

Spring 3-1-1993

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Recommended Citation

Bernard M. Shapiro, *Presidential Politics And Deficit Reduction: The Landscape Of Tax Policy In The 1980S And 1990S*, 50 Wash. & Lee L. Rev. 441 (1993), <https://scholarlycommons.law.wlu.edu/wlulr/vol50/iss2/3>

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PRESIDENTIAL POLITICS AND DEFICIT REDUCTION: THE LANDSCAPE OF TAX POLICY IN THE 1980s AND 1990s

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No major tax legislation enacted since 1980 has escaped the pull of the often conflicting forces of White House politics and deficit reduction. Tax legislation over the last dozen years largely has stemmed from either Presidential political considerations or efforts to cut growing federal budget shortfalls, or both. These often conflicting forces continue to guide tax policy as the Clinton Administration and congressional tax-writers engage in debate over a 1993 tax bill.

I. "REAGANOMICS": SUPPLY-SIDE ECONOMICS AND TAX-CUT BIDDING

In 1980, Ronald Reagan ran for president on the theme of reversing the federal government's traditional reliance on "demand side" economics. In times of economic downturn, the U.S. government typically has attempted to spur economic activity by stimulating demand for goods and services through tax cuts and spending programs. The side effect of this fiscal stimulus had been too many dollars chasing too few goods, which in turn produced inflation. Ronald Reagan's economic theme was to create supply by encouraging investment.

In terms of tax policy, Reagan's supply-side economics promised tax cuts both for individuals and business. Individuals under the Reagan plan would receive a 30% tax cut, phased in over three years. As a result, the Administration believed that individuals would save more money, which in turn would spur investment and lead to robust economic growth. Businesses, on the other hand, would be allowed to accelerate depreciation, reducing the depreciable lives of assets from their longer "useful lives" to shorter cost recovery periods.

Overall, the Reagan plan was projected to produce a balanced federal budget in four years. At the time of Reagan's inauguration, the federal budget deficit stood at about \$75 billion. By 1984, however, the deficit had swollen to about \$185 billion. What went wrong?

In retrospect, the culprit appears to have been political posturing in the aftermath of the Reagan election. The Republicans in 1980 gained a majority in the Senate—for the first time in years—that was anxious to exercise its new clout. Meanwhile, the Democrat-controlled House of Representatives did not wish to be on the outside looking in as politically popular tax cuts were being formulated.

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The Republican majority in the Senate wanted to be an active player in the *initial* drafting of tax legislation, although the U.S. Constitution requires all revenue-raising matters to originate in the House of Representatives.¹ Typically, the House Ways and Means Committee will hold hearings, draft a tax bill, and then send the legislation before the full House for consideration. The Senate Finance Committee—the counterpart of Ways and Means—generally begins to act on the tax bill only after it has cleared the House.

Senator Bob Dole (R-KA), the new chairman of the Finance Committee, decided that he did not want to be left considering a tax bill that was the product of the Reagan Administration's negotiations with House Democrats—a tax bill simply sent to the Senate for “rubberstamp” approval. As a result, the Finance Committee began moving on tax legislation before the House could act on a bill.

At the time, two different versions of a tax bill were being contemplated in the House: a tax package drafted by the Democrats on the Ways and Means Committee and an alternative put forward by a group of conservative House Democrats. The conservative House Democrats ended up working with House Republicans to try to defeat the bill that the Democratic Ways and Means Committee members sent to the House floor.

In the end, a bidding war erupted over tax cuts—the heart of Reagan's domestic campaign platform—as the Republican Senate, mainstream Democrats in the House, and the conservative Democrats in the House offered competing plans. When the frenzy was over, a tax bill with a revenue cost of \$750 billion over a five-year period became law.²

Looking back, this was more than the federal government could afford. Promised spending cuts to accompany the tax reductions never materialized, and the federal budget deficit grew unchecked.

