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CLASS WARFARE 1988-2005 OVER TOP INDIVIDUAL INCOME TAX RATES: TEETER-TOTTER FROM SOAK-THE- RICH TO ROBIN-HOOD-IN-REVERSE

*John W. Lee, III**

I. INTRODUCTION

In an innovative 1955 Tax Policy Hearing before a Subcommittee chaired by Representative Wilbur Mills, conservative Arkansas Democrat (and soon to become legendary Chair of the House Ways and Means Committee), a New York Stock Exchange lobbyist suggested “facetiously” that “you might subject everybody’s income by definition, to a capital gains rate, then we can start all over again. [Laughter].”¹ When just that came to pass in a teeter-totter fashion—from the equilibrium of ordinary

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1. The witness had just offered a first alternative of a scheduler income system: “you might consider having 5 or 10 baskets, each of them labeled different things, each of them carrying a different rate.” *Hearings on Federal Tax Policy for Economic Growth and Stability Before the Subcomm. on Tax Policy of the Joint Comm. on the Economic Report*, S. Rep. No. 84-1310 345-46 (1955) (statement of Jonathan Brown, representing New York Stock Exchange). That too came to pass under the 1986 Code. *See infra* note 120 and accompanying text.

income and capital gains rates at an earlier top capital gains rate, first the individual ordinary income rate was raised at top only, then capital gains rate cut, then ordinary rates “temporarily” cut disproportionately at top, and then capital gains and dividends rates “temporarily” cut at top to a sixty-year low all over a seventeen-year period, 1986-2003—it was not funny at all to anyone caring about progressivity in Federal income taxation.²

The 1986 Code had ended (albeit temporarily) the individual tax preference³ for capital gains income over services and any other ordinary income (such as portfolio income) by generally applying twenty-eight percent⁴ as the top individual tax rate for both individual capital gains and services income.⁵ A same top twenty-eight percent rate for individual capital gains and ordinary income could be expected to end or at least

2. Dana Milbank & Jonathan Weisman, *Middle Class Tax Share Set to Rise; Studies Say Burden of Rich to Decline*, WASH. POST, June 4, 2003, at A1 (demonstrating that the biggest gains were set to go to the top 1% or so (\$337,000+) and to low-income taxpayers; middle income taxpayers would have a higher tax burden because they do not qualify for targeted tax breaks to the poor or investment-related tax breaks to the wealthy); John S. Irons & John Podesta, *A Tax Plan for Progressives; A Simpler and Fairer Tax Code—One That Rewards the Hard Work of the American Middle Class—Can Be Good Policy and Smart Politics*, AMER. PROSPECT, Jun. 2005, at 52.

3. David H. Safavian, *Indexing Tax Attributes for Inflation: Dispelling Myths and Advocating Change*, 1995 DET. C.L. REV. 109; David Nicklaus, *Capital Gains Already Get Tax Breaks*, ST. LOUIS POST-DISPATCH, Dec. 11, 1994 at E1 (“The Tax Reform Act of 1986 swept away the capital-gains preference. Democrats hailed that change as a victory for fairness, because capital gains accrue mainly to the rich.”).

4. That the twenty-eight percent rate had been the top individual capital gains rate (from 1978 to 1981) was a coincidence. The target rate changed as revenue estimates progressed. JEFFREY BIRNBAUM & ALAN MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM 227, 245, 258, 271 (Random House, Inc. 1987) (arguing that President Ronald Reagan’s “revenue neutral” mandate demanded targeted revenue offsets for any new revenue losses); accord Kenneth J. Kies, *The Current Political, Budgetary, and Tax Policy Environment Suggests the Possibility of Major Federal Tax Legislation in the 100th Congress*, 35 TAX NOTES 179, 183 (1987). The same treatment of capital gains and ordinary income was required by the rule of distributional parity per income class, viz., the effective rate at the top could not be decreased as much as the top ordinary reduction from fifty percent to twenty-eight percent would produce without offsetting revenue increases aimed at the top, particularly capital gains preference and immediate end of individual tax shelters. *Id.* at 183-84 (describing “distributional acceptability” . . . “a per se politically unacceptable feature was that the percentage reduction in taxes for the highest income level of taxpayers exceeded that which would be received by middle-income taxpayers.”).

5. A not insignificant fly in the same top rate ointment was the “phantom” thirty-three percent rate on individual taxable income from a floor of \$71,900 to a ceiling of \$149,250 in 1988 dollars (from \$115,040 to \$239,168 in 2004 dollars). BIRNBAUM & MURRAY, *supra* note 4, at 220 (story of origin). This tax on the near rich was also required by distributional acceptability. Kies, *supra* note 4, at 184.

decrease the serious violations of the tax policies of (a) *vertical equity* (ability to pay or progressivity), and (b) *horizontal equity* (like amounts of income should be taxed the same)⁶ theretofore wrought by preferential federal income tax treatment of individual capital gains realizations. These gains, taxes, and arguably economic benefits are concentrated in the hands of the top five percent and especially in the top half of the top one percent of individual taxpayers.⁷

During the first modern capital gains tax preference era from 1921-1986, the federal tax law dipped deeply in large incomes through *nominally* progressive income tax rates, but for large incomes consisting mostly of capital gains (taxed at *effective* rates substantially below the maximum individual ordinary income rate) such dipping was done with a very coarse grained sieve.⁸ Highest income taxpayers with substantial capital gains realization enjoyed a Federal tax effective rate lower than that of taxpayers

6. GOV'T ACCOUNTABILITY OFFICE, NO. GAO-05-1009SP, UNDERSTANDING THE TAX REFORM DEBATE: BACKGROUND, CRITERIA, & QUESTIONS (2005) [hereinafter UNDERSTANDING THE TAX REFORM DEBATE], available at <http://www.gao.gov/new.items/d051009sp.pdf>; John W. Lee, *Critique of Current Congressional Capital Gains Contentions*, 15 VA. TAX REV. 1, 4 (1995) [hereinafter Lee, *Critique*]; John W. Lee et al., *Restating Capitalization Standards and Rules: The Case for Rough Justice Regulations (Part One)*, 23 OHIO N.U. L. REV. 631, 676 n.161 (1997).

7. Martin J. McMahon, *The Mathew Effect and Federal Taxation*, 45 B.C. L. REV. 993, 1002-05 (2004); Deborah A. Geier, *Incremental Versus Fundamental Tax Reform and the Top One Percent*, 56 SMU L. REV. 99, 110-16 (2003). For my earlier work using SOI studies and other sources to show concentration of capital gains realizations and business ownership at the top one percent level see Lee, *Critique*, *supra* note 6, at 40-42 nn.148-49, 43-44, 49 n.173; and John W. Lee, *A Populist Political Perspective of the Business Tax Entities Universe: "Hey the Stars Might Lie But the Numbers Never Do,"* 78 TEX. L. REV. 885, 908-10 (2000); but see John W. Lee, *Entity Classification and Integration: Publicly Traded Partnerships, Personal Service Corporations, and the Tax Legislative Process*, 8 VA. TAX REV. 57, 100-01 n.169 (1988) [hereinafter Lee, *Entity Classification and Integration*] (demonstrating that SOI data reveals the concentration of reported income in a handful of very large corporations).

8. HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 68 (University of Chicago Press 1938) (describing the combination of high nominal individual ordinary income tax rates with a substantial individual capital gains preference as

a grand scheme of deception, whereby enormous surtaxes are voted in exchange for promises that they will not be made effective. . . . Politicians may point with pride to the rates, while quietly reminding their wealthy constituents of the loopholes. . . . Congress . . . [should] quit this ludicrous business of dipping deeply in large incomes with a sieve.).

with less income but where the income was wholly or mostly ordinary.⁹ Vertical equity or progressivity was a farce during this era.¹⁰

The matured pattern under the 1954 Code, from at least the 1960s on, was that perhaps a quarter of high income individuals did *not* regularly recognize substantial capital gains, which produced great horizontal disparities in *effective* income tax rates at the level of the top one percent or so of individual tax return filers.¹¹ High services-income-only individuals were therefore hammered as compared with high income individual taxpayers with equivalent amounts of capital gains income,¹² a departure from horizontal equity.

9. Leandra Lederman & Stephen W. Mazza, *Addressing Imperfections in the Tax System: Procedural or Substantive Reform*, 103 MICH. L. REV. 1423, 1425 n.7 (2005); *US Moves - Quietly - Toward a Flat Tax*, CHRISTIAN SCI. MONITOR, Dec. 1, 2003, at 13 (describing how the super-rich pay proportionately less federal income tax than the merely rich. In 2000, the 400 richest taxpayers (reporting average \$173 million) paid an effective tax rate more than five percentage points lower than those making \$1.5 million to \$5 million. The disparity will greatly increase as the capital gains rate was lowered from twenty percent to fifteen percent, and extended to dividends in 2003.).

10. John W. Lee, III, *The Capital Gains "Sieve" and the "Farce" of Progressivity 1921-1986*, 1 HASTINGS BUS. L. J. 1, 33-5, 47-8, 64, 67-9, 80 (2005) [hereinafter Lee, *The Capital Gains "Sieve"*]; Robert J. Samuelson, Opinion, *Tax Reform R.I.P.*, WASH. POST, May 12, 2004 at A23 (describing the capital gains preference as the biggest break for the wealthy in 2004: worth \$82 billion). From the beginning, populists were aware that preferences such as the reorganization provisions (and especially the capital gains preference) allowed high income individuals to evade progressivity. See 57 CONG. REC. S828-29 (daily ed. December 23, 1918) (statement of Sen. LaFollette). Professor Bank maintains that the majority in Congress really was only seeking to *offset* the impact of regressive *consumption* taxes with somewhat progressive *income* taxes aimed only at upper class taxpayers. Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U. L. REV. 329, 333 (1996) (indicating that the 1913 amendment reflected a more than fifty year struggle to replace the regressive tax system with a proportional, *not* progressive, system). Populists, however, sought a progressive system. *Id.* Fairness also encompasses horizontal equity, i.e., taxing similarly taxpayers with the same amounts of income, as by eliminating the capital gains preference and especially tax shelters; *Hearings on Impact, Effectiveness, and Fairness of the Tax Reform Act of 1986 Before the House Ways & Means Comm.*, 101st Cong., 2nd Sess. 172 (1990) (statement of James Holden, ABA Section of Taxation); *Id.* at 254 (statement of Rep. Gephardt); *Id.* at 525 (statement of Chair Rostenkowski). Fairness also includes "progressivity." *Id.* at 22. Here, the 1986 Act looked good only when compared to the early 1980's. *Id.* at 124, 135-36 (Statements of Aaron and Pechman); see also Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465 (1987) (arguing that the Tax Reform Act of 1986 took a large structural step away from progressivity and towards a flat tax.).

11. Lee, *The Capital Gains "Sieve"*, *supra* note 10, at 33-35, 47-48.

12. *Id.* at 33.

The distribution per percentiles of individual income classes of individual taxpayers of such capital gains tax preference benefit has always been skewed sharply to the top income reporters.¹³ That skewed distribution follows from the extreme concentration of individual *ownership* of capital assets and especially of *realizations* at the higher individual income levels;¹⁴ pooling at the top half of one percent (who currently report more than fifty percent of stock gains reported in most years¹⁵), astonishingly so in the case of the top 400 individual taxpayers—

13. In the “Roaring Twenties” when, according to J.F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* 88 (Univ. of Wis. Press 1985), the “standing joke was that three Presidents had served under [Treasury Secretary] Andrew Mellon, fewer than 10,000 individual taxpayers with \$100,000 or more [\$1,070,286 in 2004 purchasing power] in annual income paid about 50 percent of the individual income taxes and received almost 90 percent of the benefits of the flat capital gains rate.” Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 8, 12. In 1959, as the percentage of capital gains made up of stock dropped from earlier 85% to below 50%, the percentage of capital gains reported by taxpayers with reported income in excess of \$50,000 [\$322,000 in 2004 dollars or about top 1%] dropped to 35.9%. *Id.* at 30-32.

14. See Lee A. Sheppard, *The Rentier Society*, 108 *TAX NOTES* 176 (2005) (“The top 1 percent owns 34 percent of all shares and half of all securities and business assets.”). The meaning of high income varies with the speaker’s rhetoric. The term ranges from top twenty percent at its broadest scope to more commonly top five percent or top one percent at its narrowest scope of taxpayers by household income (usually joint return anyway), sometimes expressed by percentage of households, and sometimes by a dollar floor. Average household “comprehensive” income for 2000 for the top twenty percent was \$202,000; top five percent, \$446,400; and last, but by no means least, top one percent, \$1,326,900. CONG. BUDGET OFFICE, *EFFECTIVE FEDERAL TAX RATES UNDER CURRENT LAW, 2001 TO 2014* 16 (2004), available at <http://www.cbo.gov/ftpdocs/57xx/doc5746/08-13-EffectiveFedTaxRates.pdf>; CONG. BUDGET OFFICE, *HISTORICAL EFFECTIVE FEDERAL TAX RATES: 1979 TO 2002* 4 Table 1 (2005), available at <http://www.cbo.gov/ftpdocs/61xx/doc6133/03-01-EffectiveTaxRates.pdf> (for 2002, \$175,900, \$350,700, and \$938,100). The decline primarily reflects the bursting of the stock market bubble. See *infra* notes 177-78 and accompanying text. CBO uses “adjusted pretax comprehensive” household income, which includes all cash income (both taxable and tax-exempt), taxes paid by businesses (which are imputed to individuals, as noted above), employee contributions to 401(k) retirement plans, and the value of income received in kind from various sources (including employer-paid health insurance premiums, Medicare and Medicaid benefits, and food stamps, among others). The calculations use the Census Bureau’s fungible value measure to determine the cash equivalent of in-kind government transfers. CONG. BUDGET OFFICE, *HISTORICAL EFFECTIVE FEDERAL TAX RATES: 1979 TO 2002* at 2-3.

