innovation in tax laws in the early 1980s.

The remainder of this paper is organized as follows. Section 5.1 provides a brief historical overview of changes in federal tax policy during the 1980s. Section 5.2 discusses changes in public perceptions about taxation and the responses of the two major political parties to these changes. Section 5.3 examines how two important institutional features of federal policy-making, the House Ways and Means Committee and the constitutional system of checks and balances, influenced the shape of tax policy during the decade. Section 5.4 contains the conclusion.

5.1 Tax Reform in the 1980s: An Overview[3]

The election of 1980 set the stage for the most comprehensive change in the tax code in a generation. Ronald Reagan, aided by a working majority in Congress, managed to push through Congress the Economic Recovery Tax Act (ERTA) of 1981. The scope of these changes was dramatic. Among the most important elements of ERTA were the following: personal income tax rates were cut, with a further cut in capital gains taxes; tax "bracket creep" was halted by tying the brackets to changes in the Consumer Price Index (CPI); businesses and individuals were allowed to accelerate capital depreciation; businesses were allowed to "lease" tax credits to other businesses; and estate taxes were lowered. Taken together, these changes have been estimated by the Office of Management and Budget (OMB) to have lost about $750 billion to the Treasury between fiscal years 1981 and 1986.

Concern over a reduction in revenues brought on by a deterioration of the economy and the effects of the 1981 tax cuts led Congress in 1982 to consider and pass the largest tax increase to date in peacetime history. Leadership in support of a tax increase came from within Congress, particularly the Senate Finance Committee, which was the focus of negotiations between Congress and the Reagan administration. The resulting Tax Equity and Fiscal Responsibility Act (TEFRA) promised to raise about $90 billion in new revenues over a three-year period.[4]

TEFRA rolled back some of the accelerated depreciation provisions of the ERTA and other corporate tax benefits; restricted and phased out the use of "safe harbor" leasing arrangements; required federal employees to pay Federal Insurance Contributions Act (FICA) tax for Medicare coverage; instituted a more comprehensive "minimum tax" for wealthy individuals; instituted a series of measures to improve compliance with federal tax laws, including the ill-fated attempt to institute withholding for interest and dividend payments; raised taxes to augment the airport trust fund; and raised excise taxes on telephone calls and cigarettes. Most of the revenues gained through this law came in the increase in business taxes, which recovered about one-third of the revenues lost in the previous year's tax cuts.

The most astonishing and puzzling reform of this decade was the 1986 Tax Reform Act (TRA). The TRA was exceptional in the degree to which it followed many of the prescriptions that academic economists had been advocating for decades, resulting in a broadening of the tax base. The net effect of the TRA was also to add some progressivity back into the personal income tax system that had been lost in 1981, even though the 1986 reform had many elements of a "flat tax" (see table 5.1). Individual income tax rates were lowered, more low-income individuals were taken off the rolls, and the number of brackets was reduced from 14 to four.

To make up for the loss of revenues from these changes, corporate taxes were increased, the minimum tax was raised, the capital gains special exclusion was repealed, interest deductions for consumer purchases were phased out, the investment tax credit was repealed, and deductions for business expenses and Individual Retirement Account (IRA) contributions were tightened (see table 5.2). The scope of the changes represented by the TRA was so sweeping and contrary to expectations about the American policy-making process that experts and observers still remain puzzled in trying to explain its passage.[5]

Controversy remains over the degree to which the 1986 act accomplished the announced goal of "revenue neutrality." Congressional analyses accompa-

Table 5.1 **Estimated Percentage Change in Tax Liability for Income Classes due to the 1986 Tax Reform Act (Estimates made at the time of passage)**

Income class (1986 dollars)	1987	1988
Less than $10,000	−57.2	−65.1
$10,000–$20,000	−16.7	−22.3
$20,000–$30,000	−10.8	−9.8
$30,000–$40,000	−9.4	−7.7
$40,000–$50,000	−9.8	−9.1
$50,000–$75,000	−1.0	−1.8
$75,000–$100,000	4.3	−1.2
$100,000–$200,000	4.6	−2.2
Greater than $200,000	9.8	−2.4

Source: U.S. Congress, Joint Tax Committee. 1987. *General explanation of the Tax Reform Act of 1986.* Committee Print, 100th Cong., 1st sess., p. 17, table I-2.

Table 5.2 **Summary of Estimated Budget Effects of the 1988 Tax Reform Act, FY 1987–91 (in billions of dollars).**

	Tax Year					
Provisions	1987	1988	1989	1990	1991	1987–91
Individual	−14.0	−41.0	−37.9	−15.6	−13.5	−121.9
Corporate	25.3	23.9	22.5	23.4	25.2	120.3
Excise	.3	.4	.3	.2	.2	1.5
Employment	.1	. . .	. . .	. . .	. . .	−.1
Gift and estate	. . .	. . .	. . .	. . .	. . .	. . .
Customs	. . .	. . .	. . .	. . .	. . .	. . .
Totals	11.5	−16.7	−15.1	8.0	12.0	−.3

Source: U.S. Congress, Joint Tax Committee. 1987. *General explanation of the Tax Reform Act of 1986*. Committee print, 100th Cong., 1st sess., p. 1358, table A-1.

Note: Ellipses indicate amounts of less than $50 million. Details may not sum to totals because of rounding.

nying the passage of the bill reported no net change in revenues through the first five years of its implementation. It was assumed that revenues would be lost on net during its first three years (fiscal years 1987–89), but that these lost revenues would effectively be made up by fiscal year 1991 (see table 5.2). However, OMB estimates of the reform's effects are quite different (tables 5.2 and 5.3). According to the OMB, the tax reform act ended up being the second-largest tax cut of the decade. Data now becoming available also suggest that initial assumptions overestimated the net increase in business taxes, but underestimated the net cut in individual income taxes (*New York Times*, 3 March 1990, A1).

A change in the tax law that is frequently overlooked is one that concerned Social Security. In response to the recommendations of the National Commission on Social Security Reform, Congress passed fundamental changes to the program in 1983, including a provision to bring new federal workers under the system and to raise payroll taxes. Indeed, changes associated with the 1983 Social Security Act amendments represented by far the largest net tax increase of the decade, in terms of total revenues, once they were fully implemented: these modifications called for almost $100 billion to be raised in fiscal year 1990, compared to the $57 billion attributable to the effects of the 1982 TEFRA (table 5.3).

In addition to these major laws that had a substantial and long-term impact on federal revenues, about a dozen others were passed during the decade that changed the structure of the federal tax system. Probably most interesting among these changes was a marked increase in the number of dedicated trust funds in the budget and the total amount of money reflected in them. In fiscal year (FY) 1979, trust funds accounted for 41% of federal revenues, but by 1988 this had grown to 52%. The growth of trust funds in part reflected the

Table 5.3 **Changes in Budget Receipts, FY 1982–1990.**

Year	1982	1983	1984	1985	1986	1987	1988	1989	1990
Receipts under tax laws in effect January 1991	650.8	656.0	749.4	821.3	822.5	873.9	1,002.6	1,088.2	1,167.3
Administrative action	.2	.2	.0	.2	.2	1.0	.8	.8	.6
Legislative changes:									
ERTA 1981	−35.6	−82.6	−136.8	−168.5	−170.3	−207.5	−264.4	−290.9	−322.8
TERFA 1982		17.3	36.0	40.7	39.2	49.2	57.3	55.7	57.2
TRA 1986							−8.9	−24.4	−20.3
Changes in Social Security	1.9	5.3	15.5	31.2	30.5	39.7	70.3	85.2	105.1
Other laws passed:									
1982		1.7	4.2	4.4	4.2	4.5	4.9	5.1	5.1
1983			−2.4	−1.7	−1.7	−1.0	−.6	−.9	−1.4
1984			.9	9.3	9.3	16.0	25.4	27.7	31.0
1985							2.9	3.0	3.0
1986							1.6	2.6	1.5
1988							11.4	16.9	18.7
1988							2.0	3.0	9.3
Other	.5	−.4	−.4	−.1	.1	0.6	3.4	3.8	3.3
Total recepits	617.8	587.5	666.4	736.8	734.0	776.4	908.7	975.8	1057.6

Source: U.S. President, 1982–90. These are estimates provided in the annual budget documents, therefore they are subject to frequent revision. Therefore, these figures should be taken to represent ballpark figures, rather than hard-and-fast estimates.

