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Commentary: The Tax Legislative Process -- A Critical Need

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The one thing I will say is that, in contrast to Gene's recommenda-
tion, and I think—wish—that future decisions be left to fu-
ture policymakers. My later years in Congress teach me one thing,
and that is that future decisions will never be left to future policy-
makers as long as present policymakers can prevent it. I think that
is really beyond hope.

For the immediate outlook, I think we simply have to look for-
ward to more of the same, particularly since the strategy in the
1990 budget agreement was to redefine the budget problem. We
discovered that a $150 billion deficit was not enough to excite leg-
islators into action, and therefore we redefined it as a $300 billion
deficit, which seems to have more impediments in terms of individ-
ual initiative. But it also means that at these very high levels of
the new deficit targets, we are going to be on this treadmill of esti-
mating spending and then scrambling to back-and-fill in terms of
taxes for some time. This produces a scattershot approach in terms
of who is vulnerable and what sources of revenue are possible.

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I will react to some of the problems that Gene highlighted, in
two broad categories. One is the problem of creating fiscal slack,
and the second is the problem of the interaction of the tax and the
budget process. It is obviously no secret—everybody's commented
on it—that we have terrible problems raising taxes, and this has
meant a dramatic flight from federal general revenues. What I
want to call attention to is what this has meant for the way in
which we raise taxes, even though we don't always call them taxes,
and to suggest that, if this were something people were more aware
of, it might lay the groundwork for a shift in attitudes so that some
of our revenue-raising would be more efficient and perhaps more
fair.

The flight from federal general revenues has been largely in
the form of more or less mandatory costs to fund specific bene-
fits—what you might call a rise in internalized taxes. Now this may
or may not be appropriate, but let me explain some of the things
that I have in mind when I use that description.

First of all, there may be a greater enthusiasm for private reg-
ulation, which can be a form of taxation. I'm thinking here of pro-
visions in the Clean Air Act, provisions for the disabled, even some of the provisions of the immigration law, affirmative action in some ways, problems of leave policy for people with children. This may not be all bad. Some of these things internalize costs in ways that are very desirable, but they may simply impose costs on the private sector that, either economically or in terms of equity, are better placed upon the general public. If we don’t have that option, I suspect that insofar as we want to achieve certain goals, we will look more and more towards private regulation—imposing costs on the private sector. Perhaps some of you would say we won’t, and that’s bad also because we won’t get expenditures in areas that are so desperate for expenditures that anything will be an improvement.

The second form of revenue raising that is not federal general revenue is user fees, and there’s been quite a bit of that in 1990—the gas tax, the increase in Medicare by expanding the base. I have mixed feelings about all of this. I think the things that they are spent on are very desirable, and we certainly are undertaxed compared to other western industrialized nations as far as social insurance is concerned. But it may be that a lot of the things that these taxes are spent on, such as public transit, should be financed through general revenues. We have other kinds of what I call “in-kind” taxes that are not tied to specific expenditures, but which are popular in the sense that they are tied to specific purchases by individuals—sin taxes on alcohol and tobacco are viewed this way. Many of the taxes—environmental taxes, e.g., a surtax on the corporate income tax base which was meant to fund some of the Superfund activities—are thought of as in-kind specific user taxes in some rough sense. Maybe good, maybe not. But it’s obvious that the pressure is in this direction. Now that doesn’t mean that nothing happens in the general revenue area. Within the area of federal general revenues, most people have commented on the problems of complexity, things like the passive activity loss rule, and the kiddie tax, and how last minute revenue estimates drive increases in federal general revenues. I don’t propose to comment on those topics.

I do want to comment on one thing nobody has mentioned: the bubbles. I like the bubbles. I know they’re called Darmanesque—I’m also from outside Washington, but I think that’s considered something of a slur. Bubbles are good. They keep alive the possibility of progressivity, which I think is healthy. I think the 31 percent tax rate is directly the result of people reacting against the bubble. We still have plenty of bubbles. The corpo-
rate tax system is still bubbled. We now have these personal ex-
emption and itemized deduction bubbles. They're certainly not
bad if the incentive effects aren't terribly serious. The increase in
the marginal tax rates resulting from these bubbles is really not
dramatic at all. And it's not at all clear to me that they have much
negative incentive effect, which is supposed to be one of the things
you worry about when you have higher marginal tax rates, because
people can't figure out in advance what the impact of these bub-
bles is going to be anyway. This is one compromise made in getting
an increase in federal general revenues that is often thought to be
bad, but may not be so bad after all.

Now I do have some comments as to ways in which we might
increase federal general revenues. No one has mentioned the mini-
mum tax. The minimum tax may be a popular way of raising fed-
eral general revenues, by raising the rate a percentage point here
and there. There also is the fact that it's not indexed for inflation.
Tax Notes recently had a piece on this. I'd like to see a study
about how many years it will take, based on various projections of
inflation and increases in income, before the minimum tax will be-
come the main revenue raiser. That would be a way in which the
federal income tax could become a major source of increases in rev-
enue over time.

