by Gene Steuerle

Tough Choices, Opportunity, or Both?

For the last several years, Congress has been on a spending spree unlike any in the nation's history — a turnaround of about 7 percent of gross domestic product in going from surplus to deficit. In addition to size, what made this spree unique was that tax cuts, defense increases, large automatic growth in entitlement spending, new health entitlements, and discretionary spending increases all were pursued at the same time, even while revenue projections were dropping after the collapse of a late-1990s bubble stock market. In the mid-1970s, *The Wall Street Journal* editorial page started pushing for what it called a "two Santa Claus" policy. The complaint was that the Democrats got to be Santa Claus with expenditures, then the Republicans reluctantly had to increase taxes. Better it argued, would be for the Republicans to be Santa Claus, too, on the tax side of the ledger — creating, it argued, a better economy and a viable political position for the Republicans. But no one then predicted the world to which we have evolved — two-Santa-Clauses-at-the-same-time. When both show up together — when taxes are cut while expenditures are increased — it's especially hard to hold onto any belief that somehow the budget will remain balanced in the long run.

Forget about whether there might be some gain to government from a higher spending or lower taxes. The politics are perfectly clear: Politicians love to increase spending and cut taxes, regardless of merit, especially if they can leave to others decisions on how to pay for those actions. Truth in accounting, however, requires recognition that everything government does affects both sides of the balance sheet. Cut taxes now, and either expenditures have to be cut, or taxes raised in the future. Spend more now, and someone has to cover the cost with higher taxes (or lower future spending). Add in interest costs, and the future problems of getting back under control are even worse. But eventually a day of reckoning comes.

It has come. The latest spending spree is fast coming to a close. Deficits lurk large and little flexibility is left in the budget. For more than 20 years, budget analysts have been warning about the upcoming retirement of the baby boomers. Now that retirement is no longer around the corner, but down the street, as baby boomers begin to retire in 2008, well within the 5- and 10-year budget windows through which Congress views the effects of the budgets it enacts.

More and more policymakers have been trying to spend money before the other fellow does, pushing more and more spending increases and tax cuts into the future. But while this game of chicken is almost over, the cars have been driving toward the cliff so long the drivers don't even know how to turn them around. Identifying who pays for government is the tougher side of governing, much harder than simply reducing tax rates or increasing farm price supports, and it's usually not popular with many of those who have to cough up their spending or tax benefits.

Into this budget milieu also comes a powerful push for tax reform. But being for tax reform is like being for expenditure reform. It can mean anything and everything from lowering rates as a matter of economic policy to pushing for a consumption tax to providing simplification to broadening the tax base either to reduce the deficit or to reduce tax rates further. Interest groups already are pushing for their favorite tax reform, which just coincidentally happens to coincide with their own special wants. However, as in the early 1980s — another deficit period in which major tax reform was adopted — some pressures are probably unavoidable. Without reform, tens of millions of taxpayers — mainly households with children — will be forced onto the alternative minimum tax, mainly because it treats dependent exemptions, state and local tax deductions, and miscellaneous tax deductions as if they were tax shelters. A newer type of tax shelter, often involving transactions in international markets, needs to be brought under control. Meanwhile, almost every part of the tax code is unduly complex — multiple provisions for children, more than 10 capital gains tax rates, and at least a half-dozen educational incentives are only a few examples. Meanwhile pension tax subsidies, supposedly meant to increase saving, cost more than the entire amount of personal saving in the United States; housing ownership subsidies are not available to many moderate income taxpayers but only those who are better off; and the additional amounts spent on health tax subsidies every year are so perverse they increase, not decrease, the number of uninsured. The IRS simply cannot and does not administer the current system well, which, in turn only adds to incentives to cheat, while leaving honest taxpayers with an even higher share of the total tax burden.

True reform is made more difficult by the increased power of lobbyists. They practically designed the last major tax bill of 2004. Tax Analysts is fond of quoting one prominent Washington lobbyist to the effect that if a lobbyist didn't get anything in that bill, he had to be a very bad lobbyist. That bill, too, involved multiple layers of complexity, including an allowance for those running some coffee bean brewers and Hollywood producers (provided that no more than half the production is done outside the United States, somehow measured, and the film is not pornographic, somehow measured).

Unlike many years ago, policy options are not first put forward by nonpartisan staffs assigned to design something in the public interest based on broad outlines of principles set by the president or some other leader. The staffs of Treasury or the Joint Committee on Taxation, if consulted at all, now are asked for the most part to provide apologetics for positions that are often poorly thought out in the first place. Does all of that mean that reform of both taxes and the budget — the two compelling demands of the time — is impossible? Not really. Democracy is often good at acting (or at least reacting) when it has to, even though it often wallows when pressures are few. Moreover, when elected officials are forced in tight budget periods to recognize those who pay for government, they often adhere much more closely to principles than when they engaged in giveaways, which are more likely to go to those first at the trough or with the best connections.

The catch is that true reform requires creative thinking. It can't be all things to all people, and it really can't be put together by the lobbyists, whose role must be relegated back to the end, not the beginning, of the policy process. This requires a fundamental change from the past free-spending years in the way that policy is put together.

Without an emergency, perhaps nothing significant will happen for a little while. We can probably limp along with only modest progress on the budget, only adding to later difficulties as the baby boomers move ever more into the retirement population and economic growth slows. Tax reform, as it has so many times before, can get tied up in endless debates over multiple and often contradictory goals. But that is not a happy path either, and can lead to a disillusion with current elected officials just as much, if not more than actual reform.

So . . . if one prediction is possible, it is that the need to act creates an opportunity. Whether the president and Congress grab at the opportunity — and, equally important, whether they are able to shift gears to engage in this very different type of policymaking — remains to be seen.