Note: The first row of figures is an estimate of the amount of revenue that would have been generated in each fiscal year if no changes to tax law had been made in the 1980s. Other rows gives estimates of the revenue gains or losses for that fiscal year attributable to the relevant change in tax law. For instance, if there had been no changes to federal tax law during the decade, then the federal government is estimatjed to have received $1,167.3 billion in revenues during FY 1990. The net effect of the 1981 ERTA is estimated to be a loss of revenues during FY 1990 to the order of $322.8 billion. The net effects of changes to the 1981 ERTA itself are reflected in the estimates for the relevant subsequent tax laws; e.g., the effects of rolling back the accelerated depreciation provisions of the ERTA that occurred in 1982 are reflected in figures for TEFRA.

rise in Social Security contributions mandated in 1983 and before, but not entirely: The share of non-Social Security trust-fund receipts rose from 19% to 24% of all federal revenues between FY 1979 and FY 1988.

The growth in the importance of dedicated revenues and trust funds within the federal budget reflected at least two strategies that became increasingly popular as the decade progressed. One was the popularity of pay-as-you-go schemes: by limiting expenditures in these programs to current revenues plus accumulated surpluses, national politicians could claim they were enacting popular programs without adding to the size of the deficit. Second, trust funds were popular among program supporters because having a dedicated income stream was believed to protect programs from future spending cuts.

Throughout the decade, outlays for programs tied to trust funds rarely approached income to the funds. At the end of FY 1979 the OMB reported combined trust fund balances of $183.6 billion. By the end of FY 1988 these balances had grown to $548.4 billion, a nominal increase of 200% and a real increase of 83%. This gradual accretion of trust fund surpluses served to blunt the deficits occurring in the "federal funds" portion of the budget. In 1988, for instance, trust funds reduced the size of the federal deficits by about 39%.[6] Because trust fund surpluses are invested in U.S. Treasury securities, the practical effect was to make more revenues available for the federal funds portion of the budget.[7] Because interest is then paid from the Treasury to the trust funds, the net effect is also to provide some general fund revenue for trust fund programs such as Social Security.[8]

Few would dispute the degree to which tax laws are different in 1990 compared to 1980 or the level of upheaval that accompanied most of these changes. According to one estimate of the effects of the various tax laws during the decade, in fiscal year 1990 the federal government will collect approximately $100 billion less in revenues than it would have collected if no changes had been made to the tax code during the 1980s (table 5.3). The 1981 cuts accounted for over 90% of revenues lost during the decade—a total of $323 billion in FY 1990 alone—while laws passed after 1981 amounted to a net increase in revenues of over $200 billion in FY 1990.

Leaving aside net aggregate changes in revenue levels, changes early in the decade shifted revenues away from corporations and toward personal incomes, especially wages (fig. 5.1). Later reforms restored the relative standing of corporate taxes, but did not end the shift in the individual tax burden from a broad-based income tax toward a narrower tax on wages, reflected in rising Social Security contributions.

Another important change in the tax code was its attention to investment, saving, and capital formation. Both parties went into 1980 dedicated to addressing the prevailing "stagflation" with a host of proposed revisions to the income tax code. Indeed, the name of the tax change that finally passed in 1981, the *Economic Recovery* Tax Act, illustrates the legacy of this concern. Every major provision that was placed in the act was justified as a method of

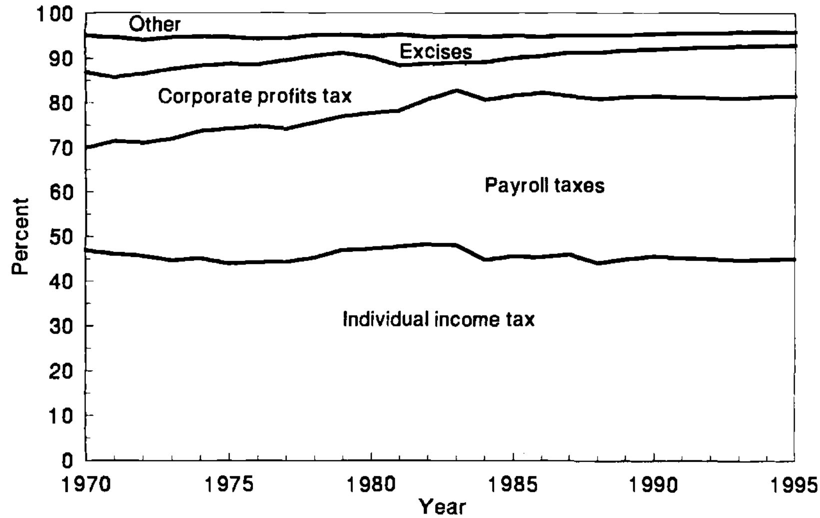

Fig. 5.1 Percentage composition of federal receipts by sources, FY 1970–95 (figures for FY 1990–95 are estimates)
Source: U.S. President, 1991, A-286.

stimulating economic vitality. Yet, one is struck at the rapidity with which many of these provisions were rescinded or scaled back—some in the interest of recovering lost revenues (as with TEFRA in 1982) and some in the interest of lowering marginal rates (in 1986). In fact, one close observer of the 1986 reform battle noted that "the architecture of the Senate committee bill makes the capital gains increase a load-bearing wall" for the distribution of the resulting tax cut among income groups (Shanahan 1986a).

Because net spending cuts were never enacted during the decade nearly to the degree of the net tax cuts (especially the 1981 tax cuts), the persistent problem of the federal deficit is closely related to taxation politics during the decade (see McCubbins, in this volume). Indeed, tax increases in 1984, 1985, 1986, 1987, and 1988 (amounting to about $50 billion in new revenues by FY 1990) were a direct consequence of grappling with the budget, either within the formal reconciliation process under the Budget Act or under less formal negotiations between congressional leaders and the administration.

Having sketched out the contours of changes in tax policy during the 1980s, I will use the next two sections to explore shifts in attitudes and institutions that gave rise to the rocky road down which tax policy traveled in the 1980s.

5.2 Change and Continuity in Tax Preferences

Practically no one enjoys paying taxes. Yet most accept the inevitability of taxes along with life's other "givens." While taxes are inevitable, the contours of taxation—amount, type, and incidence—are not. Quite naturally, these basic questions about tax policy have animated much political debate throughout American history. The political parties in part owe their identities to their respective answer to the "tax question." And, it is their desire to win elections that keeps them attuned to changes in public attitudes about taxes.

In trying to understand tax policy during the 1980s it is instructive at the outset to look to preferences—first, those expressed by the general public and, second, those articulated by the parties. To some degree changes in tax policy in the 1980s can be attributed to changes in preferences expressed by the public and the parties. In large measure, however, expressed preferences remained remarkably stable, a fact that will lead us in the following section to analyze the institutions that translated preferences into policy.

5.2.1 Taxes and Public Opinion

In considering changes in tax law during the 1980s, it is important to back up and consider changes in taxation politics during the preceding decade. While one thing was constant—all groups and individuals in society continued to prefer to pay lower taxes to higher—two important developments occurred in the seventies that influenced tax debate in the eighties: (1) a nationwide, grass-roots "tax-revolt" that began in the states and (2) a shift in the debate about the consequences of tax reform toward an emphasis on the microeconomics of taxation.

What has been termed the tax revolt of the seventies began primarily as a state-level phenomenon best symbolized by the passage of Proposition 13 in California in 1978. The genesis of this movement is still subject to debate, but citizens' support for the measures advocated by tax warriors was associated with feelings that government had grown rapacious, inefficient, and bloated. Ironically, these attitudes infrequently coincided with a rejection of activist government. Indeed, few supporters of measures such as Proposition 13 believed that restrictions on state and local tax revenues would require service cuts. In the words of Sears and Citrin (1982), supporters of tax-cutting measures at the state level appeared to want something for nothing: because government was so full of waste, fraud, and abuse, it was commonly assumed that cutting revenues would simply cause state governments to cut waste, allowing existing services to continue at preexisting levels.[9]

If dissatisfaction with state-level revenue policies animated much of local politics in the middle 1970s, it was a matter of time before the electoral connection would manifest that dissatisfaction at the federal level. As citizens were reining in states' abilities to levy taxes, they were also changing their overall evaluation of the equity of the federal system of taxation: throughout the decade, the federal income tax was perceived to be the least fair of all taxes (fig. 5.2). It is not surprising, therefore, that members of Congress (MCs) agitated more vigorously for reform of the federal tax code as the