15. Historically the top one percent has annually reported fifty percent or more of capital gains realizations. Lee, *Critique*, *supra* note 6, at 64 n.231. In 1999, the top two percent reported seventy-three percent of capital gains. CONG. RESEARCH SERV., NO. RL31562, *AN ANALYSIS OF THE TAX TREATMENT OF CAPITAL LOSSES* (2002), available at <http://www.thememoryhole.org/crs/RL31562.pdf>; Lee, *The Capital Gains “Sieve”*, *supra*

the “fortunate 400.”¹⁶ Both the percentage of benefit of any capital gains preference by an income class and in an income class flows to the wealthiest individual tax payers. The greater the individual’s income, the greater the percentage of their income, tends on the average, to consist of capital gains.¹⁷ The result, as Professor Lawrence Zelenak points out, was that:

In 2000 the minimum AGI required for membership in the “Fortunate 400” was \$86.63 million, and the average AGI for the 400 was \$173.9 million. The average tax rate for these 400 returns in 2000 (as a percentage of AGI) was 22.29 percent. The New York Times has calculated that current law (reflecting the 2001 and 2003 tax cuts), if applied to the 2000 incomes of the Fortunate 400, would produce an average tax rate of only 17.5 percent. Based on average pretax income of \$173.9 million, the effect of the rate reduction from 22.29 percent to 17.5 percent would be to increase after-tax income by 6.2 percent.¹⁸

A colleague familiar with my work in this area once asked what was novel about the story of the 1989-2005 rate wars. That the rich get richer and the poor get poorer is not a new story. Professor Marty McMahon has called it the “Matthew Effect,” based upon a story told in the New Testament Gospel.¹⁹ What is new about the 1988-2005 rate wars and reinstatement of a substantial capital gains preference?

Part IV discusses the most distinctive feature of the 2001 and 2003 Acts’ tax cuts: income redistribution from middle and lower income

note 10, at 80 (showing that the top one percent to two percent reported sixty-nine percent of capital gains in 1985).

16. Lawrence Zelenak, *Framing the Distributional Effects of the Bush Tax Cuts*, 105 TAX NOTES 83 (2004); Martin A. Sullivan, *Economic Analysis: The Rich Get Soaked While the Super Rich Slide*, 101 TAX NOTES 581 (2003); see also David Cay Johnston, *Richest Are Leaving Even the Rich Far Behind*, N.Y. TIMES, Jun. 5, 2005 at A1 (indicating that the share of income of the top 0.1% of taxpayers, about 145,000 taxpayers, each with at least \$1.6 million in income (average income \$3 million) “more than doubled since 1980, to 7.4 percent in 2002. The share of income earned by the rest of the top 10 percent rose far less, and the share earned by the bottom 90 percent fell.”).

17. Zelenak, *supra* note 16, at 93 (realized capital gains was the largest component of AGI of Fortunate 400, and a five-fold increase in capital gains was a large factor in the increased share of AGI between 1995-2000); Leonard E. Burman & Deborah I. Kobes, *Composition of Income Reported on Tax Returns*, 101 TAX NOTES 783 (2003) (top 400 taxpayers reported more than 71% of income as capital gains; less than 17% as wages); Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 80 (top 1%’s capital gains income increased 171% from 1978 to 1990).

18. Zelenak, *supra* note 16, at 86. The net effect of tax reductions and spending cuts necessitated by the 2001 and 2003 tax reductions again appears to favor the rich at the expense of other taxpayers. *Id.* at 94-95.

19. *Matthew* 25:29; McMahon, *supra* note 7, at 994.

households to top income households—“Robin Hood in reverse.”²⁰ The excess of wage tax revenues over current outlays for social security benefits is used to buy special Treasury securities held in “trust funds.”²¹ (Wage taxes are heavier than income taxes for eighty percent of individual taxpayers and are especially regressive with a capped base limited to earned income and impose a flat-rate without deductions or exemptions). Federal Reserve Board Chair Alan Greenspan and the Congressional Budget Office agree that without taxes being raised to unacceptable levels, the Treasury will not be able to meet these obligations when Social Security must redeem them in order to meet current benefit obligations.²² This very fiscal inability to pay promised Social Security benefits to baby boomers when the ratio of workers to retirees drops substantially in the future is why the wage taxes were increased almost twenty-five years ago to generate trust funds.²³ The income redistribution in the event of such inability of the Treasury to pay its debt to Social Security may be readily appreciated from the similar magnitude of the tax cuts to the rich and the amounts Treasury will owe to Social Security. The Congressional Budget Office (“CBO”) estimates that revenue cost of making *all* of the 2001 and 2003 Bush II tax cuts permanent (which disproportionately benefit the top income households) would be \$1.5 trillion (including interest) over the ten-year period following their scheduled sunsets.²⁴ That amount is roughly equal to the amounts the Treasury will have borrowed from the Social Security funds (plus interest) over the same period.²⁵ Similarly, if President George W. Bush’s tax cuts benefiting the top one percent of households were made permanent (as the President and the Republican majorities in Congress intend), instead of “sunsetting” or terminating pursuant to their own terms, the lost revenue over the next seventy-five years would be roughly equal to the actuarial shortfall in Social Security estimates in its benefit program over the same period (*exclusive* of the amounts the Treasury owes the trust funds).²⁶

Part V examines the evidence that another goal of the ideologues advocating tax cuts (which disproportionately benefited the rich) was to force the Government to shrink by reducing its revenues.

20. See *infra* notes 343-67 and accompanying text.

21. See *infra* notes 350-53 and accompanying text.

22. See *infra* note 367.

23. See *infra* note 362 and accompanying text.

24. See *infra* note 354 and accompanying text.

25. See *infra* note 353 and accompanying text.

26. See *infra* notes 358-59 and accompanying text.

Part III discusses the unmasking of the real interest groups which proponents of capital gains rate cuts seek to benefit. Previously, proponents tended to emphasize the interests of small business, farmers and timber interests (and homeowners).²⁷ This time the target is more clearly the stock market where high income individuals (the contributing class) play such a large role in the individual investor category, and to a lesser extent middle income investor class.²⁸

Part II reveals the role of the Administrations in raising and lowering top individual income tax rates and the circumstantial evidence suggesting that at least initially a powerful current was tit-for-tat antagonism between the major players.

II. THE UNDOING OF THE 1986 CODE PARITY OF TAXATION OF ORDINARY INCOME AND CAPITAL GAINS

From the fresh start in the Internal Revenue Code of 1986 of taxing top individual and capital gains and ordinary income to the same twenty-eight percent, Congress unfortunately did start all over, again fashioning special rates not available as a practical matter to all individual taxpayers.²⁹ How did the Great Compromise of the 1986 Code come undone?

A. BUSH I ADMINISTRATION "PUSHED, PUSHED, PUSHED, PUSHED, PUSHED" FOR A CAPITAL GAINS PREFERENCE WITH NO INCREASE IN ORDINARY INCOME RATES 1988-1992

President George H.W. Bush campaigned for a renewed capital gains preference without raising the ordinary rate beginning in his 1988 presidential campaign and continuing throughout his 1992 reelection bid.³⁰

27. See Lee, *Critique*, *supra* note 6, at 13, 23-34.

28. See *infra* notes 294-307 and accompanying text.

29. The Bush I 1990 thirty-one percent (exclusive of phase outs) top individual ordinary rate versus the twenty-eight percent top individual capital gains rate did not effect much of a preference (9.68%); under Clinton's OBRA 1993, a 39.6% top individual ordinary rate versus a twenty-eight percent top individual capital gains rate created more of a capital gains preference (29.29%); even more so with his OBRA 1997 (capital gains cut to twenty percent for most capital assets (50.50%)). The Bush II "temporary" top rate of thirty-five percent and top capital gains rate of fifteen percent (2001 and 2003, respectively) for most capital assets resulted in effect in a 57.1% capital gains preference.

30. *A Talk with Bush: "People Won't Want to Gamble,"* BUS. WK., Aug 22, 1988, at 30 ("The Administration has been unwilling to open up the tax code for various reasons. Fine, I've been a part of this Administration. We're going to change in 1989. I will open up the tax code."); Tim Grey, *Bush, "I Will Open Up the Tax Code,"* 40 TAX NOTES 744 (1988)

Senator Bill Bradley (D-N.J.), if not the father, at least the uncle³¹ of the 1986 Code (having acted as its chief congressional policy entrepreneur³² for Treasury Secretary for Tax Policy Stanley Surrey's "large idea" of lowering income rates through broadening the income tax base), described

(explaining that in his 1988 Presidential Campaign George H.W. Bush called for lowering the maximum individual capital gains rate to fifteen percent, claiming such a cut would generate additional revenue – a supply side argument); 134 CONG. REC. S3959 (daily ed. Apr. 14, 1988) (statement of Senator Bumpers); see also Elizabeth Wehr, *Bush's Capital Gains Plan Revives Old Debate*, 47 CONG. Q. WKLY. REP. 369 (1989) ("A Joint Taxation analysis released Feb. 23 found that the plan would produce \$3.3 billion in revenue in fiscal 1990, but that it would result in an overall loss of \$24.2 billion for fiscal 1989-94."). On August 18, 1988, Vice President Bush, in accepting the nomination as the Republican presidential candidate, took the pledge, "Read my lips—no new taxes." Paul Taylor, *Bush's Vivid Self-Portrait*, WASH. POST, Aug. 19, 1988, at A27; Tom Redburn, *Bush Plans Daily Sessions on Deficit; Budget: He Is Eager to Strike a Deal Before Congress' August Vacation; Top Lawmakers Are Skeptical It Can Be Done That Quickly*, L.A. TIMES, Jul. 24, 1990, at A13 (arguing that the Bush Administration insists on a capital gains tax cut, but unwilling to accept Democrat demand as a quid pro quo for higher income tax rates for upper brackets). In the 1990 House Hearings on Fairness, populist Democrats repeatedly pointed out that a renewed revenue losing capital gains preference, without a rate increase, inherently breached the 1986 compact of low rates paid for by a broad base. *House Hearings on Fairness*, supra note 10, at 12-13, 21 (statements of Reps. Dorgan and Pease). The charge seldom arose, however, in either the 1989 or 1990 Floor Debates. *House Democrats Have a Better Idea? Offer Counterproposal to Capital Gains Cut*, 89 TAX NOTES TODAY 194-2 (1989).

31. I owe this delightful phrase to Ed Cohen who once modestly rejoined with this quip when I described him as the father of the 1954 ALI-ABA proposed Subchapter C. He's right, he was one of four: Stanley Surrey, Alvin Warren and Tomas Tarleau. Bill Bradley was more the godfather of the great compromise, politically popularizing Surrey's big idea of lowering rates through eliminating or restricting tax preferences, e.g., lowering the individual top ordinary income rate and eliminating the individual capital gains preference. The Dean of the Senate, Senator Pat Moynihan, pointed this out in the 1993 floor debate. 139 CONG. REC. S5985 (daily ed. May 18, 1993) (statement of Sen. Moynihan).