Tax legislation in the following years was needed to “correct” the imbalances of the '81 Act. The Tax Equity and Fiscal Responsibility Act of 1982³ and the Deficit Reduction Act of 1984⁴ were intended to take back some of the 1981 tax cuts, while at the same time delivering on the promise of spending cuts. Under an alleged “gentlemen's agreement” reached in deliberations over the 1982 tax bill, for every dollar of tax increases, spending would be reduced by three dollars. In the end, however, that supposed agreement was not followed—the ratio of tax increases to spending cuts was closer to one to one. The 1984 Act yielded similar disappointing results.

1. U.S. CONST. I, § 7, cl. 1.

2. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.).

3. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.).

4. Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified as amended in scattered sections of 26 U.S.C.).

II. TAX REFORM AND THE RISE OF GRAMM-RUDMAN-HOLLINGS

Ronald Reagan emerged from his landslide victory in the 1984 Presidential election facing a deficit approaching \$200 billion. In the campaign, Democratic nominee Walter Mondale had attacked Reagan over his failure to balance the budget, and the challenger pledged that he would support tax increases if elected. Reagan took a different tack: he argued that the tax Code instead needed "simplification" in the wake of the 1981, 1982, and 1984 tax acts.

Reagan's campaign pledge manifested itself in Treasury I⁵ and Treasury II⁶—proposals for tax reform that included large cuts in tax rates and a broadening of the tax base. When the dust finally settled in the House and Senate, we had the most comprehensive tax reform act in history.⁷

In passing the Tax Reform Act of 1986, Congress fine-tuned the Reagan program to broaden the base and lower rates. The Act reduced the top individual tax rate to 28%, cut the corporate income tax rate, repealed the investment tax credit, eliminated beneficial tax treatment for capital gains, and scrapped numerous tax shelters. Lost in the shuffle was Reagan's campaign call for tax "simplification": a significant amount of complexity was added to the tax Code as a result of the Act, and Congress ultimately took "simplification" out of the original title.

Again, deficit reduction suffered. Not one dollar raised by TRA '86 was used to reduce the deficit. Congress instead shifted over \$100 billion of increases in business taxes to reduce taxes on individuals. Meanwhile, during the consideration of the tax reform legislation, it became obvious that Congress did not have the discipline to pass a significant spending reduction bill.

To address these budget problems, Congress in 1985 enacted a new budget enforcement program referred to as Gramm-Rudman-Hollings.⁸ The legislation mandated reduction of the deficit—which in 1985 stood at about \$180 billion—over a five-year period. Deficit reduction of about \$36 billion a year beginning in 1987 would cut the budget shortfall to zero by 1991, the drafters believed.

Gramm-Rudman-Hollings directed Congress to cut the deficit through "budget reconciliation" bills, which set specific targets for tax increases and spending cuts necessary to meet annual deficit-reduction targets. Reconciliation bills enacted in 1987,⁹ 1988,¹⁰ and 1989¹¹ provided the only

5. U.S. TREASURY DEP'T, *TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH* 194 (1984).

6. U.S. TREASURY DEP'T, *TAX PROPOSALS TO CONGRESS FOR FAIRNESS, GROWTH & SIMPLICITY* 253-56 (1985).

7. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.).

8. Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, 99 Stat. 1038 (codified as amended in scattered sections of U.S.C.).

9. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (codified as amended in scattered sections of U.S.C.).

“vehicle” for tax legislation during these years. Any tax cut initiatives contemplated by the tax-writing committees had to be offset by additional revenue increases above and beyond those they were required to produce for deficit-reduction purposes.

III. “READ MY LIPS” AND OBRA '90

By 1990, five years after the enactment of Gramm-Rudman-Hollings and two years into the presidency of George Bush, the deficit stood at \$278 billion. What happened?

Gramm-Rudman-Hollings failed to reduce the deficit for a number of reasons. First, in 1987, the stock market crashed,¹² and Congress scaled back the deficit-reduction plan in an attempt to help protect the troubled economy. Instead of cutting the deficit to zero in five years, the revised plan was designed to balance the budget in seven years.