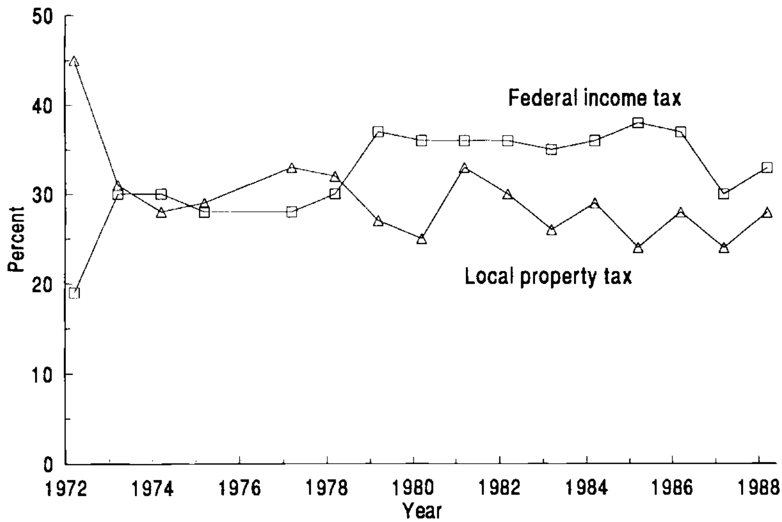

Fig. 5.2 Which do you think is the worst tax—that is, the least fair? (only responses naming the federal income tax and local property tax are graphed)
Source: Advisory Commission on Intergovernmental Relations 1988

1980s began, and that proposals to cut taxes and amend the Constitution to limit the federal government's tax powers became popular.[10]

Whether this revolt had any lasting effect on the federal level beyond support expressed for the 1981 tax cuts is unclear. Once rates were cut in 1981, the number of citizens who believed federal tax rates were too high dropped and the number who favored an increase in tax rates rose, especially if the purpose of the proposed tax increase was to expand popular federal programs.[11] (Still, surveys by the Advisory Commission on Intergovernmental Relations [1988] suggest the most popular revenue-raising proposal by far is a national lottery.) The sense that the political rage over the tax issue had been sufficiently vented is attested to in the gradual undoing of the tax consequences of 1981 and the almost unheard of passage of tax increases in four successive election years.

The second interesting political change during the 1970s that influenced tax debate in the eighties was a subtle shift in the elite debate about federal taxes that deemphasized macroeconomic policy stability and emphasized microeconomic efficiency. The specific economic ills that were addressed in this debate were diverse, but the most important were the stagflation of the 1970s and the United States' increasing lack of competitiveness in global markets. The movement that fostered the debate was most clearly associated with the "supply-side" economics school, which argued that the existing tax system provided disincentives for work, discouraged entrepreneurship and innovation, discouraged capital formation, and channeled scarce resources into unproductive sectors of the economy.[12]

The arguments advanced by supply-side economists in the 1970s supplied a political agenda for the Reagan tax changes in 1981.[13] Many if not most of the reforms advocated by supply-siders were adopted by Congress in 1981, including a reduction in the top marginal rate, accelerated depreciation, and provisions to encourage saving.

Related to this debate about the structure of the federal tax system was a new willingness to use the tax code to achieve certain social ends. While the use of tax preferences to achieve social and economic ends has always been a part of the tax code, conservatives (and a few liberals) began to see the tax code as the optimal way to achieve social goals in comparison to bureaucratically managed social programs. This analysis was a direct consequence of the work of Niskanen (1970) and others, who noted that bureaus were inherently inefficient in achieving social purposes. By providing benefits directly through the tax code (e.g., providing tax incentives to build low-cost housing instead of having the federal government build housing projects) social ends could be achieved virtually automatically, without bureaucratic inefficiencies.

In a time of general disenchantment with bureaucratic government, these types of arguments even became attractive to many liberals. Further, faced with fiscal constraints, tinkering with the tax code provided an attractive avenue to continue social programs at a lower level of visibility. The result was a proliferation of tax preferences designed to achieve specific social purposes. While this practice of accelerated "tax expenditures" began in the middle-1970s—the Carter energy program virtually floated in tax incentives—their use ballooned beginning in 1981 and continued strong until the 1986 tax reform eliminated many tax preferences (see table 5.4).[14]

One consequence of this proliferation of tax expenditures, in addition to the narrow economic benefits that were conveyed on segments of society, was the growing complexity of the tax code. The complexity of the individual income tax brought on a gradual rise during the 1980s of the percentage of tax returns filed using the 1040 form, rather than the IRS's shorter 1040A or 1040EZ.[15]

This complexity, brought on by the proliferation of special income tax provisions, was one of the most important motivations behind tax reform in 1985 and 1986. The magnitude of tax expenditures appears to have been significantly reduced (table 5.4), although the length of the IRS forms most individuals must fill out has remained unchanged or has even lengthened.

All would probably agree that a positive outcome of the heightened salience of the issues raised by tax reform has been a greater widespread appreciation of how economic actors respond strategically to provisions of the tax code. An important negative consequence has been the progressive complexity of the tax code, which makes taxpayers even more skeptical of the federal government's ability to govern and less confident that future changes to the tax code will indeed achieve the results foreseen by reformers.[16]

Table 5.4 **Federal Tax Expenditures in Selected Outlay Functions, FY 1975–89, (In billions of 1989 dollars)**

	Fiscal Year			
Function	1975	1979	1985	1989
Energy	7.1	7.6	28.6	1.0
Natural resources and environment	.8	1.6	2.3	2.9
Commerce and housing credit	.2	110.9	213.8	153.1
Education, training, employment, and social services	4.2	21.2	31.6	21.4
Health	12.7	26.2	39.3	46.7
Income security (including Social Security)	37.0	52.6	137.2	94.7
Total tax expenditures				
Dollars	159.1	267.0	486.3	373.0
Percent of outlays	21.2	31.4	45.2	33.3

Source: U.S. President, various years.

5.2.2 The Parties Respond

From the beginning of the Republic, tax policy has been at the root of partisan divisions in the United States, and tax preferences ultimately reflect the constituency bases of the two parties. Jeffersonianism arose, in part, in reaction to Hamiltonian (i.e., Federalist) tariff policies.[17] Almost from the creation of the Republican Party in the 1850s, Democrats and Republicans have fought fiercely over tax policy: first, they fought over the level of the tariff, with Republicans defending protection and Democrats favoring "a tariff for revenue only" and an income tax. Since the permanent institution of the income tax in the 1910s, the two parties have fought over its salient features, with Democrats favoring more progressive rates and a greater reliance on taxing corporate profits and Republicans opposing both policies.

On the whole, the public appeals made by the two parties in the 1980s evoked each party's respective heritage, although this does not mean that they did not respond to the transformation of the taxation issue begun in the 1970s. In line with the past, the 1980 Democratic party platform emphasized the equity of the tax system, highlighting changes in the tax code to help lower- and middle-class taxpayers. The Republican platform emphasized a tax cut in general, with a reduction in the top rates in particular to encourage "productivity and saving." The 1984 Democratic platform decried the "combination of loopholes for the few and high rates for the many" instituted during the preceding four years, while the Republicans promised to "eliminate the incentive-destroying effects of graduated tax rates" that had been foisted upon the country by a string of Democratic administrations. In general, when it came to working on particular changes in the tax code, Democrats in the

1980s attempted to protect progressivity while efforts to reduce business taxes and to lower capital gains and other taxes paid disproportionately by wealthy individuals were generally led by Republicans in Congress and in the White House.

Arguing that partisanship pervaded the process and defined the major divisions of the tax-reform debate does not mean that these cleavages were always clear. As mentioned in the previous section, Democrats proved to be as adept as Republicans in offering concessions to businesses and high-income taxpayers when bargaining over the 1981 tax cut became most intense. And divisions within the Democratic party became evident in 1981 and during the 1989 effort to cut capital gains taxes. In these cases, Republican administrations could exploit divisions within the Democratic party to promote the passage of Republican tax policy. Still, strategic attempts to court pivotal voters, in the electorate and in Congress, should not be confused with fundamental changes in the parties' cores as embodied in platforms and expressed by activists.

Details of the tax debate in the 1970s and into the early 1980s can be understood from the perspective of the parties trying to forge winning electoral coalitions around an increasingly salient issue. Although it did not require the Republican party to give up long-held beliefs, it can be argued that the Republican resurgence after the debacle of 1974 came through their identification of taxation as an issue bound to attract votes. Ronald Reagan's own message particularly embraced the politics of the tax warriors of his own state and set the agenda for the early years of his administration.[18]

The Democratic response to the heightened salience of taxation was more tortured. The problem for the Democrats was especially focused in 1981: reeling in the wake of the 1980 election, when the Senate had unexpectedly gone Republican, House Democrats could only wonder whether 1982 would be a repeat of 1980 (or even of 1934, the last time the party controlling the presidency gained seats in the House during an off-year election). Southern Democrats were especially in a tight spot, since the 1980 election represented the greatest strength of the Republican party in the South since Reconstruction. Southern Democrats had lost 8 of their 77 seats in the House in the 1980 election, along with 4 of their 16 Senate seats. Of the Southern Democrats who remained in the House, Ronald Reagan was proficient in winning votes in their districts: Reagan carried 58% of the southern districts that sent a Democrat to the House in 1980 (*Almanac of American Politics* 1982).[19]

The result of the South's electoral uncertainty in 1981 was to induce support among most Southern Democrats for ERTA. On the four substantive roll call votes on the 1981 tax cut, Southern Democrats supported the cut by margins of 71%, 54%, 88%, and 96%, respectively (Congressional Quarterly *Almanac* 1981).[20] Northern Democrats opposed these votes by margins of 72%, 93%, 60%, and 65%, while Republican support only once dropped below 99% support, when they opposed the Udall substitute with a 97% margin.[21]

Once the 1982 recession dissipated the threat of a "Reagan realignment," Southern Democrats returned to the fold, and, until the aborted effort to cut capital gains taxes in 1989, Southern and Northern Democrats generally joined forces to oppose Republicans on tax votes in both the House and Senate. For instance, the roll call votes in the House of the 1982 TEFRA found, on average, 73% of the Northern Democrats and 74% of the Southern Democrats voting against 42% of the Republicans (Congressional Quarterly *Almanac,* 1982).