The second thing I want to comment on—by way of thinking
big rather than small—is to mention sales taxes. Rostenkowski is
not here, and neither is Al Ullman, for reasons which had some-
thing to do with his sympathy for a sales tax. But I really think we
need to start thinking about general sales tax revenues in this
country. If we're really thinking about getting revenue in any sig-
nificant way, we have to start laying the groundwork for changes to
be made 20 years, 30 years from now, just as the tax expenditure
debate laid the groundwork many years in advance. We don't do
anything along the lines of sales taxes the way Europe does. Why
not? One reason may be that our federal system leaves it to the
states to raise taxes, and perhaps states feel that their sources of
revenue from sales taxes would be vulnerable if the federal govern-
ment moved in. What about a federal sales tax of about three per-
cent or so, something fairly small to start off with, allowing a credit
against that for any sales tax paid under a state law that provides
for a general sales tax, up to some ceiling—perhaps two-thirds of a
three percent sales tax, leaving a one percent federal sales tax to be
collected. In those states without a general sales tax, a moderate
federal general sales tax would be imposed. This might have some
attraction for states because the umbrella provided by this kind of a tax would give some incentive to the states to adopt taxes which might not otherwise exist. The unemployment insurance model is the one I’m thinking of, except that here I hope the federal tax would piggyback onto existing state general sales taxes, rather than—as I believe was the case initially for most states with respect to the unemployment insurance tax—forcing states to get into the business of something that they weren’t doing at all.

Obviously the problem that people have alluded to is incentives. We just don’t have an incentive to raise revenues. People have wondered why. I think the answer may be fairly straightforward at this point—we simply mistrust public expenditures. We’re going through a period of time when we just don’t think public revenues and public expenditures are a way of solving problems. I don’t know whether this is a reaction to the war on poverty, or what it is. We are undertaxed compared to most other industrialized nations, yet there’s something about our public sector psyche that is simply different from a lot of other countries. So we need, in terms of leadership, as other people have mentioned, some way of selling to the public some kind of an increase in federal general revenues. I think it can be done with leadership, with public political rhetoric. Surtaxes can be imposed for particular purposes. I can imagine selling a sales tax, for a while at least, as an education tax. I know public finance people don’t like earmarking, but it can still be sold. In Massachusetts where I once lived there is the old age tax; it was nothing but a five percent sales tax, but everybody called it the old age tax, even though it wasn’t earmarked, and there was in the public rhetoric a sense that this tax was being imposed for a particular purpose. If we are indeed enthusiastic about a change for expenditures in a particular area of the law, it seems to me that the right kind of leadership could sell an increase in federal revenue in the future for something like education.

I want to make one or two comments about the integration of the tax/budget process that’s been alluded to. We now have the pay-as-you-go system which links taxes to entitlement expenditures. By “entitlement” I mean something viewed as a political entitlement in the sense that it’s too hard to repeal. “Entitlement” in the sense I am using means social security and welfare law—things for which the social contract is supposed to be so powerful that it is just not proper to withdraw these particular expenditures, usually redistribution of income activities.

In the pay-as-you-go system, there is a linkage of taxes and
certain kinds of spending. The problem that I see with this is that it's too limited. Tax expenditures are very often, in the way I'm using the word "entitlement," not entitlements at all. They are analogous to discretionary spending. And this is true of many of the social capital types of expenditures that have been extremely popular, e.g., in the 1990 Congress, child care and housing. I can't see why people who worry about tradeoffs should not be able, if they end a tax expenditure, to increase discretionary spending. I don't know politically why this was not considered. Maybe it was, and rejected. It may have something to do with the hostility to the phrase tax expenditures. In this respect I think we might be paying the price for the hostility to tax expenditures by not including them in the tradeoff with certain kinds of discretionary spending. The only suggestion I would make along these lines is that we consider reviving political integration of tax provisions with spending provisions. By political integration I mean integration of the committee consideration of certain kinds of activities, for example, with co-consideration by the education authorization committees and the tax committees, linking together reductions in tax expenditures with increases in discretionary spending on various kinds of education. I believe this would take a change in law, but it seems to me that it would be a reasonable experiment if we are serious about education. We might even consider taxing what some consider the original issue discount on some of the prepaid tuition plans; I wish somebody had thought of doing this when we got rid of the exemption for the living expense portion of scholarships, because there were a lot of elements of federal revenue that could have been squeezed out of the tax expenditure system and placed in discretionary expenditures in the area of education.

C. Eugene Steuerle

Let me make one comment on each commentator. I tend to agree with Gail's question whether future decisions would be left to future decisionmakers as long as present decisionmakers can prevent it. I do think that there are subtle ways over a long period of time where we can have an enormous impact in ways that—if we can just get them into the system—are often acceptable to policymakers.

I'll give two quick examples. One is in the Social Security Act of 1983, when we increased the retirement age from 65 to 67. That