Furthermore, the deficit targets set by the plan proved overly optimistic, especially in light of certain unforeseen events, such as the savings and loan crisis, which drained billions of dollars out of the federal budget. In addition, spending in federal “entitlement” programs—such as Medicare—outpaced estimates. Finally, Congress and the President failed to enact any new significant reductions in “discretionary” federal spending programs.

George Bush entered the White House having campaigned on two tax-related planks. The first was his infamous statement, “Read my lips, no new taxes,”¹³ which was later translated loosely by the Administration as a pledge not to increase individual or corporate income tax rates. Second, he pledged to cut the capital gains tax rate. Both promises led to trouble.

Congress and President Bush in 1990 agreed that the \$64 billion deficit target set for the following year by Gramm-Rudman-Hollings could not be met. They also agreed that a new budget mechanism and new specific deficit-reduction options were needed, and that a bipartisan “summit” was necessary to hammer out a plan.

Once the summit negotiations got underway in the summer of 1990, it became clear that an agreement between Congressional Democrats and the Administration would not be reached unless President Bush backed off his “no new taxes” pledge. The President ultimately agreed to put taxes on the table over the objections of some of his political advisors.

In the end, a five-year, \$500 billion deficit-reduction package—OBRA '90—was fashioned, including an increase in the top individual income tax

10. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-203, 101 Stat. 3342 (codified as amended in scattered sections of 26 U.S.C.).

11. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2106 (codified as amended in scattered sections of 101-239, 103 U.S.C.).

12. Tim Metz et al., *Stocks Plunge 508.43 Amid Panicky Selling*, WALL ST. J., Oct. 20, 1987, at A1.

13. Tom Shales, *Bush Bringing the Party to Life; From the New Nominee, A Splendid Acceptance Speech*, WASH. POST, Aug. 19, 1988, at C1.

rate to 31% and significant excise tax increases. Bush's attempt to include a capital gains tax cut in the package was beaten back by Congressional Democrats, who argued that the proposal would provide a boon to the wealthy while causing a loss of federal revenues.

Bush therefore entered 1991 both having retreated on his "no new taxes" pledge and having lost his bid to provide capital gains tax relief. With the President licking his wounds and with the attention of the nation focused on the Persian Gulf War, the tax-writing process was put on hold.

OBRA '90 allowed for this "moratorium" on tax legislation: the Act removed the annual responsibility of the tax-writing committees to produce tax increases aimed at deficit reduction through budget reconciliation legislation. Instead, the tax increases included in the '90 Act itself, coupled with the new "caps" on spending, were intended to cut the deficit automatically over the following five years.

IV. 1992: "GRIDLOCK" THWARTS TAX LEGISLATION

Despite projected \$300 billion budget shortfalls, attention in 1992 turned away from the deficit and toward the November Presidential elections. The economic recession, though technically over, was at the forefront of the Presidential campaign as consumer confidence plummeted. Congressional Democrats attacked President Bush—still viewed favorably by a majority of the public for his action in the Persian Gulf—over his handling of the economy.

In response, President Bush in January unveiled an "economic stimulus" program, including targeted tax incentives, such as an investment tax allowance for businesses and enterprise zone tax incentives, designed to spur economic growth. Bush called on Congress to pass his program by March.

Congressional Democrats met this ambitious timetable, but turned the effort into a political exercise. Added to the President's original proposals were a proposed increase in the top individual income tax rate and a millionaire's surtax—proposals clearly intended to draw a White House veto. The Democrats knew that Bush would not sign the bill (H.R. 4210) in fear of again violating his "no new taxes" pledge, and that the President could then be criticized as having failed to act on the economy. Bush did veto the legislation, and cries of "gridlock" began to be raised on Capitol Hill.

Lawmakers tried again later in the year as the economy continued to sputter. Congressional Democrats drafted a tax bill (H.R. 11) over the summer and fall that included many of the economic stimulus proposals originally offered by President Bush and left out many of the more significant tax increases that drew the White House veto of H.R. 11 earlier in the year.