Therefore, the rising salience of taxation and the parties' response had two major influences on tax reform in the 1980s. First, taxation was an issue on which Ronald Reagan claimed his mandate in 1980 and on which Southern Democrats tried to secure their electoral positions in 1981. The confluence of these two events opened the door for an overall decrease in revenues and a dramatic reduction in corporate taxation in 1981. Second, results from the 1982 and subsequent congressional elections made it clear that Ronald Reagan did not have extraordinary electoral appeal and that the "partisan realignment" some political scientists and commentators were anticipating would not be forthcoming. The Democrats became more unified, and Republicans themselves were more frequently on the defensive with the electorate in fiscal matters. Thus, improved Democratic fortunes in Congress for the rest of the decade helped restore corporate taxes and some of the progressivity that was lost in 1981.

5.3 Institutions and Tax Policy

While preferences may be the ultimate source of policy in a democracy, there is a plethora of different institutions through which those preferences may be channeled into policy outcomes. In this section I focus on two institutional systems—one small, the other great—and their influence on tax policy during the 1980s. The first is the committee system in the House of Representatives and the second is the system of divided powers defined by the Constitution.

5.3.1 Reform in the Tax Committees

Much has been written about the institutional reforms that gripped Congress in the 1960s and 1970s. The end result of these reforms was to distribute political influence more evenly throughout the two chambers, but especially in the House, which was the more rule bound of the two. More than most committees, the House Ways and Means Committee, the key tax committee in Congress, was buffeted by several waves of reform.[22]

Almost from the beginning of the Republic, the Ways and Means Committee had been afforded a special place in the power hierarchy of the House, and that power remained virtually undiminished (and frequently expanded) until the 1960s.[23] It was the first substantive standing committee created in the House; it has continued to have sole oversight over tax legislation in the House for two centuries; before the emergence of a formal party leadership system at the turn of the twentieth century, its chair was typically regarded as the floor leader of the majority party in the House; after 1910 its Democratic members became the "committee on committees" for all Democratic committee assignments; with the rise of social insurance legislation in the 1930s it acquired considerable authority over spending programs such as Social Security and Medicare; and its legislation was considered in private sessions, frequently coming to the House floor under a "closed rule," which prohibited amendments. Combined with the leadership of independent and wily chairs, such as Wilbur D. Mills (D–Arkansas) who chaired the committee from 1959 to 1974, Ways and Means was usually *the* authoritative instrument of making tax policy in the entire federal government.

As a practical matter, Ways and Means' firm grip on tax policy was Janus-faced. On the one hand the strict control exercised over tax policy by Ways and Means and the strict screening mechanism for choosing its members yielded a conservative tax code whose provisions changed slowly and which produced revenues sufficient to fund the expenditures granted by its sister control committee, Appropriations. On the other hand, iron-clad control meant that certain types of "reforms" were unaddressable, especially those favored by the growing number of liberal Democratic representatives who entered Congress in the 1950s and 1960s. It also meant that the few tax preferences that were meted out were provided at the sufferance of the chairman in a way the rank and file often thought arbitrary.

Formal reforms that most affected the Ways and Means Committee during the 1960s and 1970s included the following: the committee's size was increased by approximately 50%; the Democratic members of the committee ceased to function as the party's "committee on committees"; Ways and Means was required to create subcommittees with staff and agendas controlled by the subcommittee, not the committee chair; and the use of the "closed rule" was severely restricted and brought under the oversight of the Democratic caucus. In addition, the chairs of all House committees became electable through secret Democratic caucus balloting. And all committees were required to hold meetings in public unless its members voted in a roll call to close a particular meeting. Finally, party leaders began appointing fewer members to the committee who came from safe electoral constituencies and placed more electorally "marginal" members on the committee.

The general impact of these institutional reforms was to make Ways and Means a more permeable political body and, ultimately, to make tax policy more amenable to shifting political winds.

Events of 1981 were frequently used as evidence about the cumulative faults of the various committee reforms, especially those that changed the authority of Ways and Means. According to the conventional accounts of this legislative session, the considered judgment of Ways and Means' leaders and staff were frequently ignored, and its electorally vulnerable members were in no institutional position to protect the principle of a coherent tax code against the appeals of vocal (and well-heeled) special interests. In the end, the frenzied bidding between the Reagan administration and House Democratic leaders, all of whom used tax preferences as currency, was facilitated because the institutions of tax control had been gutted.

So, at best, these earlier reforms facilitated political responsiveness in the tax code in the wake of the 1980 election. At worst, these reforms gutted the Ways and Means Committee's function as a bulwark against lost revenues, trendy tax theories, and preferential treatment of prosperous special interests through tax breaks.

The earlier changes in Congress had less dramatic impact on subsequent reforms as the decade progressed. Indeed it can be argued that changes to the tax code after 1981 came *because* party and tax committee leaders found ways to circumvent the porosity of the postreform Congress and its tax committees.[24]

For instance, success in developing TEFRA in 1982 is often attributed to Senator Robert Dole's (R–Kansas, chair of the Senate Finance Committee) deciding to mark up the legislation in a closed party caucus and then enforcing a strict germaneness rule when the bill was considered on the floor. After 1984, Dan Rostenkowski (D–Illinois, chair of the House Ways and Means Committee) began regularly closing all markup sessions of his committee. And, the 1986 Tax Reform Act may have been saved from becoming yet another loophole giveaway when the chairs of the Ways and Means and Finance Committees intervened at crucial moments to lead closed-door, behind-the-scenes bargaining (Birnbaum and Murray 1987; Conlan, Wrightson, and Beam 1990).

Changes made by party leaders in assigning members to Ways and Means also point in a more subtle way to the restoration of that committee's insulation from short-term electoral forces. The transformation of the Ways and Means Committee can be dated with the 94th Congress (1975–76), when the committee's size was expanded from 25 to 37 members. Combined with new appointments necessitated by electoral defeat and retirement, most members of Ways and Means were new to the committee. And, of these brand new committee members, nearly half were serving either in their first or second terms in the House (table 5.5).

Following another large entering class with the 1976 election, only one-third of the members of Ways and Means had served on the committee for at least two Congresses. Thus, not only was the typical member of Ways and Means in the late 1970s a neophyte in terms of prior House and committee service, but he (or she) was of the "Watergate generation." Classes elected in 1974 and 1976 were renowned for being especially adept at keeping close to their constituents and using new technologies and techniques to win reelection. (A large part of this innovation was out of necessity, since many members of the classes of 1974 and 1976 were Democrats elected from typically

Table 5.5 Prior Service in House of Representatives, New Appointees to Ways and Means Committee, 80th–101st Congress (1947–91)

Congresses	Decade	%[a]	*N*
82d–86th	1950s	8	25
87th–91st	1960s	20	25
92d–96th	1970s	51	43
97th–101st	1980s	29	24

Source: Congressional Directory, various years.

[a]% of new members of Committee on Ways and Means serving first or second term in the House of Representatives.

"Republican" districts, and thus especially vulnerable electorally.) Thus, the instincts of many members of Ways and Means were not geared toward resisting constituent pressure once the 1981 tax wars rolled around.

For the past three Congresses, however, party leaders have begun again to appoint more senior and electorally secure members to Ways and Means (Strahan 1990, 146). While all new members are now of the post-Watergate era, waiting longer before appointing members to Ways and Means led to different committee dynamics in the late 1980s and into the 1990s. In particular, the views of recent appointees are better known to party leaders making committee assignments, which leads to fewer surprises in committee deliberations. In addition, senior members tend to be less electorally vulnerable, opening the way for Ways and Means, once again, to resist, rather than to capitulate to, shifting policy sentiments. Indeed, in his recent comprehensive analysis of politics and policy-making in the post-reform Ways and Means Committee, Strahan (1990) attributes the success of the 1986 reform almost entirely to efforts by House Democratic leaders and chairman Rostenkowski to restore the tax-making process to something resembling the pre-reform status quo.