32. The policy entrepreneurship model of legislation "borrows" from the "garbage can" model, suggesting that enactment of a law requires the convergence of "streams" consisting of "problem recognition," "policy proposals," and "politics," together with an "entrepreneur" to guide the law's passage through Congress. JOHN W. KINGDON, *AGENDAS, ALTERNATIVES, AND PUBLIC POLICY* 88-94, 122-23 (2d ed. 1995) (defining "garbage can" theory, first designed to explain the "organized anarchy" of universities, as applying where the participants do not clearly know or define their goals and participation in decisions is fluid and unpredictable); John W. Lee & Eugene Seago, *Policy Entrepreneurship, Public Choice, and Symbolic Reform Analysis of Section 198, the Brownfields Tax Incentive: Carrot or Stick or Just Never Mind?*, 26 WM. & MARY ENVTL. L. & POL'Y REV. 613 (2002) (citing Michael Cohen et al., *A Garbage Can Model of Organizational Choice*, 17 ADMIN. SCI. Q. 1-25 (1972)); Paul J. Culhane, *NEPA's Effect on Agency Decision Making: Article: NEPA's Impacts on Federal Agencies, Anticipated and Unanticipated*, 20 ENVTL. L. 681, 683 (1990).

on the Senate floor in 1992 the process of unraveling the great compromise of lowering the individual tax rates by broadening the tax base.³³

The Tax Reform Act of 1986 cut rates by giving up various loopholes including capital gains. Half of the witnesses coming before the Finance Committee were willing to give up the capital gains preferences if the top rate were cut to about 28 percent, but the "other half of them said that even if you get the rate down to 12, we still want a capital gains differential." So the pragmatists won, the ideologues lost. . . . Before the ink was dry, people started coming in saying, "[Twenty-eight] percent is not enough. We want a lower rate on capital gains." When they would come in, I would say to them, "Well, you know you keep going down this road and what is going to happen is, rates are going to go back up, rates are going to go back up." They kept going down this road and this Congress spent from 1988 to 1992 debating the question of whether we should have a capital gains differential or not. Instead of leaving the rates low and not having a differential, the people who wanted to [have a] special capital gains rate came in and *pushed, pushed, pushed, pushed, pushed*. And what we are seeing today is the inevitable result of that: Rates going up, up, up, up, up until we are almost back to the old system.³⁴

33. Senator Bill Bradley (D-N.J.) identified in the early 1980s the political problem of high rates and big preferences eroding the effective rate at the top. Joseph J. Minarik, *How Tax Reform Came About*, 37 TAX NOTES 1359, 1364-66 (1987). Senator Bradley's efforts here nicely illustrate policy entrepreneurship. Just as this theory calls for, Senator Bradley identified the problem, then effectively popularized politically Surrey's large tax policy idea of radically lowering federal income tax rates and paying for (offsetting) the otherwise revenue loss by base broadening (through eliminating or at least curbing preferences--such as identified by Stanley Surrey). Also consistent with policy entrepreneurship scholarship, Senator Bradley's popularizing of rate lowering through base broadening was so successful that it became identified at least politically as his tax policy issue, having substantial impact on the Tax Reform Act of 1986. See e.g., 132 CONG. REC. S13782 (daily ed. Sept. 26, 1986) (statement of Chair Packwood). A Boolean search of "Bradley w/25 reform" for September 1986 in the Congressional Record brings up references to him as an "early leader" in tax reform, advocating tax reform for four to five years, and a moving force of tax reform. See generally BIRNBAUM & MURRAY, *supra* note 4, at 165-66, 1370; THOMAS J. CONLAND ET AL., TAXING CHOICES 37-38, 143-46, 164 (1990).

34. 139 CONG. REC. S76992-3 (daily ed. Jun. 23, 1993) (statement of Sen. Bradley) (emphasis supplied) (arguing against a Democratic-proposed small business corporation capital gains preference). Surely this was an oblique reference, as the Senate rules require, to President George H.W. Bush's obsessive push for a capital gains preference. See Ronald D. Elving, *Spotlight Turns to the Senate for Action on Capital Gains*, 47 CONG. Q. WKLY. REP. 2533 (1989)

(Gephardt also invoked the spirit of the 1986 tax bill, saying it achieved a 50-year goal of tax reformers to tax capital gains as ordinary income in exchange for lower rates. 'Now before the ink is fairly dry, the president comes back and says, 'Let's break the deal,' to quote Gephardt. That may have been the line that prompted

Just as Senator Bradley warned, ordinary rates went back up in President Bill Clinton's first tax act, OBRA 1993.³⁵ This Act passed each Chamber of Congress with a paper-thin Democratic majority, raising³⁶ ordinary rates at the top only,³⁷ e.g., the Millionaire's Surtax (39.6 percent

Bush, in a post-vote phone call to Archer, to single out Gephardt for criticism: 'I tell you, I'm displeased with Gephardt, the way he made it so really kind of personal. . . .')

I guess that truth hurts. The threat of President George H.W. Bush's capital gains proposal to the Tax Reform Act of 1986's "level playing field" was perceived from the beginning. Lawrence Haas, *Slippery Slope*, 21 NAT'L J. 583 (Mar. 11, 1989); Ronald D. Elving, *Capital Gains Cut May Trigger Dismantling of 1986 Bill*, 47 CONG. Q. WKLY. REP. 2246 (1989).

35. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993). Budget Reconciliation Acts obviate Senate supermajority rules for tax increasing acts. CONG. RESEARCH SERV., NO. RL33030, THE BUDGET RECONCILIATION PROCESS: HOUSE AND SENATE PROCEDURES (2005); Elizabeth Garrett, *Federalism in the 21st Century: States in a Federal System: Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 KAN. L. REV. 1113, 1166 n.232 (1997); Andrew Taylor, *When It Comes to Budget Rules, Congress Can Just Waive Goodbye*, 62 CONG. Q. WKLY. 692 (2004). Clinton's tax act was derived from the 1992 "footnote" tax bills passed by Congress, which had provided some capital gains preferences (targeted away from high income individuals), but they were vetoed by President George H.W. Bush because they raised individual rates at the top. Cf. Adam Clymer, *Senate's Tax Bill Wraps Up a Bouquet of Trial Balloons*, N.Y. TIMES, Mar. 15, 1992, at A30. ("The reason for these seemingly fruitless efforts is to pave the way for future action. Mr. Moynihan calls the practice a 'footnote.' If a provision has been passed once, even if fails to be enacted, it seems less controversial the next time around.").

36. Clinton's Democratic support was hard-won and rarely certain. George Hager & David S. Cloud, *Democrats Tie Their Fate to Clinton's Budget Bill*, 51 CONG. Q. WKLY. REP. 2122 (1993)

(Plainly worried and reluctant to take the leap, the House voted 218-216 on Aug. 5 to pass the \$496 billion, five-year deficit-reduction package, as close as the vote could get without going the other way. Fully 41 Democrats voted no; one more would have killed the plan. (Vote 406, p. 2200). Twenty-four hours later in the Senate, it took Vice President Al Gore to break a tie and make the final tally 51-50.);

1993 CONG. Q. ALMANAC 36-C.

37. E.g., 139 CONG. REC. H2988 (daily ed. May 27, 1993) (statement of House Ways & Means Committee Chair Rostenkowski) (bill focused on upper-income taxpayers); *Id.* at H2953 (daily ed. May 27, 1993) (statement of Rep. Derrick) (seventy-five percent of taxes in the bill fall on households with incomes over \$100,000—top six percent (\$131,000 in 2004 dollars); sixty-three percent on households with over \$200,000 in income); *Id.* at H3003 (daily ed. May 27, 1993) (statement of Rep. Rangel) (class warfare rhetoric translates as "they can not tax the rich"); 139 CONG. REC. S7674 (daily ed. June 23, 1993) (statement of Sen. Pryor) (78% paid with incomes over \$200,000.).

bracket) touched the top one percent only;³⁸ and making no change in the twenty-eight percent ceiling on capital gains. Incidentally, "Clinton started out with a program of economic stimulus, social investment, job creation, universal health insurance and tax and campaign-finance reforms aimed at putting big money interest in its place. But after a few bruising defeats, Clinton backed off."³⁹ Consequently, the increased revenue from the rate hikes at the top was used for deficit reduction which resulted in the Federal Reserve lowering interest rates,⁴⁰ which had a far greater effect on the economy than any presidential initiative would have had.⁴¹

B. PUSH AND SHOVE BACK

On another level, President Bill Clinton's 1993 raising of the individual ordinary income rates can be traced back to a personal conflict starting in

38. 139 CONG. REC. S7685 (daily ed. June 23, 1993) (colloquy between Sen. Kent Conrad, (D-N.D.), and Sen. Jim Sasser, (D-Tenn.), regarding the tax breakdown by income class).

39. Robert Kuttner, *Divided, We Stand a Chance*, WASH. POST, Jul. 23, 1995, at C9; Marshall Ingwerson, *A Tale of Chaos Shadows Clinton*, CHRISTIAN SCI. MONITOR, Jun. 30, 1994, at 14. In the case of the budget bill, "Blue Dogs" [conservative Southern Democrats in the House] forced more spending cuts in 1993 than Clinton had proposed. Eric Pianin & Ruth Marcus, *Clinton Grasps for Votes in Budget Showdown; Conservative House Democrats Win Pact to Curb Entitlements*, WASH. POST, May 27, 1993, at A1; David S. Broder, *Blue Dogs to the Rescue*, WASH. POST, March 5, 1993, at A21; Dan Carey, *As Hostilities Rage on the Hill, Partisan-Vote Rate Soars*, 54 CONG. Q. WKLY. REP. 199, 201 (1996). The Senate filibustered the economic stimulus part of the Administration's package. 103 CONG. REC. S11609 (daily ed. Sept. 14, 1993) (statement of Sen. Byrd); Adam Clymer, *The House Hands a Budget to an Ungrateful Senate*, N.Y. TIMES, May 30, 1993, at A4; Steve Mufson, *Clinton Willingness to Cut "Stimulus" Plan Casts Doubt on Its Value*, WASH. POST, Apr. 16, 1993, at F1. Clinton always was lucky. Richard Gwyn, *Lucky Clinton May Ride Wave of Recovery*, TORONTO STAR, Nov. 15, 1992, at B3.

40. Ingwerson, *supra* note 39

(After the election, it became increasingly clear that the deficit was bigger than previously believed and that the strongest impact Clinton's first budget would make on the economy was the direction it pushed long-term interest rates. To spur business expansion, home buying, and car sales, Clinton needed to show the Federal Reserve chairman and the bond market that he would seriously reduce the deficit. Then interest rates would drop.)

Federal Reserve Chair Alan Greenspan lowered interest rates to banks to historic lows not seen in decades contributing to consumer confidence which helped continue the recovery. More importantly, Greenspan kept the interest rates low when neither inflation nor wages rose by the fifth and sixth years of the recovery as they traditionally did by that age of a recovery. Louis Uchitelle, *Outlook '97: Economy & Industry; The Link Grows Cloudy Between Jobs and Prices*, N. Y. TIMES, Jan. 2, 1997, at C7.

41. Clay Chandler, *Control Freaks; Despite All Their Boasting, Politicians Don't Much Affect the Economy*, WASH. POST, May 5, 1996, at C2.

1989 between President George H.W. Bush and House Ways & Means Chair Dan Rostenkowski (D-Ill.) over the ordinary income-capital gains parity. Chair Rostenkowski had made his reputation by passing, in partnership with Republican President Ronald Regan, the Tax Reform Act of 1986, a key feature of which taxed high income individual capital gains at the same maximum twenty-eight percent rate as ordinary income.⁴² As Vice President, George H.W. Bush had rarely been involved in the tax reform debate which resulted in the 1986 Code.⁴³

1. Rostenkowski's Misstep

In 1989, Rostenkowski began negotiations with the First Bush Administration over a compromise for indexing the cost basis of selected individually held capital assets (designed to please both Democrats and Republicans but in fact displeasing both).⁴⁴ Probably not coincidental to Rostenkowski's proffer, Bush (known for annually posting tens of thousands of handwritten "stroke notes"⁴⁵) and Rostenkowski ("well-known for his long memory and eagerness to wreak revenge"⁴⁶) had served together on the House Ways and Means Committee at the time of the Tax Reform Act of 1969.⁴⁷

42. BIRNBAUM & MURRAY, *supra* note 4, at 103, 223, 227, 276.

43. *Id.* at 94 ("[In] one of his rare involvements in the tax-reform debate . . . [Bush] argued that the oil and gas industry was essential to the nation's security.").

44. Pat Jones, *Stuck on Capital Gains, Ways and Means Action Slows to a Crawl*, 44 TAX NOTES 479 (1989) (arguing that the original Rostenkowski proposal would have provided indexing only for future purchases of capital assets, thus encouraging sales of existing investments; the compromise would allow Democrats to claim no rate reductions and Republicans to claim practical effect of rate reductions). Democrats opposed it because it was the functional equivalent of a capital gains deduction and reduced revenues. See STAFF OF THE JOINT COMM. ON TAXATION, NO. JCX-43-89, DISTRIBUTIONAL EFFECT OF CHAIRMAN ROSTENKOWSKI'S CAPITAL GAINS PROPOSAL (1989) (demonstrating that 75% of benefit went to taxpayers making more than \$100,000 (\$152,000 in 2004 dollars)). Republicans may have opposed it because their capital gains constituencies (timber, livestock and private firms) had scant or no basis to adjust or did not hold the assets (public stock) long enough for inflation to have a significant effect. Lee, *Critique*, *supra* note 6, at 33.

45. George F. Will, *The Pastel President*, NEWSWEEK, Apr. 24, 1989, at 86 ("[The] Bush presidency rests on 60,000 thank-you notes, aptly called 'stroke notes.' It is politeness in lieu of political purpose."); Richard Cohen, *Breeding Will Tell*, WASH. POST, Oct. 17, 1992, at A23. ("George Bush . . . writes endless thank-you notes and . . . amassed a Christmas card list that, in 1986, contained a mere 30,000 names.").

46. BIRNBAUM & MURRAY, *supra* note 4, at 105 (Trent Lott, then a House leader, told a colleague, "If you cross Rostenkowski, he'll get your ass.").

47. Ronald D. Elving, *Democrats Pursue Consensus on Capital Gains Cut*, 47 CONG. Q. WKLY. REP. 2299 (1989)

Once Rostenkowski had breached the dyke of the unified House Democratic leadership opposition to any renewed capital gains preference (at least if ordinary income rates were not increased),⁴⁸ a coalition of House conservatives (mostly Republicans and conservative, largely southern or border-state Democrats⁴⁹) proposed a generic capital gains cut including timber and real estate with no ordinary income rate increase.⁵⁰ President George H.W. Bush quickly switched vehicles and jumped aboard the conservative coalition's proposal,⁵¹ thereby infuriating Rostenkowski.⁵² The conservative coalition's capital gains tax cut proposal passed both the House Ways & Means Committee and then the entire House⁵³ over the

(Rostenkowski and Bush have been friends since they served together on Ways and Means more than 20 years ago. Bush has made a cut in capital gains taxes his top priority in tax policy. And despite his longstanding opposition to lower taxes for capital gains, Rostenkowski had seemed at least marginally more amenable to the idea as late as midsummer.);

Pat Jones, *Taxwriters Moving Slowly but Surely on Capital Gains*, 44 TAX NOTES 623 (1989); Lee, *The Capital Gains "Sieve," supra* note 10, at 43. Accordingly, I surmise that Rostenkowski felt betrayed by an old friend.

