

by Gene Steuerle

Let It Snow: Opportunity Time For the Treasury

Step One: Stepping Up to the Plate

Almost no one who has served at the Treasury can help but feel pride at the integrity, vitality, and importance of the institution. With a heritage going back to Alexander Hamilton, time after time it has had to grapple with the economic and financial problems facing the nation — and come up with solutions. It often stands without peer and has always been among the most respected departments in the Executive Branch. In no small part, its prestige derives from a reach and responsibility that stretch beyond the narrow interests of a particular state or region, type of consumer good like housing, factor of production like labor, field like education, constituency like farmers or manufacturers, or interest group. When it comes to matters of taxation or economics or the budget, it often stands alone in its search for efficient and fair answers and with the fullest recognition that all choices have consequences. Often it aligns itself with the Office of Management and Budget simply because they are the two parts of the executive branch that recognize there is a balance sheet to the budget: When somebody receives (more expenditures, a tax reduction), someone pays (more taxes, less expenditures). Its professional staff has been and remains among the finest anywhere.

At this point in 2004, the press and public have turned their attention to the presidential campaign trail. Both candidates continue to make promises that do not yet add up, although they both hint that a correction and unspecified other changes will be forthcoming after the election. Both dodge for now the significant decline in economic growth now scheduled by federal programs that push most people into full retirement during middle age when they have one-third of their adult lives remaining in front of them. Meanwhile, fundamental restructuring of systems ranging from taxation to health care are required simply by unsustainable growth trends, whether it be in the number of taxpayers subject to the alternative minimum tax or the cost of health care.

In this world, economic leadership is going to be required soon after the election, no matter who wins. That leadership, in turn, must inevitably rely on the best information on budget issues, financing problems of government, and the complex details of the tax and expenditure programs that are out of sync. That information resides more at the Treasury Department than anywhere else.

But will the Treasury be ready? While the answer is unknown, we can learn from past history. When presidents become ready to act on difficult issues, they are much more likely to succeed when the Treasury has already done its homework, anticipating and creating opportunities. Two prerequisites are required to step up to the plate. First, the Treasury must engage now in studies that it is ready to put on the table after the election. Second, it must re-establish and enhance its reputation as a department that can be relied on to report in the public interest. For the Treasury, respect is like goodwill is to the business world. Otherwise, even the best plans in the world will be attacked, fairly or not, as simply more politics. My next column will deal with this second requirement. For now, let's look a bit more at the first.

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When it comes to taxes, history provides a clue. The two most systemic tax reforms of the last four decades occurred in 1969 and 1986, but significant preparations were already underway at the Treasury during the campaign years 1968 and 1984. I distinguish here between systemic reform and those changes that primarily focus on reducing rates or simply adding on some new preferences. The latter require much less thinking because they dodge the issues of trade-offs, of creating losers as well as winners in the search for a tax system that is fairer and more efficient. Each of the two studies noted above involved the cooperation and advanced work of dozens of Treasury's staff. They also required some vision of what was possible at the time and how the studies could be conducted.

In the area of entitlement reform, I also believe that Treasury must lead the way in the near future. The Social Security Administration will not lead on Social Security reform. Even its estimating function ignores the important impact on income tax and other revenues that might arise from reform. It is incapable of integrating Social Security, private pension, and Medicare reform if any of those links should be desired. Moreover, it pays little attention to the broader economic effects of such factors as the scheduled slowdown in labor force growth. The Office of Management and Budget in theory has some role here, but it simply lacks even basic modeling capability. The Treasury, with the

COMMENTARY / ECONOMIC PERSPECTIVE

secretary as the lead trustee of the Social Security and Medicare Trust Funds, is put in a position of leadership partly by default. At least if systemic reform is wanted, Treasury has a major role to play.

The department, of course, can sit idly by this year, waiting for political direction to arise from the campaign. But campaigns are poor guides, often yielding obstacles to reform and yielding yet more contradictions into budget and tax policy. In 1984, while working on the tax reform study, we used to cringe whenever some promise was made in the campaign that made it difficult to create a more integrated reform. For instance, the president's promise not to touch the home mortgage led to a number of the complications regarding interest deductions that remain to this day. If the Treasury doesn't undertake its own set of studies, based solidly on principles, there is almost no way that the White House is going to know how to engage in real reform next year.

These preparations and studies are required as much if the Democrats win as if the Republicans win. Again, going back in history, we find that the 1969 tax reform under President Nixon was related in part to the Treasury work in 1968 when Johnson was presi-

dent. On many issues like international taxation, there is a desperate need for someone to make some sense out of the morass. Given his pledge to do something in this arena, a President Kerry will need as much help, if not more, than a President Bush. Whoever is elected president, moreover, will experience a strong mandate from taxpayers to do something about the AMT. Those tax pressures, as well as those arising from the deficit, will lead to demands for base-broadening measures. The Treasury must have some ideas already well developed. Meanwhile, other economic and budget pressures require immediate attention to the baby boomers. Don't forget: They begin retiring during the next presidential term.

To be ready to step up to the plate requires some vision of how to prepare. Treasury must not get tied up in trying to please every constituent group represented by some political hack in the administration waiting to move on to his new lobbying job. That is a recipe for going nowhere. It must start with principles, and follow them to their logical conclusions. The political trade-offs should come later. That is Treasury's traditional job and what the public has a right to expect of it yet again this year.

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