Therefore, as the decade ended it appeared that party and tax committee leaders were moving to reduce the visibility of tax decision making and to reduce tax policy porosity. Whether these will represent long-term changes will likely be answered as tax policy continues to be debated in the 1990s.[25] If it does represent a break from the immediate past and a return to the politics of the Wilbur Mills era, then the resurgent permeability of Ways and Means will certainly cut two ways. The committee (and ultimately the internal revenue code) may be more resistant to particular demands for tax relief, but there are no guarantees that such impermeability will induce responsiveness to more general demands for tax reform, as was charged against the pre-reform Ways and Means Committee.

5.3.2 The Separation of Powers and Tax Policy

Another key institution that deserves mention is the division-of-powers system embodied in the Constitution. Of course, this is an institution that remained formally unchanged during the 1980s, but it is also an institution that affected the course of tax politics in important ways.

By separation of powers I am of course referring to the system by which the three legislative "branches"—the Senate, House, and presidency—are elected in separate elections from different constituencies. Majorities in the Senate and House, along with the president, must simultaneously concur with a piece of legislation before it overturns the status quo to become law. Therefore, in considering legislation, majorities in each congressional chamber, in addition to the president, hold a veto power over legislative changes.

Recent work in the public-choice theory of legislatures has been impressed by the veto game created by the Constitution (see McCubbins 1990, and in this volume), but it has also noted that the power to veto legislation is not absolute (see Kiewiet and McCubbins 1991, chap. 9). This is because the Constitution also allows Congress to move first (and, in the case of taxation, the House to move before the Senate) and thus set the agenda in legislation.

Figure 5.3 illustrates a very simple example of how the "trilateral veto power" might interact with congressional agenda-setting power to limit changes in tax policy. Imagine that the continuum in figure 5.3 delineates the mix between income and corporate profits taxes. In the example, the House median (*H*) prefers taxes to be oriented more toward corporate profits, the president (*P*) prefers more taxes to come from personal incomes, and the Senate median (*S*) prefers some middle course. Let *Q* indicate the status quo, or the current tax mix, which is to the right of the president's ideal.

Assuming Euclidean preferences,[26] the House median could not craft a tax bill that would take tax policy all the way to its ideal point, since the president would object to such a bill (although the median senator would concur). But, there is a bill, labeled B_H, that the president would prefer to *Q* and which the medians in both congressional chambers would also prefer. Thus, the presidential veto would keep the president from having to endure tax policy located at *H*, but agenda-setting power such as that granted to the House in the Constitution allows the House to move policy closer to it, to B_H.[27]

Such "agenda-cum-veto" power was important during the 1980s because, during the entire decade, control of the federal government was split between the Democrats and Republicans. Thus, tax policy was susceptible to such vetoes. Once the tax code was changed dramatically in 1981 it would be nearly impossible to amend the code to change total revenues dramatically or to change significantly the relative standing of each party's core constituents.

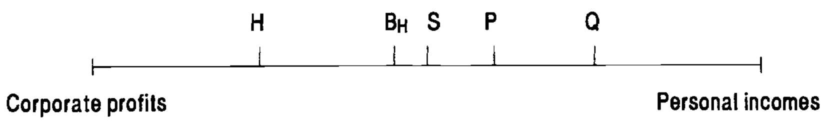

Fig. 5.3 One-dimensional examples of "trilateral veto game" between the House, Senate, and president over tax policy

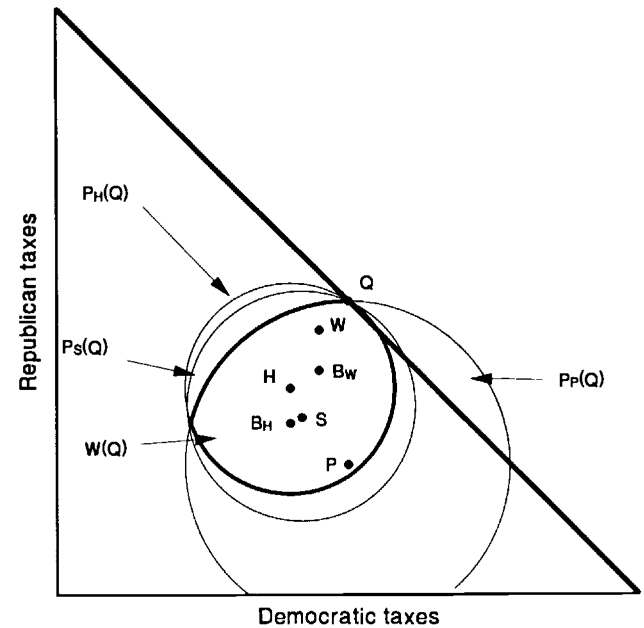

Fig. 5.4 Location of pivotal members of the House and Senate and the president in relation to the status quo after the 1980 election

Figures 5.4, 5.5, and 5.6 below use a simple spatial model and one of among many plausible depictions of relevant preference to suggest why it was possible to overcome the objections of the House majority Democrats in 1981 and pass an essentially Republican tax reform, and then why stalemate was virtually guaranteed afterwards.

Figure 5.4 presents, in stylized fashion, the location of the relevant actors following the 1980 election along two dimensions of tax policy. The first dimension measures the amount of revenue to be generated by taxing corporations and high-income individuals, while the second dimension measures the revenues generated by taxing low- and middle-income individuals. For brevity I will call these "Republican taxes" and "Democratic taxes," respectively, to indicate whose constituents will pay more taxes.

The status quo, Q, is the baseline from which the other bliss points are located. (The diagonal line represents all points at which tax policy would yield revenues identical to Q.) "Pivotal" members of the House Ways and Means Committee, the House, and the Senate, along with the president, are represented as points labeled W, H, S, and P, respectively.[28] Each point indicates that, as we move away from the status quo, a majority in each institution preferred more and more tax cuts and they preferred those cuts to be targeted more and more toward high incomes and corporations. A series of circles represents the regions in which the relevant political actor would prefer tax policy to be, compared to the status quo. These circles represent each institution's "preferred-to set" against the status quo, indicated by $P_i(Q)$ for $i = H$, S, and P. (To aid in clarity, the Ways and Means Committee's preferred-to set is omitted, but it would be a small circle centered on W and passing through Q.)

In order to change tax policy, any credible proposal must lie within the intersection of the preferred-to sets of the House, Senate, and president. This intersection is termed the "win set" [$W(Q)$] and is highlighted with bold lines in figure 5.4.

Note two things about this diagram. First, assuming Ways and Means would follow the traditional course and report the tax bill to the floor under a closed rule,[29] it would have reported a bill identical to its own ideal, W, since $W \in W(Q)$. However, the high salience of the issue virtually guaranteed that the liberal Democratic majority on Ways and Means would be unable to impose its will on the House. Thus, in a series of negotiations within the committee and with key leaders of House Democrats, Rostenkowski managed to get a bill through Ways and Means more like B_W—less progressive than most on the committee preferred but still more Democratic in character than that preferred by Senate Republicans and the administration. The key to this strategy, however, was an up-or-down vote on the plan, engineered through a closed rule.

What the administration and its followers believed, however, was that a majority in the House would support a bill such as B_H (larger overall cuts and oriented more toward businesses and high-income individuals) if the House were given the opportunity to vote for it. In fact, supporters of the administration prevailed, and the committee-reported tax cut was effectively paired against the Republican substitute, leading to an ultimate victory for the president.

A bill much like B_H was ultimately sent to Ronald Reagan for his signature. It contained a smaller cut than he originally called for in his February 18 tax address, and its mix of business and individual tax changes was not his ideal, but the outcome was virtually as good as he could do, given preferences in Congress.

Once something like B_H had been installed as the status quo, notice how the dynamics of tax reform shifted (fig. 5.5). (Ideal points in figs. 5.4 and 5.5 are identical. In fig. 5.5, Q has been shifted to reflect passage of B_H as the tax law.) First, compare the win sets of figures 5.4 and 5.5. In figure 5.4 this was a large region southwest of the old status quo, constrained principally by majority preferences in the House. In figure 5.5 (after the tax cut) it has collapsed to a barely perceptible lens radiating out from the new status quo to the northeast. Substantively this suggests that the range of bargaining over tax policy shrank dramatically after 1981. Second, notice that while there is room to negotiate for a tax increase, it is slight. What movement is possible allows for slight adjustments upward of Republican and Democratic taxes.