48. Rob Bennett, *The Mapo Kid and the Reverse Toaster Theory*, 45 TAX NOTES 1625, 1626 (1989); 45 CONG. Q. ALMANAC 114 (1989).

49. See Lee, *The Capital Gains "Sieve," supra* note 10, at 16 n.75 (indicating that the block has now disappeared with the Southern Succession of Democrats by Republicans).

50. 45 CONG. Q. ALMANAC 114 (1989). Conservative Coalition on the Ways & Means Committee consisted of all Republican Members and Reps. Ed Jenkins. (D-Ga.), Andy Jacobs, Jr. (D-Ind.), Ronnie Flippo (D-Ala.), and J.J. Pickle (D-Tex.).

51. Elving, *supra* note 34 ("House Republicans, bolstered by Southern and timber-district Democrats, trounced the Democratic leadership September 28 with a nearly fifty-vote margin in favor of cutting the tax on capital gains. The 190-239 vote against the leadership's alternative plan moved the capital gains battle to the Senate. . . ."); Tom Redburn, *News Analysis; Not Always Easy to Get a Bill out of the Woods; In a Typical Case, Capital Gains Measure Had to Be Steered Though Forest of Timber Interests*, L.A. TIMES, Oct. 6, 1989, at 22; Dale Russakoff, *They're All Tree-Huggers Now*, WASH. POST, Oct. 5, 1989, at A29.

52. Pat Jones, *Ways and Means on Capital Gains: Through the Looking Glass*, 45 TAX NOTES 1303-04 (1989).

53. The July 1989 Rostenkowski approach contained an elective two-step "exclusion" alternative to indexing reminiscent of earlier House Ways and Means predilections for complex capital gains provisions for assets held five to ten years: additional basis equal to twenty-five percent of the sales price, after ten years additional basis equal to fifty percent of sales price. Pat Jones, *Taxwriters Moving Slowly but Surely on Capital Gains*, 44 TAX NOTES 623-25 (1989); see Lee, *The Capital Gains "Sieve," supra* note 10, at 29 (1963), 56 (1978). Rollcall vote No. 253, defeated Chair Rostenkowski's IRA plus rate increase to thirty-three percent above the "bubble" substitute for the JAF capital gains package 239 to 190, 3 not voting. 135 CONG. REC. H6313-14 (daily ed. Sept. 28, 1989). Fifty-three out of the sixty-seven Democrats voting nay to the Rostenkowski amendment were Southern; all House Republicans voting (172) voted nay. Thus, the Conservative Coalition was 172 Republicans and 67 Democrats. A no vote was the rough functional equivalent of a yes vote

scathing objections of Chair Rostenkowski.⁵⁴ Senate Majority Leader George Mitchell was able to keep capital gains out of the Senate bill only through parliamentary *leger-de-main*.⁵⁵ The House capital gains cut died in Conference.⁵⁶

The 1989 House floor debate in effect distilled, sometimes down to trace quantities, the themes and rhetoric of 1960s and 1970s capital gains debate (again calling up JFK's 1963 capital gains proposals⁵⁷).⁵⁸ Capital

for the capital gains provision but also yes for a rate increase at the top. The final House vote on the 1989 Omnibus Reconciliation Act was 333 yeas to 91 nays. *Id.* at H6727 (daily ed. Oct. 5, 1989) (Rollcall vote No. 274).

54. See Jones, *supra* note 52.

55. Ronald D. Elving, *What's in a Rule?*, 47 CONG. Q. WKLY. REP. 2616 (1989) (Proponents of using the Byrd rule noted that the capital gains tax cut that received 10 votes in the Senate Finance Committee was estimated to gain revenue in its first two years but lose revenue thereafter. Thus, in their view, a point of order based on the Byrd rule, if upheld by the chair (the senator presiding, who rules on the advice of the Senate parliamentarian), would require 60 votes to waive.);

Mitchell Rips GOP Tax Tactic, ST. LOUIS POST-DISPATCH, Oct. 27, 1989, at A19 (stating that they did not have sixty votes needed to cut off debate); see generally CONG. RESEARCH SERV., NO. RL30458, THE BUDGET RECONCILIATION PROCESS: THE SENATE'S BYRD RULE (2004), available at <http://www.house.gov/rules/RL30862.pdf>; CONG. RESEARCH SERV., NO. RL33030, THE BUDGET RECONCILIATION PROCESS: HOUSE AND SENATE PROCEDURES, (2005).

56. 45 CONG. Q. ALMANAC 109 (1989). History repeats itself. In 1963-1964, the House passed JFK's capital gains quid of an additional capital gains preference but not his quo of taxation of unrealized capital appreciation at death, and the Senate and Conference rejected the House provision. See Lee, *The Capital Gains "Sieve," supra* note 10, at 35-36.

57. 135 CONG. REC. H6276 (daily ed. Sept. 28, 1989) (statement of Rep. Archer). Representative Tom Downey (D-N.Y.), an opponent of the Committee's capital gains provision, responded that "one of the first political axioms must be that when conservative Republicans invoke President Kennedy's name that we had all better beware." *Id.* at H6278. For JFK's 1963 proposal, see Lee, *The Capital Gains "Sieve," supra* note 10, at 27-30 (arguing that capital gains rate cut more than paid for by taxation of unrealized capital appreciation at death (spurring earlier realizations) and paring away 1940s and 1950s special interest add-ons).

58. See Lee, *The Capital Gains "Sieve," supra* note 10, at 45, 47, 52-53, 59-63; Lee, *Critique, supra* note 6, at 10-83; Elving, *supra* note 34

(Beyond the timberline lay yet another field of votes for Jenkins-Archer: members interested in encouraging growth investment, in general, and high-tech entrepreneurs in particular. Such concerns appeared to cost the leadership half the Democratic votes from Maryland, several in California (including Rep. Norman Y. Mineta, whose district includes part of the high-tech Silicon Valley) and a smattering from the Northeast as well. Finally, the pro-cut coalition included Democrats who had seen small investors lose to taxes much of the reward from a lifetime investment. . . . [T]he main line of attack was that the cut would be overly generous to the rich The Joint Committee on Taxation has said 60 percent of

gains royalties from timber played the preeminent role,⁵⁹ probably because President George H.W. Bush's original proposal included neither such statutory capital assets nor depreciable real estate.⁶⁰ Clearly, George H.W. Bush's real target for capital gains relief was corporate stock.

2. Rostenkowski's Response to Bush I

The next step in this apparent tit-for-tat approach to tax legislation was Rostenkowski's 1990 direction to the Ways & Means committee staff to do the spadework on the failure of trickle down economics.⁶¹ Their studies

the dollar benefits of the Jenkins-Archer plan would go to those families with more than \$200,000 in annual income. But Republicans counterattacked by saying 70 percent of those receiving at least some benefit from the cut were families with earned income of \$50,000 or less.).

59. 45 CONG. Q. ALMANAC 115 (1989). See 135 CONG. REC. H6290 (daily ed. Sept. 28, 1989) (statement of Rep. Wolpe) (discussing the "extraordinary influence of some individual contributors and some special interests, nothing more and nothing less."); *Id.* at H6277 (statement of Rep. Rangel) ("[T]imber becomes the issue rather than the social needs of our country."); see also Michael Kinsley, *Fat Cats with Claws Out*, LONDON TIMES, Oct 7, 1989

(Capital gains is a classic special-interest lobbying issue, in which the beneficiaries are few, but well organized, while the losers are many but diffuse and largely ignorant." People contacting congressmen may mistakenly see a capital gains tax cut as a recipe for economic growth or are not a cross-section of America. Rep. Ben Jones (D-Ga.) said that people he had been hearing from were "small farmers, timber interests and people with a little bit of real estate."); Charles Krauthammer, *Stealing from the Future*, WASH. POST, Sept. 28, 1989, at A31 (timber sales preferentially treated "[b]ecause the key congressmen needed to get the capital gains cut passed are timber-state Democrats (mostly from the South.)).

60. Pat Jones, *Depreciable Asset Exclusion Complicates Debate on Bush Capital Gains Plan*, 42 TAX NOTES 1288 (1989) (describing that cut would apply to the sale of stock and nondepreciable assets).

61. This data had not been developed in the 1988 Presidential Campaign. KEVIN P. PHILLIPS, *THE POLITICS OF RICH AND POOR* 9-14, 46-47 (Random House 1990) (arguing the data was not yet fully developed and "Democrats laid little groundwork for any serious critique in 1988"); *Id.* at 5, 30 (indicating that Dukakis was uncomfortable with populism due to upper-middle-class "civic religion"), 42, 50-51 (showing that Dukakis out drew other Democratic candidates in contributions from business people, lawyers and financiers and relied on *competence* not ideology), and 84 (demonstrating that tax issues were ignored in 1988 as in 1928). Lee Attwood, a key Republican strategist, stated that the way to win a presidential race against the Republicans was to stir up "class warfare." *Id.* at 30-31; accord, WILLIAM GREIDER, *WHO WILL TELL THE PEOPLE* 274 (Simon & Schuster 1992). Gov. Bill Clinton did just this in his 1992 Presidential Campaign. John Lee, "Death and Taxes" and Hypocrisy, 60 TAX NOTES 1393, 1397 (1993) ("The voters most strongly supporting Clinton were those who both were concerned about the future economy and that that their standard of living was slipping.").

showed the 1980s had been a decade of at best pre-tax income stagnation for all but the high income taxpayers (whose income doubled at the top one percent level).⁶² This economic pattern was *doubly* exacerbated by (1) a nearly twenty-five percent *drop* from 1977 to 1990 in the effective Federal rate of taxation for the top one percent (from thirty-five percent to twenty-seven percent) due to ordinary income and capital gains rate cuts; and (b) a 2.6 percent and 6.6 percent *increase* in the effective tax rates of the lowest and next lowest quintile taxpayer, respectively (bottom forty percent of households by income), due to wage tax increases, whose *pre-tax* income adjusted for inflation in turn had fallen 11.8 percent and 2.7 percent, respectively.⁶³

The decrease in effective rates at the top reflected the combination of cuts in tax rates at the top in 1978 and 1981 (and frozen in place by the 1986 Code) and growth in capital gains and executive compensation.⁶⁴ The inequitable increase in effective Federal tax rates at the bottom forty percent was due primarily to increases in the early 1980s in the regressive wage tax rate and an increase in the dollar amount of the wage base ceiling for computing wage taxes.⁶⁵

62. See McMahon, *supra* note 7.

63. STAFF OF HOUSE WAYS & MEANS COMM., TAX PROGRESSIVITY AND INCOME DISTRIBUTION, 101st Cong., 1st Sess. 1-2 (Comm. Print 1991); STAFF OF JOINT COMM. ON TAXATION, TAX POLICY AND THE MACROECONOMY: STABILIZATION, GROWTH AND DISTRIBUTION, 102nd Cong., 1st Sess. 55 (Comm. Print 1991). Additionally, the Republican Administrations decreased the level of transfer payments to lower income individuals over this period. KEVIN P. PHILLIPS, THE POLITICS OF RICH AND POOR 86-89, 204-05 (Random House 1990). Furthermore, “[o]ver the 1980’s, [middle class] families on the surface appeared to be keeping up, but only because more and more women went into the work force producing second earners for many American families.” 136 CONG. REC. H8699-700 (daily ed. Oct. 2, 1990) (statement of Rep. Obey); see David S. Cloud, *The Cry for Middle-Class Cuts: Looking Behind the Rhetoric*, 50 CONG. Q. WKLY. REP. 105, 108 (1992).

64. Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 79.

65. See *supra* note 64. The Congressional Budget Office reports that bottom twenty percent, next twenty percent, and top one percent, respectively had the following effective rates for Federal taxes in 1980 and 1985, respectively:

	All federal taxes	Individual income taxes	Wage taxes	All federal taxes	Individual income taxes	Wage taxes
Lowest 20%	8.0	0.2	5.3	9.8	0.5	6.6
Next 20%	14.1	4.5	7.6	14.8	4.0	8.8
Top 1%	34.6	22.3	1.0	27.0	18.9	1.3

Chair Rostenkowski, armed with these statistics on (1) the failure of trickle down, as evidenced by the rich getting richer and paying a lower effective tax rate and the poor getting poorer (adjusted for inflation) and paying a higher effective tax rate (due to wage tax increases); and (2) regressivity of excise taxes in his pocket,⁶⁶ challenged President George H.W. Bush in 1990 to reduce an otherwise increase in the National Deficit by \$511 billion over a five-year budget window, 1990-95.⁶⁷ President George H.W. Bush took up the challenge, perhaps a politically ill-advised move.

