

Summers' Time: The Tax Option (Part 2 of 5)

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Contrary to popular belief, strategic preparation for future government policy often takes place within departments and agencies at the end of a presidential term. Campaigns are busy focusing on tactics, sometimes making promises that don't really add up or at least are not balanced by considerations of future budgetary needs or administrative practicality. Especially ignored are changes that by their nature would identify losers, such as raising the taxes of some voters or cutting the government benefits of others.

Campaign time provides departments and agencies with the opportunity to quietly prepare realistic options and to initiate studies that eventually direct attention to important national issues ignored by campaigns. The research leading to the Tax Reform Acts of 1969 and 1986 are only two examples of such strategic thinking within the Treasury Department at the end of a presidential term. Since every period is unique, it is only appropriate to ask on what issues can current Treasury Secretary Lawrence H. Summers provide leadership.

There is a claim made against baby boomers, at once a compliment and a critique. It is that this generation has been especially good at finding out what is wrong with institutions—at times tearing them apart to make room for the new. But, along with this ability to understand and detect institutional weaknesses seems to come an inability to build and create the necessary new institutions at the same time. The healthy skepticism that makes them (us) alert to what is wrong is often converted into an unhealthy skepticism that makes them unable to decide on what is right and worth building, despite the imperfections.

Thinking somewhat globally, I would argue that several basic institutions under the purview of the Treasury Secretary are in the midst of fundamental change today. Such change reflects not so much internally generated failures of the institutions themselves but rather the impact of large-scale economic and social forces. Those forces will cause reformation, reconstitution, and reconstruction of such institutions as the income tax system, the transfer tax systems and systems surrounding entitlements for the elderly, international agencies, and the Treasury Department itself. I will begin my focus on the income tax system.

Ever since the Tax Reform Act of 1986, the tax code has been used more and more for social purposes. At the same time, it has been made exceedingly complex, with a vast array of provisions to deal with almost any need or problem than one can name.

In filling out tax returns, people are often required to solve multiple simultaneous equations simply to figure out their own tax liability. That is, they can't figure out whether they can do one thing on their return until they know whether they can do another, and vice versa.

In some ways, room for the many additions to complexity were made possible by some of the simplifications achieved earlier and, even more so, by computer advances that have made it possible for taxpayers to bear the increased complexity and still file returns with some degree of accuracy. The cost of each layer of complexity may have been modest relative to other economic needs, but the net result is a system that is clearly much more of a mess than it has ever been. Moreover, the cracks in the dam are widening, and every single year the president and the Congress now debate over dozens, if not hundreds, of new breaks and credits and special exceptions.

Let's not be naive about what is going on. First, tax expenditures have become the preferred political method for getting almost any type of new subsidy. The Republicans have tended for decades to favor tax breaks over direct expenditures, and now that most subsidies are mainly for individuals rather than businesses and often more for social policy than economic policy, the Democrats have figured out how to play the same game. If you're a politician and you want to get a subsidy for tsetse fly imports, then your best chance is to use the tax system rather than the expenditure system.

Second, as a matter of budget policy, small tax breaks have been used successfully to fight off big tax cuts.

Whenever the Clinton administration engages in this fight, it usually offers a lot of small items to a lot of people in a way that either appears to do more for them or spreads out benefits to more interest groups. Say what you want about the tax policy that results, the short run tactic has often worked to meet those budget goals. In addition, recent budget rules have reinforced the tendency to use the tax code even more indiscriminately by forcing discretionary programs into tighter and stricter budget caps than apply to the larger pile of taxes and entitlement expenditures.

Third, when it comes to social policy, a lot of people believe you should take your money any way you can get it. Traditional tax policy principles such as equal justice under the law, simplification, and transparency often go by the wayside. If the name of the game is to get more social expenditures of one type or another, and the easiest way to do it is by using some weakly designed tax provision, then so be it. So the thinking goes.

Moreover, opponents of spending through the tax system have sometimes weakened their own position by assuming almost automatically that direct expenditures are better than tax expenditures. From a budgetary standpoint, it is true that direct expenditures are accounted for more accurately. However, administrative errors in expenditure programs are often quite large and understated. For example, most welfare programs use monthly accounting periods. Given the extraordinary difficulty of enforcing an annual accounting period in the income tax system, it would not be surprising if there were not some degree of error in almost every monthly "report" filed for welfare purposes.

Now if you're Treasury Secretary, it's hard not to go along with the show. In effect, if you tend to favor the budget policy and social policy goals, then bad tax policy might just be one of the costs that you convince yourself is worth paying. Tactically, step-by-step down this path, the notion is that the alternative would have been worse.

There is a problem, however, if you are Secretary of the Treasury. You have a fiduciary responsibility over the tax system that simply doesn't reside in any other office in government and certainly not in the office of a White House political counselor or even in the office of the Secretary of another department. Most of the executive offices of government—whether departments or White House offices—are set up around special interests. The occupants of those offices like to think of themselves as advocates for those interests, whether business, housing, health, or another group.

Who, after all, can be opposed to stronger business, better housing, or improved health care? The simple fact is that if Treasury doesn't stand up for good tax policy, then almost no one will. Why? It's Treasury's job, no more and no less.

That is one reason why so many Treasury Secretaries insist that they be the lead spokesperson for administration economic policy. It is not simply a power play. It is often the only way they can actively contain the many special interest pleaders in the modern Executive Branch.

But standing up and then taking it on the chin in the current environment may not be enough. More strategic planning is required. Next week I'll suggest some ways that can be done. But the first and primary step is for Treasury to decide that it wants to be in charge of tax policy. Absent that step, no real strategic planning will occur, or, if it does, it will be merely pro forma and of little effect.

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