Figure 5.5 provides some insight into the politics of the 1986 TRA. Mem-

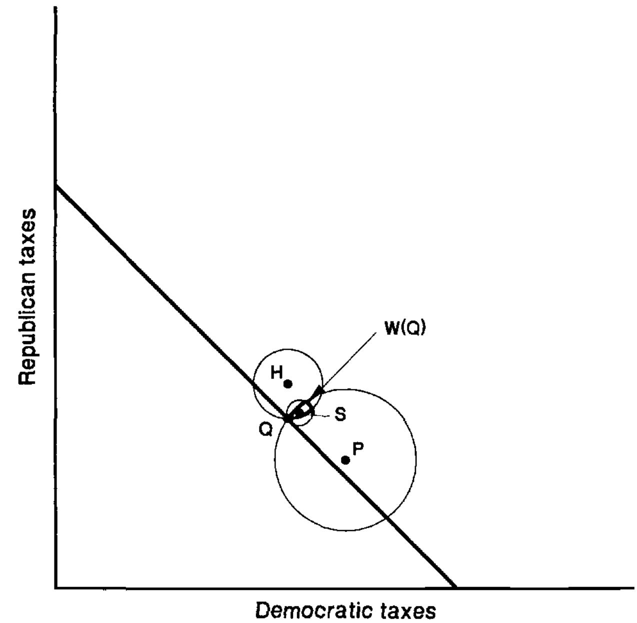

Fig. 5.5 Location of pivotal members of the House and Senate and the president in relation to the new status quo after the 1981 tax cut

bers in all three legislative institutions had reason to be dissatisfied with tax policy and to desire a change. However, the outcome of the 1981 ERTA severely constrained the range in which they could *jointly* act to change policy. With only a moderate change in preferences among the relevant actors between 1981 and 1986 any reform would have to be (nearly) "revenue neutral."

Figure 5.6 moves the location of the Senate to equal that of the House, to suggest how the election of 1986, which brought the Democrats back into control of the Senate, may have changed the interinstitutional dynamics of tax policy politics. The figure suggests that the election of 1986 left the underlying tensions of making tax policy virtually unchanged—there is room for a slightly larger tax increase than before, but only barely.

The details of this example are sensitive to the precise location of ideal points chosen, but any of the number of plausible representations yield the same results: events of 1981 moved tax policy much closer to the Pareto set and, as such, limited severely the ability to alter tax policy in the ensuing years. Thus, in the complement to spending politics (see McCubbins 1990, and in this volume), the existence of institutional vetoes in setting tax policy served to keep total taxes down during the decade, once the 1981 tax cut had been passed. Majorities in the Congress (and their supporters), along with members of the administration (and their supporters), may be seriously troubled by the current state of tax policy, either because of its total yield or

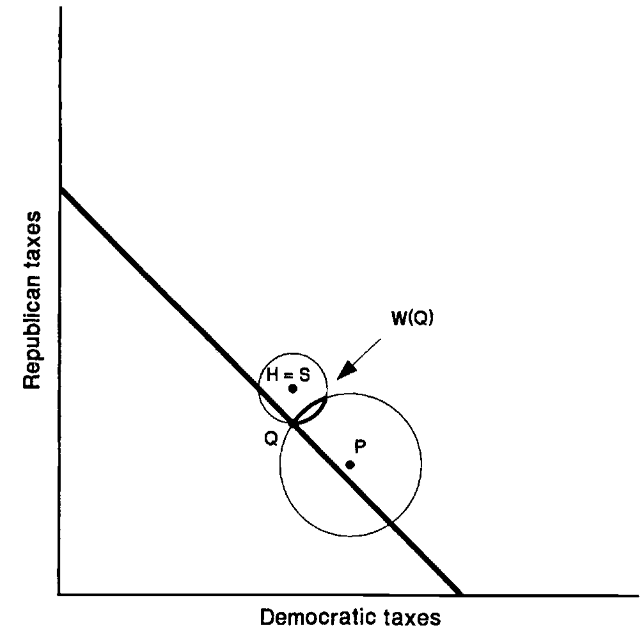

Fig. 5.6 Location of pivotal members of the House and Senate and the president in relation to the new status quo after the 1986 election

its incidence, but, given the separation of powers, there is little they can do short of dramatic electoral turnover that yields unified partisan control of the entire federal government.

5.4 Conclusion

The general thrust of the accounting presented here is simple: tax policy in the 1980s was guided by the confluence of changing preferences and institutions. As the decade began, discontent with taxation had reached a high level, and a president was elected promising to cut taxes in a particular way. Uncertainty among congressional Democrats over the magnitude and significance of Reagan's 1980 electoral victory, along with Republican gains in both the Senate and the House, provided an influx of individuals into the federal government in 1981 intent upon lowering taxes with a supply-side flavor. Reforms in the 1970s designed to make the House Ways and Means Committee more responsive to floor majorities also helped the passage of supply-side tax reform in the House nominally controlled by the Democrats.

After 1981 the story was completely different. While the 1981 tax cut was not a policy equilibrium, it was nearly so: given the configuration of policy preferences in the House and Senate, along with institutional vetoes, room to maneuver in negotiating tax policy had shrunk dramatically. There was perhaps room for reform that cut taxes a little more and restored a little progressivity to the tax code, but nothing as dramatic as the changes in 1981. Stalemate in tax policy, which is half the stalemate in balancing the federal budget, is a product of the 1981 tax reform and the constitutional system of separated institutions sharing power.

This summary of tax policy may seem to fly in the face of what appears to be volatility in tax policy after 1981, especially the events of 1985 and 1986. Yet it is also reasonable to ascribe the constant tinkering with the revenue code after 1981 and the piecemeal lurching back toward higher revenues to the severity of the constraints posed by the cataclysmic events of 1981. Nor are events of 1985–86 entirely inconsistent with this analysis. The primary reason bargaining over reform took so long, even though it was Ronald Reagan's key second-term domestic initiative, was that the outcome of 1981 heightened the inherent partisan tensions surrounding tax policy. The final deal was a delicate compromise that allowed partisans of each party to claim victory—Democrats for aiding the very lowest ends of the income scale and Republicans for moving the income tax close to a "flat tax."[30] Given the close partisan balance in Congress, had Ronald Reagan not made tax reform a crowning jewel of his second term, reform would have been impossible. Even so, the vetoes inherent in the separation of powers assured that neither party could credibly claim to have instituted their own party's ideal tax system.

Much of the course of tax reform in the 1980s can be understood beginning with an appreciation of the historic partisan division over tax policy—the changes in 1981 were clearly "Republican" reforms and the resulting efforts to deal with their budgetary effects (i.e., deficits) were hampered by the division of partisan control of the federal government for the entire decade. On the margin, institutional and political developments help to round out an understanding of tax reform during this decade. Palpable dissatisfaction with taxation that grew during the 1970s set the stage for dramatic alterations of the tax code following the repudiation of the Democratic party in the 1980 election; the rise of supply-side economics set the agenda for the particular type of revisions that were initially considered; and the democratization of Congress during the two preceding decades made tax policy more responsive to outside pressures and left committee and party leaders in Congress scrambling to adapt to this new institutional order.

Given that this essay is about policy-making in a key economic arena, one may ask about the role of economic theory and advice in shaping the course of events in the 1980s—such a discussion has been notably absent in this essay. The reason economic theory and the advice of economists has been minimized here is that there is little compelling evidence in the record of the decade that these were powerful independent factors guiding the fate of reform. To the extent that new theory entered the debate, it was largely to bolster the positions held by the two parties for over a century. In other words, the ascendance of supply-side theory shifted the grounds of debate, but it hardly reoriented the worldview of most Republican and Democratic politicians. As with innovation in other eras, neither party conspicuously embraced ideas orthogonal to their past. Thus, it is difficult to say that tax policy *consciously* followed any economic theory of taxation or that pronounced trends, such as those toward greater reliance on payroll taxes or the changing taxes on capital gains, followed any logic other than short-term electoral necessity (broadly construed).

Finally, this essay has focused considerable attention on Congress and little on President Reagan, even though he dominated the decade politically and seemed frequently to be the driving force in tax policy throughout. In part I have refrained from analyzing too closely Reagan's personal impact on tax policy because political scientists are uncomfortable basing general statements on the actions of individual presidents—the "*n* of one" problem. Aside from his fixation on the top marginal individual tax rate, I have focused here on what is most important about Ronald Reagan: he was a Republican. He brought Republican advisors into the executive branch, banished any overt mention of tax increases from public discourse, and (credibly) threatened to veto any change to the tax code that noticeably increased the tax burden on his party's constituents. That accomplished, the real political work shifted to Congress, which is charged by the Constitution with laying and collecting taxes.