3. Bush I's Misstep

In 1990, President George H.W. Bush initially seemed to waiver on exchanging a rate increase on upper income individuals for a renewed capital gains preference,⁶⁸ but then strengthened his opponents' case⁶⁹ by

CONG. BUDGET OFFICE, EFFECTIVE FEDERAL INCOME TAX RATES 1979-2001 (2004), available at <http://www.cbo.gov/showdoc.cfm?index=5324&sequence=0>.

66. Taxes on cigarettes and alcohol are regressive with the former being more regressive. *CBO Releases List of Deficit Reduction Options*, 90 TAX NOTES TODAY 37-3 (1990) (citing CONG. BUDGET OFFICE, THE DISTRIBUTIONAL EFFECTS OF AN INCREASE IN SELECTED FEDERAL EXCISE TAXES (1987)). Senator George Mitchell (D-Me.), relying on this study, pointed out that every \$1 billion increase in excise taxes would offset from nine to thirteen percent of the average tax relief provided by the 1986 Act to families with less than \$10,000 in income. In contrast, he pointed out, the same excise tax increase would offset from 0.5 to two percent of the average tax relief provided to families in the above \$100,000 income groups. 133 CONG. REC. S11782-83 (daily ed. Aug. 7, 1987). The Congressional Budget Office, *supra* note 66, reports that the bottom twenty percent, the next twenty percent, and the top one percent, respectively, had the following effective rates for excise taxes in 1980 and 1985, respectively:

	Excise taxes 1980	Excise taxes 1985
Lowest 20%	1.4	2.2
Next 20%	1.1	1.4
Top 1%	0.6	0.7

67. *Rotenkowski Outlines Deficit Reduction Plan*, 90 TAX NOTES TODAY 55-5 (1990); Pat Jones, *Spotlight on the Rosty Challenge: Deficit Plan Takes the Hill by Storm*, 46 TAX NOTES 1351, 1352 (1990).

68. George Hager, *Recapping the Budget Struggle*, 48 CONG. Q. WKLY. REP. 3478 (1990) (On October 9, President George H.W. Bush said he would accept a boost in top ordinary rate in exchange for a capital gains cut; Aides to the Senate Finance Committee revealed that afternoon that the Committee was considering raising the top ordinary rate to thirty-three percent and cutting capital gains rate to twenty-three percent; On October 11, Rep. Bill Archer (R-Tex) said Bush would accept a top rate of thirty-one percent in exchange for cutting the capital gains rate to fifteen percent, but later Bush said Democrats would not accept a fifteen percent capital gains rate so do not even offer.); *see also* George Hager, *Parties Angle for Advantage as White House Falters*, 28 CONG. Q. WKLY. REP. 3391 (1990)

pushing “obsessively”⁷⁰ for inclusion of a capital gains cut (or its rough distributional equivalent)⁷¹ *without* an ordinary income rate increase in the closed door negotiations between members of his Administration and *selected* leaders of the Congress (deliberately *excluding* Chair Rostenkowski), producing the ill-fated “parliamentary”-like⁷² Budget

(arguing that back-to-back flip-flops on ordinary rate increase in exchange for capital gains cuts delighted Democrats and embarrassed GOP); 136 CONG. REC. S15860 (daily ed. Oct 18, 1990) (statement of Sen. Kohl); *Id.* at H8923 (daily ed. Oct 4, 1990) (statement of Rep. Moody); Tim Gray, *Ways and Means Democrats Forge Tax Package: Stage Set for Battle over Tax Rate Increases*, 49 TAX NOTES 255, 257 (1990). President George H.W. Bush’s wavering on rate increases as the quid pro quo for a capital gains tax cut had actually begun back in late June 1990, as evidenced by his written announcement. 46 CONG. Q. ALMANAC 131 (1990). The Bush I Administration subsequently attempted to rewrite this history. Dan Balz, “No New Taxes” Revisited; Quayle Latest to Try to Explain Away Pledge, WASH. POST, July 24, 1992, at A16.

69. 136 CONG. REC. H10285 (daily ed. Oct. 16, 1990) (statement of Rep. Downey) (“For 10 years we have attempted to get the public’s attention about the basic unfairness of the Republican package, and George Bush has finally handed it to us. He has decided that he would rather shut down the Government of the United States than to tax the wealthy.”); accord Thomas B. Edsall & E.J. Dionne Jr., *Democracy at Work: The Tax Revolt Of the Masses*, WASH. POST, Oct. 14, 1990, at C1. See generally E.J. DIONNE, WHY AMERICANS HATE POLITICS 320 (Simon & Schuster 1991) (“Simultaneously, George Bush threw away the Republicans’ advantage on the tax issue and painted his party as the friend of the rich.”). In the 1990 House Hearings on Fairness, Populist Democrats repeatedly pointed out that a renewed, revenue losing capital gains preference without a rate increase inherently breached the 1986 compact of low rates paid for by a broad base. *House Hearings on Fairness*, supra note 10, at 12-13, 21 (statements of Reps. Dorgan and Pease).

70. *E.g.*, 136 CONG. REC. H8052 (daily ed. Sept. 26, 1990) (statement of Rep. Hertel); *Id.* (daily ed. Sept. 25, 1990) (statement of Rep. Pease) (threatening “Armageddon” because of the President’s “pigheaded” insistence on a capital gains cut, which would reduce the effective rate at the top by 4 percentage points). See generally Robert J. Samuelson, Opinion, *The Capital Gains Obsession*, WASH. POST, Sept. 26, 1990 at A25; George F. Will, Opinion, *It’s Not Modesty, It’s Arrogance*, WASH. POST, Oct. 12, 1990, at A21 (indicating that Bush I’s capital-gains obsession dissipating Reagan’s “appeal to those blue-collar Democrats who for a while stopped seeing Republicans as ‘the rich.’”).

71. The last minute substitution by President George H.W. Bush of “Growth Incentives” for small business, including a targeted capital gains preference *plus* an upfront deduction for such investments (at a revenue cost of \$11.5 billion, deliberately equal to his proposed capital gains preference), presented an even broader target for class warfare rhetoric. David Wessel & Jeffery H. Birnbaum, *Consolation Prize: Tax Shelters for Rich Could Return in Plan to Aid Small Business*, WALL ST. J., Oct. 2, 1990, at A6; Andrew Hoerner, *Small Business Incentives: An Eight-Fold Path to Who Knows Where?*, 49 TAX NOTES 133 (1990); Budget Summit Agreement 17, 21-4 (Sept. 30, 1990), reprinted by Prentice Hall Information Services.

72. 136 CONG. REC. H8921 (daily ed. Oct. 4, 1990) (statement of Rep. Boxer); accord, *id.* at H9959 (Oct. 16, 1990) (statement of Chair Rostenkowski) (who had not been invited.); Robert W. Merry, *CQ Roundtable: The Budget Summit’s Assault on Congress*, 48 CONG. Q.

Accord of 1990 attempt to meet Rosty's challenge of reducing projected growth in the Deficit by \$511 billion over five years. It relied heavily on regressive excise taxes (e.g., gasoline, alcohol, and cigarettes)⁷³ and user fees (e.g., Medicare premiums). The Budget Accord's increases fell much heavier on lower income taxpayers, especially as to sin (cigarettes and alcohol) and gasoline tax increases—"Jill and Joe Six-pack."⁷⁴

Adding insult to injury, Members of Congress in the Budget Summit at Andrews Air Force base, just outside of the Beltway, drew out plums⁷⁵ from the tax expenditure pie so their own constituencies could avoid some of the pain of increasing revenues.⁷⁶ This posture provided an ideal

WKLY. REP. 3266 (1990) (discussing an assault on committee system and coalition building); David E. Rosenbaum, *The Budget Agreement: Selling the Deal; White House and Top Democrats Take Budget Accord to Congress*, N.Y. TIMES, Oct. 2, 1990, at A23 (noting that Chair Rostenkowski could not take on House Leadership, but "he gave his followers a free hand.").

73. 136 CONG. REC. H8818 (daily ed. Oct. 3, 1990) (statement of Rep. Dellums) (stating that consumption tax increases are harder on the poor since they spend a larger portion of income on goods affected); Robert D. Hershey Jr., *The Budget Agreement: Who Will Pay; Tax Burden Expected to Fall On People of Moderate Means*, N.Y. TIMES, Oct. 2, 1990, at A24

((T)axpayers in the income ranges of \$30,000 to \$40,000 and \$40,000 to \$50,000 would be hit hardest, paying an average 3.3 percent more under the plan. Those in the range of \$20,000 to \$30,000 would pay three percent more while those in the ranges of \$50,000 to \$75,000 and \$75,000 to \$100,000 would see their total tax bills rise two percent. . . . Taxpayers with incomes of \$100,000 to \$200,000 are to pay 1.5 percent more and those with \$200,000 and more are expected to pay an extra three-tenths of 1 percent . . .);

see *supra* note 67.

74. Thomas B. Edsall & E.J. Dionne Jr., *Democracy at Work: The Tax Revolt Of the Masses*, WASH. POST, Oct. 14, 1990, at C1 (demonstrating that the accord called for the greatest sacrifice from "Jill and Joe Six-pack," who had not shared in the prosperity of the prior decade but had been key to national election outcomes for the previous 20 years and critical to GOP success in five out of the last six presidential elections.).

75. Little "Jack" Horner's plum was a deed to church property in a pie which Horner, as chief steward to the last Abbot of Glastonbury, delivered to Henry VIII in an unsuccessful ploy to avoid dissolution of the Abbot's monasteries. J Power, *All About Henry VIII, Jack Horner and Plum Pudding*, COURIER-MAIL (Dec. 11, 1985). See generally Jennifer Howard, *The Realities Behind the Rhymes; History According to Mother Goose*, WASH. POST, June 11, 1997, at H1. Thomas Horner acquired Mells the year of the deliveries to the King and was on the jury that condemned the last Abbot to death.

76. 136 CONG. REC. S15450, 15468 (daily ed. Oct. 17, 1990) (statement of Sen. Hollings) (They have been out there at Andrews eating so much ice cream that they all gained weight; they got fat out there. . . . They took good care of pleasure boats [Sen. George Mitchell (D-Me.)], . . . of the private airplanes [Senator Bob Dole (R-Kan.)]. They got all the little loopholes for oil exploration, and they fed the Japanese lobbyists by exempting electronics. And then they had the gall to come on the floor and cry: Pain; hard, tough choices; tough choices.).

opening for populist opponents of a capital gains preference, now armed with failure of trickle down data, to successfully hone class warfare/fairness rhetoric. As one legislator put it, “Now what we are saying is that we have our 28 percent [paid for in part by repeal of the capital gains preference⁷⁷] but we want more. . . . Where does the greed end?”⁷⁸

Similarly, supporters of the subsequent House Democratic alternative of piercing⁷⁹ the “bubble,” i.e., continuing the 33 percent rate after about \$185,000 (2004’s \$268,250) in taxable joint return income, declaimed that they were making the rich pay for the party of the 1980s.⁸⁰ They crowed

77. Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 78-79.

78. See *House Hearings on Fairness*, *supra* note 10, at 341 (statement of Rep. Russo).

79. This is tax jargon for continuing the thirty-three percent “rate,” then applicable to joint return taxable income (family of four) from \$78,401 to \$185,730 in joint taxable income, above such cap instead of dropping back to twenty-eight percent, the same rate that applied just below the \$78,400 joint taxable income level (the taxable income brackets at which the rates began were indexed and the stated figures are the 1990 income level amounts). Because the twenty-eight percent rate applied below and above the higher thirty-three percent rate, the income subject to the higher range was called the “bubble,” which was enacted by the Tax Reform Act of 1986 as still another trade off for lowering the top rate to twenty-eight percent. See Kies, *supra* note 4. Because the practical effect of piercing the bubble was to continue the same top marginal rate for the rich as applied to the near rich, this proposal enjoyed considerable political appeal, even in 1986. See 132 CONG. REC. S13898 (daily ed. Sept. 27, 1986) (statement of Sen. Rockefeller); *House Hearings on Fairness*, *supra* note 10, at 78 (statement of Assistant Secretary for Tax Policy Gideon) (“[B]ubble bursting proposals . . . are nothing more than simply increasing the tax on these folks from 28 to 33 percent.”); *id.* at 19, 260, 266 (statements of Sen. Bradley and Chair Rostenkowski) (demonstrating that Senate Finance Chair Bob Packwood insisted on the “bubble” in order to keep two “permanent” rates and raise revenues in order to provide more relief for middle-income individuals). Ways and Means Chair Rostenkowski pointed out that the House bill in 1985 had retained a capital gains preference, but it also had a top individual rate of thirty-eight percent—a not so veiled hint that a revived capital gains preference would require a higher rate. *Id.* at 12-13; *accord id.* at 274 (statement of Rep. Pease); *id.* at 341 (statement of Rep. Russo). Robert McIntyre, a public interest lobbyist opposing any capital gains preference, asserted that under revenue neutrality the Administration’s 1990 capital gains proposal (or indexing) would require a top rate in the 1940s. *Id.* at 163.

