Real Tax Reform Is Always Hard: Some Advice for the Task Force

By C. Eugene Steuerle

C. Eugene Steuerle is vice president of the Peter G. Peterson Foundation and previously was a senior fellow at the Urban Institute and former Treasury deputy assistant secretary for tax analysis.

Political theater? Such is the label many have attached to the tax reform task force headed by Paul Volcker. But I heard the same claim made about President Reagan's State of the Union request for a tax reform study from the Treasury Department to be made only after the 1984 election was over. Congress literally burst out laughing.

Forget the laughter. That 1984 study led to the Tax Reform Act of 1986, the most sweeping tax reform in the nation's history — and one that was bipartisan. Opportunity must be seen to be embraced.

I served as the economic coordinator and original organizer of that study. We knew from the start that if we wanted to have any impact, we had to square circles, offend many constituents, and contradict past claims of the administration itself. We lowered rates but at the same time reversed some of the base-narrowing efforts that the administration supported in 1981. We had fights with extreme supply-siders inside and outside the administration who wanted to keep negative tax rates on many investments, even with the proliferation of tax shelters and the resulting contribution to economic stagnation. And we were constantly opposed by political types everywhere, including in the White House and some departments, who either represented narrow constituencies or made the obvious but largely unhelpful objection that real reform might offend someone. And despite fears about transition costs, we moved to one of the highest real growth rates in the nation's history at that stage of an economic expansion.

Why should you or anyone else expect fewer complications this time? The success of your task force will depend on your determination as task force members. The more constraints you accept on doing what you believe to be beneficial to the public, the more you tie your study up in incomplete and contradictory recommendations. As just one example, if you want to move higher education tax benefits into a simplified structure, either as a direct spending item or as a single tax expenditure item, you either will have to accept creating losers with income under $250,000 or forgo simplification. Either decision could be interpreted as a violation of your mandate. You can't get around it. The only way to avoid creating losers (especially if we honestly recognize deficits as creating losers) is to maintain the status quo in all its "glory."

Therefore, the most important decisions the task force will make concern process. Here are my suggestions to you, the task force members, on how to proceed yet remain faithful to President Obama's mandate — just as the 1984 Treasury study was faithful to Reagan's mandate, leading to great success.

- Make sure you get complete buy-in from Treasury to provide suggestions and estimates without political interference as to what you can cover or can't cover. This will take an upfront commitment, probably from the Treasury secretary and Obama.
- Do not — I repeat, do not — start with a list of items you do and don't like. Go to trusted experts — including Treasury tax staff — for a long and detailed list of possibilities.
- Gather almost every legitimate base-broadening proposal and simplification that can be found, ignoring for now what income classes those affect. For instance, removing all home mortgage interest deductions will discriminate against borrowers and in favor of older equity owners, for reasons I will not delve into here. But that may mean preferring limitations or partial conversion to repeal. That's only one set of complicated nuances on hundreds of items that you should be addressing. This step will be extremely difficult, so don't delay.
- Recognize that some reforms cannot mutually advance all goals. For instance, some reforms to promote fairness are not

simple. Also, simplification refers as much to simplifying tax planning as to the number of lines on tax forms.

- Add a discussion of how much revenue a VAT would raise. Again, you don't have to favor it.
- Add a discussion of how government could raise Social Security revenues, including base broadening, tax rate changes, and more years of work. Higher labor force participation is one of the most important revenue options that doesn't require lifetime benefit reductions or tax rate increases.
- In light of the financial crisis, include a separate discussion of how to remove some of the tax favoritism of debt financing over other forms of intermediation.
- Go back over the options you developed in the previous step and reject those you consider bad policy, but at this stage make your decision based only on economic, social, and administrative grounds.
- Ask Treasury to come as close as possible to providing draft language on each of the remaining options. That was one of our crucial steps in the 1984 Treasury study. Unlike with past reform studies, we had a volume 2, which included a how-to manual.
- Develop several rate reduction packages that return to the public various portions of the net revenue raised through other reform. Since the president asked for it, include among your packages one that will leave neutral those income classes (but not everyone in those classes) with income under $250,000.

After this 10-step procedure, make your recommendations to the president. Everything before this is designed to get you the best answers possible before considering the politics. It's also designed to protect you from the early attacks of the lobbyists, who don't want you to think in any expansive way and will object to some of the steps for just that reason. Save the politics for last — considering the political aspects is not your primary job.

My guess is that in 2010 or 2011, fiscal and deficit issues will dominate Congress. Be sure that your report contains information relevant to that debate. You owe it not only to the public, but to your personal reputation, to be relevant.

Remember, you've got one great thing going for you: The complaints you'll receive will be nothing compared with what your chair, Paul Volcker, took on when he led the Federal Reserve in getting inflation under control in another period with severe economic problems. ■