In order to comply with the OBRA '90 pay-as-you-go budget rules, however, the bill had to be revenue-neutral. In other words, the cost of the tax incentives in the bill had to be offset by a corresponding or larger amount of revenue raisers. Congress proposed \$28 billion in relatively

noncontroversial tax increases that attempted to "tweak" revenues from the tax Code, including various "loophole" closers. In all, H.R. 11 would have raised \$28 billion in revenues over five years to offset the cost of the tax incentives.

The bill was sent to the White House shortly before the November election, but was ultimately vetoed. During the campaign, President Bush had attempted to paint Democratic challenger Bill Clinton as a "tax and spend" Democrat who had signed scores of tax increases into law during his tenure as governor of Arkansas; many of these amounted to no more than user fees and other relatively insignificant revenue raisers. As a result, Bush was reluctant to sign legislation that included numerous revenue raisers that similarly might be called "tax increases."

V. THE CLINTON PROGRAM: CAMPAIGN PLEDGES, POLITICAL REALITIES

President Bill Clinton assumed office in 1993 armed with four overall domestic policy goals, each of which has tax policy implications and each of which has been modified in light of economic and budget realities.

First, President Clinton pledged to stimulate the economy and provide for long-term economic growth through targeted new federal spending and tax incentives for businesses, including an investment tax credit.

Before Congress could implement any of Clinton's proposals, however, there was good news on the economic front that reduced the need for action in the eyes of some. The rate of growth in the gross domestic product was 3.4% for the third quarter of 1992 and 4.7% for the fourth quarter—significantly higher than had been anticipated. Senate Republicans, led by Bob Dole, successfully filibustered Clinton's "stimulus" spending package, and the House Ways and Means Committee scuttled the Administration's proposed investment tax credit.

Second, Clinton as a candidate proposed to cut the deficit in half by 1997. The caps on spending imposed by OBRA '90 had not reduced overall spending, as lawmakers in 1990 had hoped, and the deficit in 1992 stood at \$290 billion. To meet his deficit reduction target, Clinton during the campaign proposed new spending cuts as well as a package of tax increases, including a top individual income tax rate increase and \$45 billion in increased taxes on foreign corporations operating in the United States.

After entering the White House, however, President Clinton found that the deficit reduction measures advanced in the campaign would leave him short of his overall deficit-reduction goal. The new Administration claimed that new budget projections showed the deficit to be much higher than his campaign team had assumed. The Administration also found that some of the deficit-reduction measures it had counted on during the campaign were not in fact workable. For example, the Administration was unable to craft a proposal that would raise anywhere near the \$45 billion from foreign corporations that it had promised. As a result, Clinton was forced to look to additional measures, including a new tax on energy consumption, in order to help meet his deficit reduction goals.

A third Clinton campaign goal was to restore "tax fairness"—Clinton argued that tax Code changes in the 1980s disproportionately benefitted the wealthy. Clinton proposed to raise taxes on higher-income taxpayers and cut the taxes of middle-income families.

The Administration, in its fiscal 1994 budget submission, did follow through on its promise of higher taxes on the wealthy, including proposed new top income rates of 36% and 39.6%. In light of the size of the federal budget deficit, however, the Administration backed away from the promised middle-class tax relief.

Fourth, Clinton during the campaign proposed to overhaul the nation's health care system and extend health coverage to the estimated 37 million uninsured individuals. Clinton as a candidate argued that cost-cutting measures that would accompany health care reform would finance an overall package.

After entering the White House, however, President Clinton indicated that while reform ultimately would cut overall U.S. spending on health care, new revenues would have to be found to offset the program's cost in the early years. Financing options initially discussed by some in the Clinton Administration included a value-added tax (VAT), which, if enacted, would represent the biggest change to the U.S. tax Code since 1986. The Administration more recently has discussed the possibility of a new payroll tax on employers, among other options.

VI. CONCLUSION

Since 1980, no action on major tax legislation has taken place outside the context of presidential politics and deficit-reduction efforts. It remains to be seen how the Democratic Congress and President Clinton follow through on reducing the deficit and overhauling the health care system. It seems clear, however, that the tax Code will continue to serve as a tool as Democrats and Republicans alike seek to build a record that will translate into success for their parties in the 1994 and 1996 elections.