80. 136 CONG. REC. H10117 (daily ed. Oct. 16, 1990) (statement of Rep. Lehman); *id.* at S15753-54 (daily ed. Oct. 18, 1990) (statement of Sen. Harkin) (“We are asking those who can least afford it to pay for the mess left by the rich who had the party [of excesses] in the 1980’s. I say let us make the rich pay for their own party they had during the last decade.”); *id.* at H8829 (daily ed. Oct. 3, 1990) (statement of Rep. Owens); *id.* at H3599 (daily ed. June 14, 1990) (statement of Rep. Kennedy) (S&L crisis source of party metaphor). Interestingly, essentially the same rhetoric was used by Democrat critics of Secretary of the

that Reagan's 1981 "Riverboat Gamble"⁸¹ of reducing taxes at the top to a maximum of fifty percent, resulting as well in a cut in the maximum individual capital gains rate to twenty percent due to retention of the sixty percent deduction of individual long term capital gains (while increasing defense spending), had tripled the deficit rather than reaching a balanced budget as promised, benefiting only the top high income individuals.⁸² Their opponents cried class warfare.⁸³ These populist fairness arguments not only helped defeat the 1990 Budget Accord in the House,⁸⁴ but also

Treasury Mellon's tax cut plan in 1924. 65 CONG. REC. (Part 4) 3332-33 (daily ed. Feb. 29, 1924) (statement of Rep. Crosser).

81. 136 CONG. REC. H9115 (daily ed. Oct. 6, 1990) (statement of Rep. Obey). Then Senate Republican Floor Leader Howard Baker, R-Tenn, called President Reagan's 1981 tax a "riverboat gamble," which Obey had not taken. See 139 CONG. REC. S4182 (daily ed. Apr. 1, 1993) (statement of Sen. Sasser) (stating that the riverboat gamble of 1981 reduced Federal revenues by 20% and Congress had the foolishness to try to pay for that by increasing military spending by about 33%; quadrupling the national debt in 12 years). Fool me once shame on you; fool me twice shame on me. Michael Kinsley, Commentary, *Fool Me Twice, Shame on Me*, L.A. TIMES, Jan. 16, 2005, at M5; Editorial, *Administration Mislead Congress on Medicare; Whether or Not Any Laws Were Broken, Medicare Officials Deliberately Lied to Congress About the Cost of Last Year's Prescription Drug Bill, Which Barely Passed*, DENVER POST, Jul. 9, 2004, at B6.

82. See *supra* notes 59-61.

83.

[They] start a class warfare saying this is only going to benefit the wealthy, as if by bringing down the wealthy that it will help the middle class. . . . You cannot do that. The Soviet Union has tried it. Many of the Communist countries have tried it. Their capital structure is in shambles.

135 CONG. REC. H6282 (daily ed. Sept. 28, 1989) (statement of Rep. Shaw).

84. George Hager, *Parties Angle for Advantage As White House Falters*, 48 CONG. Q. WKLY. REP. 3391 (1990) ("Republicans signaled that they had had enough of the relentless Democratic charges that the GOP favors the rich, and even conservatives began backing away from their implacable opposition to new taxes. 'They beat us to death with this rich and poor thing,' conceded Rep. Bill Frenzel, R-Minn."); Bailey Morris, *Democrats Use Common Touch to Set the Agenda*, THE INDEPENDENT (London), Dec. 30, 1990, at 7 (explaining that with soak the rich strategy, Democrats defeated George H.W. Bush's campaign for capital gains tax cut benefiting the wealthy, set terms of a budget summit agreement to reduce the record Deficit, and took the high ground during mid-term election campaign by vowing to narrow growing gap between rich and poor).

The results of the mid-term elections are bolstered by data from the US Census Bureau, the Congressional Budget Office and the House Democratic Study Group, which revealed the growing income gaps between rich and poor. During recent Congressional testimony, it was disclosed that income for Americans in the top 1 per cent bracket rose by 75 per cent between 1980 and 1990 to an average of more than \$500,000. The largest increases for these 2.5 million families resulted from capital gains, which made their income equal to the total earned by the poorest 20 per cent of US families accounting for 50 million people. In addition, the perceived gains by the middle class during the 1980s were largely illusory as they resulted from the entry of married mothers into the workforce to stop family

triggered discussion in the media,⁸⁵ and began to resonate in the electorate.⁸⁶

A bi-partisan coalition of House liberals and conservatives Republicans rejected the 1990 Budget Accord: Republicans 105 to 71; Democrats, 149 to 108.⁸⁷ When the House then voted to further extend a “continuing resolution” to fund the government (to keep the pressure on Congress to effect a budget agreement), President George H.W. Bush angrily vetoed the

incomes falling. The Congressional Budget Office also reported that taxes ate a larger share of the incomes of the poor and the middle class than of the rich.);

see also Jason DeParle, *Poor Families Gain under Tax Accord*, N.Y. TIMES, Oct. 31, 1990, at A20. See CONG. BUDGET OFFICE, *THE CHANGING DISTRIBUTION OF FEDERAL TAXES: 1975-1990* (1987), available at <http://www.cbo.gov/ftpdocs/62xx/doc6208/doc18b-Entire.pdf>; CONG. BUDGET OFFICE, *THE CHANGING DISTRIBUTION OF FEDERAL TAXES: A CLOSER LOOK AT 1980* (1988), available at <http://www.cbo.gov/ftpdocs/49xx/doc4954/doc10-Entire.pdf>.

85. Karen Pennar, *The Widening Tax Gap*, BUS. WK., Jan. 15, 1990, at 16; Tom Redburn, *Lots of Tax Talk, No Big Change; Despite Tinkering With Rates, What People End Up Paying as a Portion of Income Has Stayed About the Same for Decades; The System Hasn't Redistributed Wealth Either*, L.A. TIMES, Oct. 22, 1990, at A1; John Waggoner, *Sizing Up Tax Reform; Tax Debate Centers on Fairness*, USA TODAY, Apr. 17, 1990, at B1; David Rosenbaum, *Decisions on Taxes? Forget Numbers*, N.Y. TIMES, Mar. 3, 1990, at 1-8; Stanley Meisler & Sam Fulwood III, *Economic Gap Bodes Ill for US.; A Full-time Paycheck May Not Keep the Wolf From the Door in Today's Economy. Working or Not, Many Americans Are Unable to Make Ends Meet*, L.A. TIMES, July 15, 1990, at A1; Marshall Ingwerson, *Taxes Take Roller-Coaster Ride*, CHRISTIAN SCI. MONITOR, Apr. 10, 1990, at 6; Reo M. Christenson, *America's Gross Inequalities*, CHI. TRIB., Jan. 17, 1990, at C17.

86. Robert Shogan, *Poll Finds Rising Cynicism Eroding 2 Parties' Support; Politics: Times Mirror Survey Indicates It Is More Difficult for Democrats or GOP to Win a Majority*, L.A. TIMES, Sept. 19, 1990, at A1, A16, corrected L.A. TIMES, Oct. 13, 1990, at A2 (asking “what does it mean to be a Republican,” twenty-one percent of those interviewed volunteered “rich, powerful, monied interest” compared with eighteen per cent in 1987. The original story said fifty-one percent due to a computational error). But a year later a WASHINGTON POST poll revealed that “nearly half—48 percent—said Bush cares more about serving upper-income people, up from 35 percent in a Post-ABC survey in February 1990.” David S. Broder & Richard Morin, *Economic Worries Eroding Support for Reelection of Bush, Poll Finds*, WASH. POST, Oct. 23, 1991, at A1. See also Kevin Phillips, Opinion, *Class Warfare Brings Disarray to GOP Coalition*, L.A. TIMES, Jan. 26, 1992, at M1 (“Throughout American history, eras of GOP presidential control have always started with a broad middle-class appeal, but eventually they tilt toward the economic elite.”).

87. Roll call vote No. 421. 136 CONG. REC. H8996-97 (daily ed. Oct. 4, 1990); 46 CONG. Q. ALMANAC 137, 136-H (1990) (demonstrating that Liberals opposed it for its renewal of a capital gains preference by increasing ordinary rate above capital gains rate; conservatives, for raising the individual income tax rate at the top, however small.). See George Hager, *Defiant House Rebukes Leaders; New Round of Fights Begins*, 48 CONG. Q. WKLY. REP. 3183 (1990).

continuing resolution.⁸⁸ With awful political timing, the government began to shut down nonessential services just as the three-day Columbus Day weekend (which most Federal employees had off) began.⁸⁹ This ploy backfired and House Democrats gleefully charged—using often venomous class warfare rhetoric—that President George H.W. Bush would rather shut down the government than give up on his plan for granting more tax breaks to the rich in the form of a resuscitated capital gains preference,⁹⁰ and the Budget Accord's "Growth Incentives" further rewarded the rich for having made more money in the 1980s than ever before.⁹¹ More importantly, polls showed that Republicans were blamed for the shut down.⁹²

The House passed—on a strictly partisan basis—ordinary income rate increases at the top only, coupled with a cleverly designed capital gains cut providing more of its benefits to the middle income class⁹³ than under the Bush plan. The 1990 Conference bill dropped the House's "middle class" capital gain preference (which Chair Rostenkowski reportedly never

88. William J. Eaton, *Officials Face Dwindling Options for Dealing with Budget Impasse; Deficit: Significant Actions Are Stymied by Fears of Voter Backlash or a Presidential Veto. Few Easy Choices Remain*, L.A. TIMES, Oct. 20, 1990, at A24.

89. 48 CONG. Q. ALMANAC 134 (1990).

90. *Budget Adopted After Long Battle*, 48 CONG. Q. ALMANAC 137 (1990). If the Congress and the President could not agree to waive the Gramm-Rudman deficit target by the start of the new fiscal year, October 1, 1990, sequestration was to kick in. *Id.* at 111 and 132-33. Once the 1990 Budget Accord was negotiated, Congress extended this date to October 5 in a "continuing resolution" (to keep the pressure on Congress to effect an agreement). *Id.* at 136. Since the Budget Accord had hung up for so long on George H.W. Bush's demand for a capital gains cut, Democrats seized on "shut down the Government" rhetoric. *Id.* at 134. See generally Robert J. Samuelson, *The Capital Gains Obsession*, WASH. POST, Sept. 26, 1990, at A25.

91. 136 CONG. REC. H8841 (daily ed. Oct. 4, 1990) (statement of Rep. Dorgan); 136 CONG. REC. at H7991 (daily ed. Sept 25, 1990) (statement of Rep. Schroeder); *id.* at H9942 (daily ed. Oct. 16, 1990) (statement of Rep. Alexander) ("[W]e are here today because the chickens [S&L crisis, HUD, Borrowing, national debt, deficits, etc] have come home to roost. The chickens of Reaganomics have brought us here today.").

92. Peter G. Gosselin, *Tax Issue Bedevils Budget Talks; Bush Position Still Unclear*, BOSTON GLOBE, Oct. 11, 1990, at 1. The Republicans did not learn their lesson. Michael Weisskopf & David Maraniss, *Stung and Beset, Speaker Break Down and Weeps*, WASH. POST, Jan. 18, 1996, at A1 (explaining that House Majority Whip Tom "Hammer" DeLay sauntered up to Vice President Gore and said, 'You have to realize we're serious. We'll shut down the government if we have to balance the budget.' 'Our polls show you guys lose if the government shuts down,' Gore responded."). Gore was so right.

93. The House Bill provided a lifetime \$200,000 cap on capital gains for which a fifty percent deduction could be taken and deliberately excluded public stock. See generally Pamela Fessler, *Democrats Shape Tax Debate Following Summit Failure*, 48 CONG. Q. WKLY. REP. 3400 (1990).

intended to press anyway⁹⁴), thus making no change in the existing maximum individual twenty-eight percent capital gains rate,⁹⁵ but keeping most of its high income individual rate increase (thirty-one percent starting at \$78,400 joint return taxable income and a Mini-Bubble phasing out personal exemptions at two percent per each \$2,500 in income from \$150,000 to \$250,000 joint taxable income). The individual Alternate Minimum Tax rate was increased from twenty-one percent to twenty-four percent,⁹⁶ and the new exemption phase-out “bubble” was reduced to a “Mini-Bubble” just phasing out the taxpayer’s personal exemptions (at two percent for each \$2,500 of joint return income from \$150,000 to \$275,000).⁹⁷ These were compromise substitutes for piercing the bubble since they in effect added on the average two percentage points at the top to

94. *Rosty Threatens Combat with Bush over Top Rate Increase*, 90 TAX NOTES TODAY 212-13 (1990). Rostenkowski merely mentioned “new incentives for middle class America.” 136 CONG. REC. H10296 (daily ed. Oct. 16, 1990). The “legislative history” is unusually sparse as to the middle class capital gains cuts. MAJORITY STAFF OF THE HOUSE. COMM. ON WAYS & MEANS, 101ST CONG., 2d Sess., LEGISLATIVE HISTORY OF WAYS AND MEANS DEMOCRATIC ALTERNATIVE 12 (Comm. Print 1990). The mostly Southern Democrats on the Ways & Means Committee who usually intensely trumpeted timber, small businesses, farmers, and homeowners for a capital gains preference at issue did not do so this time. Of those members, only Rep. Ed Jenkins (D-Ga.) spoke in the debate, and he failed to mention the capital gains provision, stating only that the Democratic Alternative was balanced. 136 CONG. REC. H10289 (daily ed. Oct. 16, 1990). See generally Tim Gray, *House Guts Summit Agreement in Reconciliation Bill, Shifts Revenue Burden to the Wealthy*, 49 TAX NOTES 375 (1990) (“[L]awmakers mostly ignored the mechanics of the [last-minute Democratic capital gains] measure, and even of deficit reduction.”).

95. Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, §11101, 104 STAT. 1388, 1388-403 (1990). Many incorrectly claimed that the 1990 act cut the maximum capital gains rate from the 31 percent that would otherwise have applied to 28 percent. E.g., Phil Gailey, *Can Democrats Fairly Claim “Fairness” Issue?*, ST. PETERSBURG TIMES, Oct. 28, 1990, at A4 (“[I]n ‘soaking’ the rich, the Democrats added a little bubble-bath oil to the water . . . in the form of a 3 percent[age points] cut in the top rate on capital gains, from 31 percent to 28 percent.”); John E. Yang, *Budget Deal Appears at Hand; Surtax Dropped; Bush to Sign Bill Keeping Government Open*, WASH. POST, Oct. 25, 1990, at A1. Actually the twenty-eight percent cap on individual capital gains rate was in the 1986 Code ab initio. See Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, 2218 (providing new §1(j) with a twenty-eight percent cap on the capital gains rate). “The current statutory structure for capital gains is retained in the Code to facilitate reinstatement of a capital gains rate differential if there is a future tax rate increase.” H.R. CONF. REP. NO. 99-842, at 106 (1986).

96. Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, §11102, 104 STAT. 1388, 1388-406 (1990).

97. *Id.* §11104, 104 STAT. 1388-407.

the new thirty-one percent rate for a total of the Democrats' three percent target.⁹⁸

4. 1992: Polishing Democratic Rhetoric and Proposals

After a truce in 1991, tax fairness took on an added edge in 1992, a Presidential election year, as the economy stubbornly refused to recover from the 1990-1991 recession,⁹⁹ leading to a drop in the president's opinion poll numbers.¹⁰⁰ President George H.W. Bush's January 28, 1992 State of the Union Address called again for a generic cut in the top capital gains rate (from twenty-eight percent to 15.8 percent for all capital assets, except "collectibles," held 3 years or longer, with lesser cuts after a two-year and a

98. Yang, *supra* note 96; *Deficit Reduction Bill Has New Taxes*, 46 CONG. Q. ALMANAC 167, 169 (1990); Andrew Hoerner, "Pease Plan" Emerges as Key Issue in Debate over Tax Progressivity, 49 TAX NOTES 498, 499 (1990) ("[N]eedless complication in the tax code, motivated by a strictly political desire to increase the top marginal rates while avoiding the appearance of a tax increase"); STAFF OF THE JOINT COMM. ON TAXATION, OVERVIEW OF PRESENT LAW AND ECONOMIC ANALYSIS RELATING TO MARGINAL TAX RATES AND THE PRESIDENT'S INDIVIDUAL INCOME TAX RATE PROPOSALS 13-5 (JCX-06-01) (Comm. Print 2001), available at <http://www.house.gov/jct/x-6-01.pdf> (last visited Oct. 25, 2005); Cf. Glenn E. Coven, *Congress as Indian-Giver: "Phasing-Out" Tax Allowances Under the Internal Revenue Code of 1986*, 6 VA. TAX REV. 505, 506-26 (1987) ("The phasing out of tax allowances is indeed a characteristic feature of the 1986 Code. . . . Put harshly, but not entirely inaccurately, the purpose that underlies these phase-outs was political deceit."). The Congressional Budget Office, *supra* note 66, reports that bottom twenty percent, next twenty percent, and top one percent, respectively had the following effective rates for all federal taxes, individual income taxes, wage taxes and excise taxes in 1991 (after 1990 changes were effective):

	All Federal Taxes	Income taxes	Wage taxes	Excise Taxes
Bottom 20%	8.4	-1.6	7.3	2.0
Next 20%	14.2	2.9	9.3	1.3
Top 1%	29.9	20.6	1.5	0.6

99. S. G. Gwynne, *The Long Haul*, TIME, Sept. 28, 1992, at 34 (explaining that, due to hangovers from 1980's excesses, the slump was the longest sustained weakness since the Great Depression: "the job drought, the debt hangover, the defense-industry contraction, the savings and loan collapse, the real estate depression, the health-care cost explosion and the runaway federal deficit.").

100. Art Pine & William J. Eaton, '92 Political Perspective; Ripe Year for a Shake-up in the House; Economic Woes, Gridlock and the Chamber's Own Scandals Are Among Forces Driving Some of the Most Hotly Contested Races, L.A. TIMES, Oct. 29, 1992, at A5; Lou Cannon, *Bush Loses Grip on GOP Cushion and California Campaign Is Sinking*, WASH. POST, Oct. 10, 1992, at A12; Thomas B. Edsall, & David S. Broder, *As Economic Woes Persist, Bush's Base Erodes; Crossover Democrats Are Torn, But Lean Heavily to Clinton*, WASH. POST, Sept. 9, 1992, at A1.

one-year holding period—a repeat of the 1990 mini-sliding scale).¹⁰¹ President George H.W. Bush asked Congress to put this and six other “growth initiatives” on a fast track to be enacted by March 20, 1992, or else the battle would be joined.¹⁰² This set the stage in the 1992 Presidential election year for the same fairness/class warfare rhetoric by the opponents to a *generic* capital gains deduction as in 1990, i.e., it provided deficit-financed disproportionate benefits for high-income individuals.¹⁰³

In 1992, top Joint Committee Staffers crafted for Senate Finance Committee Chair Lloyd Bentsen (D-Tex.) “progressive” bills implementing generic capital gains rates with *decreasing* percentages of nominal gain exclusions as an individual’s top marginal bracket rose.¹⁰⁴ President George H.W. Bush vetoed the two 1992 tax bills,¹⁰⁵ setting the stage for the

101. Michael Arndt, *Democrats Lay Trap for Bush on Capital Gains Cuts*, CHI. TRIB., Feb. 18, 1992, at 1 (“[L]ower rate would persuade Americans to cash in old holdings and pour money into new investments that would get the stalled economy rolling again and create jobs.”); Jerry Roberts, *Why Bush Lost*, S. F. CHRON., Nov. 5, 1992, at A1 (indicating that President’s touted bold plan for the economy “merely reflected Bush’s basic view that markets, not government, should shape the economy.”). Estimated revenue costs of President George H.W. Bush’s 1992 capital gains package were \$15.4 billion over 1992-1997. STAFF OF THE JOINT COMM. ON TAXATION, SUMMARY OF REVENUE PROPOSALS IN THE PRESIDENT’S FISCAL YEAR 1993 BUDGET (JCX-1-92) (Comm. Print 1992) (demonstrating that 62.2% of benefits would go to taxpayers reporting more than \$200,000 (\$267,000 in 2004 dollars) and 15.15%, to taxpayers reporting between \$100,000 and \$200,000); *Preliminary Distributional Effect of the President’s Budget Proposal for Capital Gains, as contained in H.R. 4200* (D-92-5-026 Feb. 13, 1992). Treasury’s estimates for Bush I’s 1990 proposed capital gains cut showed a \$12.5 billion revenue gain for the budget period while the Joint Committee’s estimates (which at the time Congress had to follow) showed an \$11.4 billion revenue loss. Lee, *Critique*, *supra* note 6, at 69 n.251; David Rosenbaum, *Decisions on Taxes? Forget Numbers*, N.Y. TIMES, Mar. 3, 1990, at 1-8.

102. 138 CONG. REC. H405 (daily ed. Feb. 11, 1992) (statement of Rep. Gephardt) (“The President’s allies tell us the March 20 deadline was a gambit—designed as a hurdle the House and Senate could not climb—to set up this institution for yet another round of Congress-bashing.”). See Eric Pianin, *Senate Kills Bush’s “Economic Growth” Package; Effect of Defecit Cited; President Vows to Veto Any Alternative Involving a Tax Increase*, WASH. POST, Mar. 12, 1992, at A6 (capital gains cut centerpiece); Chuck Alston, *Bush’s Economic Recovery Plan Finds Few Democratic Buyers*, 50 CONG. Q. WKLY. REP. 217, 218 (1992); Susan Page, *He Had Lost Before He Ran; Bush Never Focused on Home Front*, NEWSDAY, Nov. 5, 1992, at 26 (“Bush never seemed to push for it very hard, anyway. He set a March 20 deadline for Congress to act, then seemed content to let it pass with little notice.”).

103. 138 CONG. REC. H626 (daily ed. Feb. 26, 1992) (statement of Chair Rostenkowski).

104. *Highlights of Senate, House Tax Bills*, 50 CONG. Q. WKLY. REP. 520 (1992).

105. David S. Cloud, *Democratic Leaders Drive Tax Bill Through Senate*, 52 CONG. Q. WKLY. REP. 606 (1992); David S. Cloud, *Final Push Clears Tax Bill; Bush Announces Veto*,

best piece of the famous Bentsen political humor in the political theatre of the 1992 revenue acts.¹⁰⁶

C. FIRST COMPLETED STEPS IN UNRAVELING PARITY

1. Clinton's 1993 Hiking Rates on Rich Without Increasing the Capital Gains Preference

The first completed substantial step in the unraveling of the great base broadening paying for lower rates 1986 Tax Reform¹⁰⁷ was taken by

52 CONG. Q. WKLY. REP. at 712 (1992); *Read Bush's Veto Pen: No New Tax Bill*, 52 CONG. Q. WKLY. REP. at 3556 (1992).

106. President George H.W. Bush, in his news conference vetoing the first 1992 Tax Bill, stated that he did not take this step lightly. "No president has vetoed a major tax bill since Harry Truman did it in 1948." *Bush Attacks Democrats As He Vetoes Tax Bill*, 50 CONG. Q. WKLY. REP. 831 (1992). Senate Finance Chair Bentsen's riposted in the live telecast of Democratic Congressional Leadership news conference an hour later:

I heard him [President George H.W. Bush] a moment ago referring to Harry Truman. What he'd like to do is follow the pattern of a feisty Harry Truman and run against, as he did, a Republican, do-nothing Congress. [He paused a beat and slowly grinned. As I watched this live on television, I knew what was coming.] But I knew Harry Truman. And I worked with Harry Truman. And George Bush is a decent man, but he is no Harry Truman.

Id. at 834. This quip was of course patterned on Vice Presidential Candidate Lloyd Bentsen's devastating rebuke of Vice Presidential Candidate Dan Quayle's comparison of himself to John F. Kennedy. "I knew Jack Kennedy. Senator, you're no Jack Kennedy." Karen Tumulty, *The 1988 National Election; In Losing, Bentsen Became a Big Winner and Party Folk Hero*, L.A. TIMES, Nov. 10, 1988, at 1-24. Ironically, Truman's two vetoes of tax acts were overridden by a conservative coalition, whereas Bush's two vetoes were sustained by a conservative coalition. Equally ironically, Quayle had been a hardworking senator, unlike Kennedy.

107. Technically, the first step was President George H.W. Bush's OBRA 1990. A corollary to funding the 1986 Code individual tax effective rate cuts on a pay-go basis was that all special interests should *equally* bear the pain of losing at least a part of their favored tax preferences. BIRNBAUM & MURRAY, *supra* note 4, at 226, 229; *see also* Lee A. Sheppard, *A Nation of Shopkeepers: Finance Explores Accounting Issues*, 30 TAX NOTES 1314 (1986)

(The House bill would take some \$11 billion out of the hides of timber and oil. Finance Chairman Bob Packwood, R-Ore., therefore, has decided to play hardball with Ways and Means Chairman Dan Rostenkowski, D-Ill., by proposing to take a like amount from retailers, keeping in mind that the country's largest retailer, Sears Roebuck & Company, is headquartered in Chicago. These are the bargaining chips for conference.)

Each individual income class in the aggregate had to share pro rata (as a percentage reduction in the average effective rate of that income class) in the largess of the projected five percent or so average effective household income tax rate reductions. Kies, *supra* note 4. A paradigm of the 1986 Code compact of lower rates in exchange for a broader base was

President Bill Clinton's Omnibus Budget Reconciliation Act (OBRA) of 1993.¹⁰⁸ The tax provisions of OBRA 1993 raised the top individual rates to thirty-six percent and the Millionaire's Surtax (39.6 percent bracket) touched the top one percent only,¹⁰⁹ while providing no additional preference to capital gains beyond maintaining the twenty-eight percent cap for individual gain on realization of capital gains. Clinton based the 1993 tax act rate provisions on the vetoed 1992 Democratic tax acts, but lowered the beginning breakpoints for the top individual rates considerably in order to generate revenue to support his pet targets: grow the economy, generate good sound bites, and implement tax cuts and other programs.¹¹⁰

President Clinton expressly based this increase at the top on the failure of trickle down economics¹¹¹ during the twelve Reagan-Bush years:¹¹²

the same maximum (permanent) twenty-eight percent rate for individual ordinary income and capital gains—a *reduction* of twenty-two percentage points for ordinary income and an *increase* of eight percentage points for capital gains.