Notes

1. The time period of comparison here consists of intervals of three fiscal years. "Tax deficit" is defined here as

$$d_t = \sum_{i=0}^{2} (R_{t-i} - R_{t-3})/R_{t-3},$$

where R_t = real federal revenues in year t and R_{t-3} is the base year. In other words, this measure takes real revenues three years prior as the baseline and then aggregates the difference between the baseline revenues and actual revenues over the next three years. The measure is scaled by dividing each element in the sum by baseline revenues.

2. This is the point of the public-choice literature on legislatures. For useful overviews see Panning (1985) and Krehbiel (1988).

3. In the following section I primarily rely on the publications of Congressional Quarterly (relevant editions of the *Weekly Report, Almanac,* and *Congress and the Nation*) to characterize the details of the tax reforms of the 1980s. For lucid discussions of the economics of the income tax and tax reform, see Surrey and McDaniel (1985), Bradford (1986), and Pechman (1987). Citations to other contemporary accounts and interpretations of these reforms are made in the text.

4. Soon after the act was passed, the Joint Committee on Taxation estimated the following revenue increases due to TEFRA over its first three years: $18.0 billion in fiscal year (FY) 1983, $37.7 billion in FY 1984, and $42.7 billion in FY 1985 (U.S. Congress, Joint Taxation Committee 1982, 455). These predictions turn out to be close

to subsequent OMB estimates based on experience with the act's provisions (see table 5.3 below).

5. For analyses of the politics of the 1986 cut, see Birnbaum and Murray (1987), Strahan (1990), Conlan, Wrightson, and Beam (1990) and the symposium on the reforms in the summer 1987 issue of the *Journal of Economic Perspectives*. To Birnbaum and Murray, the tax reform is explained primarily in terms of the hard work of two committee chairmen, Senator Mark Hatfield and Representative Dan Rostenkowski. Conlan, Wrightson, and Beam emphasize the interactions of "ideas, experts, and entrepreneurs" in an age of "new politics" dominated by policy constraints and the news media. Strahan attributes the change to institutional developments in the House Ways and Means Committee.

6. This figure is calculated as follows. In FY 1988 total trust fund receipts were $473.7 billion and outlays were $375.9 billion, which resulted in a trust fund surplus of $97.8 billion. The overall federal deficit in FY 1988 was $155.1 billion. Had the $97.8 billion trust fund surplus not been collected (or had it been spent instead), the federal deficit would have been $252.9 billion. Thus, the trust fund surplus reduced the deficit by 39% (= 97.8/252.9).

7. It is this effect that led Senator Daniel Patrick Moynihan (D–New York) in late 1989 to propose a significant reduction in payroll (FICA) taxes (Elving 1990). Moynihan's sentiments echoed those expressed by the Democratic members of the National Economic Commission, a blue-ribbon panel appointed with the charge to find a plan to balance the federal budget. (Moynihan was a member of the commission, which issued its report on 1 March 1990.) The minority report issued by the Democrats concluded:

> Let no one suppose that a Democratic Congress will much longer allow a *payroll* tax to be used to service a $2 to $3 trillion debt owned in vastly disproportionate amounts by wealthy individuals and institutions. It already required nearly one-half the revenues of the *income* tax to pay the interest. This surely is the largest transfer of wealth from labor to capital in the history of our "political arithmetic." But at least this is a graduated tax. . . . The nation struggled for a generation to ratify the XVth Amendment to the Constitution. We are not about [to] see it effectively repealed by a reform in the financing of Social Security. (National Economic Commission 1989, 56–57)

8. About 10% of trust fund receipts are currently derived from interest payments on federal debt instruments. About one-seventh of the federal government's annual interest payments are made to trust funds.

9. There is evidence that citizens nationally did not equate taxes, spending, and budget balancing too closely. Asked in 1980 about the tax effects of a constitutional amendment requiring the federal government to balance its budget annually, 35% of respondents predicted such a requirement would cause taxes to increase, 24% predicted taxes would be unchanged, and 28% predicted it would result in a tax cut (*Gallup Poll* 1980, 77–8).

10. The Gallup Poll has taken regular soundings on citizen attitudes concerning the proposed balanced-budget constitutional amendment and suggested remedies for balancing the budget. From 1976 onward, support for a proposed constitutional amendment to require an annually balanced budget has never been supported by fewer than 63% of all respondents or by 73% of respondents who expressed an opinion. When given a choice of remedies for balancing the federal budget, the most favored remedy has typically been spending cuts. In 1983, for instance, only 18% of respondents favored using the income tax to help balance the budget; this had risen to only 22% in 1986. (In 1982 there was large support for raising excise taxes on liquor and cigarettes—70% favored vs. 23% opposed—but the question was not asked in subsequent

polls.) By increasingly larger margins during the decade the only remedy receiving majority support for reducing the deficit was cutting military spending (see *Gallup Poll*, esp. 1976–89).

11. For instance, in an early 1988 poll, 64% of respondents reported being willing to support a tax increase if the proceeds would go toward improving education. This proportion varied little according to whether the respondent had children in public or private school, or whether the respondent had children in school at all (*Gallup Poll* 1988, 16).

12. A bible of this movement was Gilder (1981); see Greider (1985), Stockman (1987), and Roberts (1984) for insiders' views of the supply-side revolution.

13. Whether this body of work merely represented a repackaging of traditional Republican "trickle-down" economics remains open to dispute. For insights to this question see Greider (1985), Stockman (1987) and Lekachman (1982). At the very least this body of literature was compelling enough that more mainstream economists felt a need to respond to it, and voters, many of whom still associated Republican economic policy with the Great Depression, became more receptive to Republican economics.

14. The definition of what constitutes a tax expenditure, in addition to the whole issue of whether tax expenditures exist at all, is controversial. Table 5.5 is useful, however, in gaining insight into the order of magnitude by which changes have been made in the tax code to effect social ends.

15. For tax year 1980, 61% of returns filed were on form 1040. This rose to 67% for 1986 before falling back slightly to 66% in 1987, the first year changes from the 1986 TRA were in effect (U.S. Internal Revenue Service, Fall 1989, 76). The 1986 TRA appears not to have affected the percentage of returns prepared by a tax preparer (U.S. Internal Revenue Service, Spring 1989, 113).

16. For a unique argument in favor of complexity in the tax code see Lindsey (1990).

17. For historical looks at the issue of taxation see Witte (1985), Hansen (1985), Taussig (1892), Bauer, Pool, and Dexter (1963), Selko (1940), and Stanwood (1903).

18. One must not go too far and ascribe Reagan's election in 1980 to his views on tax policy, or any policy for that matter. Substantial research on public opinion during the 1980 election indicates that most of the public was typically closer to Jimmy Carter on policy matters than to Reagan (Frankovic 1981). The election of Reagan itself can easily be ascribed to the poor economic performance of 1980, rather than by the public's embrace of Republican economic policies (Kiewiet and Rivers 1985; Ferejohn and Fiorina 1985).

19. Another, less-cited statistic suggests that Southern Democrats should have been less worried about Reagan's electoral appeal: Reagan only out-polled 4 of 69 Southern Democrats in their districts. Thus, while Reagan carried 58% of the Southern Democratic districts, 94% of the Democratic representatives still ran ahead of the president.

20. The first two votes were substitutes by Congressmen Udall (D–Arizona) and Conable (R–New York). The last two were votes on final passage and on the conference report, respectively.

21. On these votes there was an average of 157 Northern Democrats, 76 Southern Democrats, and 188 Republicans. Thus, assuming all the Republicans voted together, they needed only 23 Southern Democratic votes to win.

22. The standard history and analysis of the pre-reform Ways and Means Committee is Manley (1970); also see Fenno (1973). For analysis of the post-reform era, see Rudder (1978, 1983, 1989) and Strahan (1990). Bach and Smith (1988) and Smith (1989) also contain more general accounts about how the institutional reforms of the 1970s affected the relationship between the House floor and its committees.

23. The only significant diminishment of Ways and Means' jurisdiction came in

1865, when it lost authority over appropriations bills to a new Appropriations Committee and lost jurisdiction over banking regulation to a newly created Banking and Currency Committee (Stewart 1989).

24. For a sustained argument along these lines see Strahan (1990, chaps. 6, 7).

25. The repeal of the Medicare Catastrophic Coverage Act suggests that well-organized groups still have tremendous influence in the tax policy apparatus, although the persistent resistance by the leadership to efforts to cut capital gains taxes suggests just the opposite—that leaders can resist popular tax cuts when they so desire.

26. All that is really required is that the utility functions of each actor be symmetric around her ideal point. Because these models are mostly illustrative, in this section I assume that all utility functions are represented by "simple Euclidean preferences." On spatial voting models and representations of utility see Enelow and Hinich (1984) and Ordeshook (1986). For purposes of the examples I also assume the utility functions of all members of each chamber are identical.

27. In the example, the Senate median is unable to bargain for a bill closer to it ($B_S = B_H + \varepsilon, \varepsilon \to 0$) because the House median prefers Q to any B_S. Note that, given the configuration of preferences and the location of the status quo, granting the Senate median the right to move first would yield tax policy located at $B_S = S$, while granting the president the right to move first would produce $B_P = P$. On such "structure-induced equilibrium" models see Krehbiel (1988).

28. I am of course ignoring problems of social choice instability *within* each institution for the sake of clarity in the example.

29. A closed rule would allow no amendments and force an up-or-down vote on the floor.

30. Republicans were notably silent about the 1986 repeal of the capital gains exclusion, a special provision of the tax law that seems key to their concerns about stimulating investment. Subsequent attempts to reinstate the special treatment of capital gains suggests why this is so: revenue gained from the capital gains repeal provided the revenues necessary to lower the top marginal rates and to scale back preferences more favored by Democrats (e.g., IRAs) (Shanahan 1986a, 1986b; Rapp 1986). Thus a reinstitution of the capital gains exemption, which might be defensible on economic grounds, would be disastrous for revenues because of the revenue lost directly through the reinstatement and the revenues lost by the exclusions that Democrats would demand in return.

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Comment David F. Bradford

As the author confirms by his summary of the history, the 1980s constituted a period of very considerable movement in tax policy. In particular, the 1980s saw two major pieces of income tax legislation, the Economic Recovery Tax Act (ERTA) of 1981 and the Tax Reform Act (TRA) of 1986. ERTA cut indi-

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vidual and corporate rates, made "permanent" the investment tax credit, greatly accelerated depreciation, increased the capital gains exclusion, and gave up a *lot* of revenue. It also, very significantly, introduced indexing of tax brackets and exemptions, thereby profoundly altering the reversion point of income tax policy. The TRA radically reversed the treatment of investment, radically cut corporate and individual marginal tax rates, and radically shifted the revenue mix toward corporations and away from individuals. In addition to these major income tax changes, the Social Security Amendments of 1983 cut benefits and sharply increased payroll tax rates.

Stewart's focus is on the income tax changes. The logic of his approach is that of time-series analysis, although not of the formal statistical variety, with income tax policy as the dependent variable. A time-series model has two elements: (*a*) a times series of dependent and exogenous variables and (*b*) a hypothesis about the relationship between the two groups of variables, including a specification of any time shift in that relationship.

In a loose sense, the objective of Stewart's paper is to "explain" the experience of the 1980s. Strictly speaking, we cannot ask more of empirical analysis than to reject hypotheses. In this complex setting there are inevitably many hypotheses that are not rejected by the record. What we presumably must settle for are hypotheses that are somehow inherently plausible. We would also like hypotheses that are truly informative in the sense that, knowing the hypotheses about the shift in time structure of the relationship and knowing the path of the exogenous variables, we could go a long way toward predicting the path of the endogenous variables (tax policy, in the present case).

I think it is fair to describe the exogenous variables in Stewart's model as the party dominance of the houses of Congress and the presidency. During the Carter years, 1977–80, Democrats controlled all three. In the 1980 elections, Reagan captured the White House, the Republicans took over the Senate, and Republicans gained in the House. Although the Senate remained under Republican control through the elections of 1986, the threat to Democratic control of the House evaporated in the elections of 1982. In Stewart's analysis, the influence of these exogenous political events on policy took place in a system experiencing a time shift in the relationship between exogenous and endogenous variables consisting of the playing out of new "porosity" of the House Ways and Means Committee from 1980 onward.

The endogenous variable, income tax policy, is characterized along two dimensions: the amount of revenue raised and the degree of progressivity (relatedly, the "pro-" or "anti-" business nature of the rules).

Here is how I understand Stewart's time-series analysis: (1) In 1981, the Reagan landslide plus new porosity imply a radical policy shift toward the Republican position (ERTA of 1981). (2) In 1982, Democratic resurgence in the House implies the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, a reversion toward the Democratic position within the ERTA framework. (3) In 1986, a stalemate in political power implies revenue and distributional neutrality of the TRA of 1986, but the new porosity permits the considerable innovation in the details of policy. (4) After 1986, the Democratic recovery of the Senate is insufficient to break the stalemate, so no further innovation in tax policy takes place.

Although I find this description of the politics of income tax policy stimulating, I find the model unconvincing in two respects. First, I question the stability of party preferences as Stewart describes them. I would say that, in the crucial dimension of revenue, the Reagan policy preference represented a sharp break from the traditional Republican position. If that is the case, the Republican dominance after 1980 cannot explain the policy development; one must distinguish Reagan Republicanism from traditional Republican viewpoints. (And perhaps one must explain the emergence of the former?) There was also change over time in the Democratic policy position. Second, I do not feel that the dimensions of policy identified by Stewart—revenues and progressivity—capture the distinguishing features of what to me is the most remarkable break with the past in the story, the astounding-to-all-observers transformation of the structure of the income tax embodied in the TRA of 1986. It seems to me hard to explain the tax policies of the 1980s without adding (and preferably explaining) Ronald Reagan as a political phenomenon.

From the perspective of the structural character of the income tax, I would describe the time series of the dependent variable somewhat differently. When I was at the U.S. Treasury during the Ford administration, a Democratically controlled Congress was holding the fort against Republican policies that were oriented toward encouraging business investment and balancing the budget at lowered levels of spending. (Treasury Secretary William Simon vigorously promoted procapital formation policies.) The apparently most probusiness policies under discussion, advocated by Congressman Jack Kemp, were not yet Republican orthodoxy. In 1976, Jimmy Carter was elected president; among his more prominent platform planks was a commitment to clean up an income tax system he described as "a disgrace to the human race." The Carter team at Treasury, headed by Lawrence Woodworth, longtime chief of staff of the Joint Committee on Taxation, put together a comprehensive reform package with many resemblances to the TRA of 1986 (although not with such low rates). In view of the experience of the end of the Ford administration, the Carter election victory, the familiarity with Congress on the part of the Treasury, and the overwhelming Democratic control of policy, one would have expected easy passage of what, up until that time, appeared to be the "Democratic" policy position: comprehensive income taxation (lower rates but relatively heavy taxation of capital).

Carter was effectively defied by the Democratic Congress, which instead put in place a policy that incorporated a variety of procapital formation features (saving incentives, extension of the investment tax credit, some accelerated depreciation, and enhancement of the capital gains exclusion). At the time I perceived in these developments a continuation of a long-term trend away from taxation based upon accretion income and toward one based effectively on consumption (a policy dimension not taken into account in Stewart's analysis). On the evidence of 1978, that trend was an expression of bipartisan preference.

From that perspective, the ERTA of 1981 represented a continuation of, rather than break with, the trend to that point in the structure of the income tax. The major change was a new indifference to large fiscal deficits, an outcome that reflected not the victory of traditional Republican policy preference but a remarkable shift in that preference from a traditional stance in favor of fiscal soundness. In its revenue dimension, the ERTA incorporated a traditional Democratic willingness to use the tax system to direct investment with the rather untraditional Reagan-Republican interest in cutting *current* tax revenues (government debt constituted discounted future tax revenue) independently of cuts in current spending.

Stewart's model seems to me to give no basis for predicting the structural, rather than the revenue, aspects of the TRA of 1986. My explanation has two pieces. The first is the Reagan-Republican focus on low marginal tax rates (to a significant degree independent of the base to which the marginal rates applied) and the second is the widespread conviction that an accretion income tax is "right." The former led the Reagan administration to put its weight behind the incipient base-broadening forces in Congress (Bradley-Gephardt, Kemp-Roth, etc.), and the latter led the professional staff at Treasury to propose a Haig-Simons income structure (rather than a cash-flow income structure, as might have been implemented in a continuation of the policy trend noted above). Under the circumstances, component-by-component revenue neutrality would have implied a much lower corporate income tax rate than the top individual income tax rate, an outcome regarded as politically untenable (not to mention probably unsustainable in implementation). So a corollary of the Reagan approach was not only a 180 degree turn with respect to the taxation of the return to investment, but also the rejuvenation of the corporation income tax as a source of revenue.

In view of the number of oxen being gored, it was by no means assured that the resulting policy would find acceptance on the Hill, but, in retrospect, it at least makes a certain amount of sense that the Democratic political forces in the House were willing to give their assent to a version of the Reagan proposal. The biggest surprise was the Senate, where, after a false start, Packwood's Finance Committee produced the low-rate formula that ultimately carried the day.

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