108. See *supra* note 35.

109. 139 CONG. REC. S7685 (daily ed. June 23, 1993) (statement of Sen. Conrad and Sen. Sasser) (in colloquy; breakdown by income class); e.g., 139 CONG. REC. H2988 (daily ed. May 27, 1993) (statement of House Ways & Means Committee Chair. Rostenkowski) (bill focuses on upper-income taxpayers); *id.* at H2953 (daily ed. May 27, 1993) (statement of Rep. Derrick) (explaining that seventy-five percent of taxes in the bill fall on households with incomes over \$100,000 (\$132,000 in 2004 dollars)—the top six percent; sixty-three percent on households with over \$200,000 (\$264,000 in 2004 dollars); *id.* at H3003 (daily ed. May 27, 1993) (statement of Rep. Rangel) (espousing that class warfare rhetoric means “they can not tax the rich”); 139 CONG. REC. S7674 (daily ed. June 23, 1993) (statement of Sen. Pryor) (seventy-eight percent paid with incomes over \$200,000.).

110. For the fate of these spending provisions, see *supra* note 39.

111. 139 CONG. REC. H3004 (daily ed. May 18, 1993) (Statement of Rep. Slaughter); E. J. Dionne Jr., *Beneath the Rhetoric, an Old Question; Bush-Clinton Debate Frames Classic Choice: How Much Government?* WASH. POST, Aug. 1992, at A1 (“Clinton scored the ‘wrongheaded Republican notion that prosperity will trickle down if we just make the rich even richer and get the government out of the way.’”). Accord, David E. Rosenbaum, *The 1992 Campaign: News Analysis; One Economy, 2 Visions*, N.Y. TIMES, Aug. 23, 1992, at 1-1; Ronald Brownstein, *Right and Left Both Get Poor Marks for House Vote on Clinton Exam Plan*, L.A. TIMES, Sept. 22, 1997, at A7; Alan Cowell, *Off the Shelf; An Ivory Tower Embrace of Views in the Streets*, N.Y. TIMES, Jun. 9, 2002, at 3-6 (describing how Professor Joseph Stiglitz, Columbia Nobel Laureate economist, criticizes the “Washington Consensus . . . that poverty is eased by the trickle-down effect of prosperity for the elite and that governments should not get in the way of markets.” He contends that “I.M.F. and the United States Treasury . . . pursue the interests of the big investment banks rather than the poor most directly affected by their macroeconomic solutions.”).

112. BILL CLINTON, PUTTING PEOPLE FIRST 1-2 (1992). See also *Statement by President Bill Clinton at the Dedication Ceremony for Taylor, Michigan, City Hall*, FED. NEWS SERV. (Mar. 4, 1996):

While the rich cashed in, the forgotten middle class—those people who work hard and play by the rules—took it on the chin.”¹¹³ Clinton’s “conclusion was right—as the poverty rate shows—but the reasoning is wrong. To Clinton, the Reagan-Bush taxing and spending policies favored the rich at the expense of the poor. In fact, these were at most a modest cause of widening inequality. What really went wrong is that the usual relationship between an expanding economy and better incomes broke down.”¹¹⁴

Many accurately noted that the 1993 ordinary income rate increases would only restore part of the upper income cut in effective rates¹¹⁵ granted

It [economic growth] is about the idea of fundamental fairness in this country—that we are not a people who object to others being successful, we do not resent people amassing their own wealth fairly won in the free enterprise system; only thing we resent is when every American who’s doing the right thing and working hard and playing by the rules doesn’t have a chance to be treated fairly.

113. PUTTING PEOPLE FIRST, *supra* note 113, at 1-2; James Risen, *News Analysis; History May Judge Reaganomics Very Harshly; Economy: Lower Taxes and Deregulation Were Expected to Raise Government Revenues. Debt Soared Instead*, L.A. TIMES, Nov. 8, 1992, at D1

([J]ob growth was largely due to deep-seated demographic shifts, most notably because more women entered the work force.” Reaganomics was a failure, producing big political dividends for the Republicans (and may have contributed to rapid economic growth during the 1980s although real wages failed to improve), but was based on a deeply flawed economic notion: “tax cuts, especially large tax cuts for the rich, would not worsen the government’s budget deficit. . . . Bill Clinton rode to the White House on a platform of economic change, campaigning as much against the ‘trickle-down’ policies of Ronald Reagan as against those of George Bush.)

114. Robert J. Samuelson, Opinion, *Clinton Needs “Trickle Down Economics,”* WASH. POST, Dec. 9, 1992, at A23

(The good news for Bill Clinton is that the economic recovery seems firmly established. The bad news is that it won’t automatically cure the worst problems of poverty and low incomes. . . . It is not that living standards for all Americans are receding. But people in the top half of the income distribution are gaining only slowly while others are losing. . . . The rich got richer, the poor got poorer, and people in between drifted in one direction or the other. Until the 1970s, the steady rise of wages pulled more and more people out of poverty. Now, a job by itself is no longer necessarily adequate. Declining wages at the bottom frustrate upward mobility.)

See infra note 386 and accompanying text.

115. 139 CONG. REC. S7664 (daily ed. June 23, 1993) (statement of Sen. Boren); *id.* at S6498 (daily ed. May 26, 1993) (statement of Sen. Daschle) (asserting that he had “[N]ot seen progressivity for last 12 years.”). The issue of class mobility is discussed in a work-in-progress—*Selling of Bush II Income Tax Cuts*. The Congressional Budget Office, *supra* note 66, reports that the bottom twenty percent, next twenty percent, and top one percent, respectively had the following effective rates for all Federal taxes, individual income taxes, wage taxes and excise taxes in 1993 (OBRA 1993 rate changes were effective retroactively to the first of the year.):

by Reagan's first American tax revolution.¹¹⁶ Conversely, opponents complained that since so many deductions had been eliminated or curtailed, the rate increases would produce much higher effective rates.¹¹⁷ In fact, CBO reveals that the increases in effective federal income tax rates at the top one percent for 1992 through 1996 were a modest ten percent or so increase—from 21.2 percent, to 23.2 percent, 23 percent, 23.7 percent, and 24.2 percent, respectively.¹¹⁸

	All Federal Taxes	Income taxes	Wage taxes	Excise Taxes
Bottom 20%	8.0	-2.3	7.2	2.5
Next 20%	13.5	2.5	8.8	1.6
Top 1%	34.5	23.2	2.1	0.7

116. Editorial, *Clinton's Restructuring*, BOSTON GLOBE, Feb. 21, 1993, at 66 (“[T]ax revolution worked by President Reagan and Congress in 1981 was notable for backing away from the principle of high progressivity that had characterized the system for 50 years”); Sylvia Nasar, *Nobel Economics: Spending the Check*, N.Y. TIMES, Dec. 5, 1999, at 3-1 (discussing the supply-side tax revolution during the Reagan presidency).

117. 139 CONG. REC. H2711 (daily ed. May 24, 1993) (statement of Rep. Hancock).

118. CONG. BUDGET OFFICE, EFFECTIVE FEDERAL INCOME TAX RATES 1979-2001, *supra* note 66.

2. Clinton's 1997 Capital Gain Rate Cut as a Sop to GOP: "[Y]ou think I raised your taxes too much. It might surprise you to know that I think I raised them too much, too."¹¹⁹

In 1997, in order to obtain cooperation by the Republican-controlled Congress as to tax and balanced budget bills, President Clinton cut the top capital gains rate generally back to twenty percent, eighteen percent after an eighteen month holding period,¹²⁰ thus ceding away part of Rostenkowski's victory. The 1997 capital gains story started off (and finished) differently than 1993-1996: Congressional Republicans and the Clinton Administration appeared to want to strike a balanced budget

119. Transcript, *Statement by President Clinton at Presidential Gala Dinner Westin Galleria Hotel* (Fed. News Service Oct. 17, 1995). *For the Record—Clinton Now Thinks '93 Act Went Too Far*, 69 TAX NOTES 393 (1995); Ann McFeatters, *Not So Golden Words From on High*, NEWSDAY (New York), Dec. 26, 1995, at A33

(Clinton made his biggest faux pas of the year when he said it might surprise his audience (rich Texans) to know that he thought he raised their taxes too much in 1993. This infuriated Democrats who took a political risk to support his tax plan (not one Republican voted for it). He tried to put the raging genie back into the bottle by saying that his mother told him never to make speeches after 7 p.m., the implication being that he's prone to mistakes at night.)

But with hindsight there may have been a tactical element. Todd S. Purdum, *Who's Sorry Now?; Stalwart in Defense of His Shrinking Turf*, N.Y. TIMES, Dec. 10, 1995, at 4-1

(When Republicans won control of Congress last year promising tax cuts and leaner Government, Mr. Clinton revived his own call for middle-class tax relief and renewed his efforts to 're-invent' Government. When Republicans said that Mr. Clinton was resisting balancing the budget, he said he wanted to, too—but insisted it would take 10 years. Finally, last month, to restart the Government after it was halted by a stalemate over a temporary spending bill, Mr. Clinton agreed to the Republicans' call for balancing the budget in seven years but only in exchange for language to protect popular programs for health, education and the environment that the White House thinks could be key to the President's re-election.)

See also Christopher Swope, *Clinton and the GOP Congress: A Rough Road to Agreement*, 55 CONG. Q. WKLY. REP. 1002, 1004 (1997).

120. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §311, 111 Stat. 831-2 (1997) (amending I.R.C. §1(h)) (noting, additionally, collectibles were taxed at twenty-eight percent; depreciation recapture, twenty-five percent).

deal.¹²¹ A sharp downward trend in the projected deficit over the next five years¹²² permitted more moderate spending cuts, allowing the

121. New factors were (1) better numbers, 143 CONG. REC. H4686 (daily ed. Jun. 26, 1997) (statement of Rep. Spratt) (“[T]he only reason we are standing here debating a tax bill, or debating a balanced budget bill yesterday, is that CBO came up with \$225 billion in additional revenues.” Corporate income tax revenues went up by \$72 billion or over seventy percent since 1992); see David R. Francis, *Budget Relief Coming at Faster Clip*, CHRISTIAN SCI. MONITOR, Aug. 13, 1997, at 8 (noting that unemployment was at modern lows and the stock market at record highs generating higher tax revenues); (2) settled politics (*viz.*, continued divided government with the Republicans in control of Congress and President Clinton re-elected), George Hager, *Clinton Budget “Alive on Arrival” But GOP Wary of Fine Print*, 55 CONG. Q. WKLY. REP. 327, 328 (1997); (3) lessons from two years of budget negotiations (gentler rhetoric and awareness of the other side’s bottom lines, Eric Black Sharon Schmickle & Tom Hamburger, *Healthy Economy Helped Congress Float Budget Bill; The New Budget Agreement Is a Gamble of Sorts: Congress Gave Tax Breaks and Avoided Cutting Programs by Betting the Economy Would Remain Healthy*, STAR TRIB. (Minneapolis), Aug. 3, 1997, at A17 (Clinton got college-tuition tax breaks, expansion of the child tax credit to the working poor, rollback of parts of welfare overhaul, and health coverage for several million more children; Republicans got first tax cut in sixteen years, capital-gains tax break after more than a decade of fighting for one, estate tax relief, \$500-a-child tax credit as sought in the Contract with America, and expanded Individual Retirement Accounts); (4) Clinton and Republicans needed a legislative win, Alison Mitchell, *Return of Partisanship to Capitol Hill*, N.Y. TIMES, Nov. 14, 1997, at A1 (without a Democratic Congress, President Clinton pledged to build a “vital center;” Republicans, equally chastened by failure to capture the White House, vowed to find common ground); (5) new leaders (Sen. Trent Lott (R-Miss.) and Ways & Means Chair Bill Archer (R-Tex.)); and (6) everyone wanted tax cuts. Alissa J. Rubin, *House Man of the Hour Archer Says He’s Ready to Deal*, 55 CONG. Q. WKLY. REP. 480 (1997) (House Ways & Means Committee Chair Bill Archer’s star rises as Speaker of the House Newt Gingrich’s wanes). Also, both Congressional Republicans and the Clinton Administration wanted a big legislative achievement to draw public attention away from political and other scandals. George Hager, *As Each Side Moves to Center, Plan is Almost a “Done Deal,”* 55 CONG. Q. WKLY. REP. 1179, 1181 (1997); George Hager, *White House, GOP Make Quiet Start In Search of a Deal*, 55 CONG. Q. WKLY. REP. 527 (1997). Estate tax cuts early emerged as an issue with bipartisan support. Alissa J. Rubin, *Estate Tax Cut Gets New Backers As Hill Mulls Budget Strategy*, 55 CONG. Q. WKLY. REP. 687 (1997).

122. William G. Gale, Opinion, *The Budget Deal: An Opportunity Lost . . .*, WASH. POST, Aug. 1, 1997, at A21

(Fortuitous events, sound monetary policy and responsible fiscal actions in 1993 have produced a large tax windfall for the government;” misspent on Republican priority of twenty-five percent cut to investors whose assets have trebled in value in three years and Democratic priority of subsidizing middle class kids to attend college which they mostly would have anyway.);

CONG. BUDGET OFFICE, THE ECONOMIC AND BUDGET OUTLOOK: FISCAL YEARS 1999-2008 (1998), available at <http://www.cbo.gov/ftpdocs/3xx/doc316/e&b01-98.pdf>. The “numbers” got even better, CONG. BUDGET OFFICE, REVISED BASELINE BUDGET PROJECTIONS FOR FISCAL YEARS 1999-2008 (1998), available at <http://www.cbo.gov/ftpdocs/3xx/>

Administration to spend money on key priorities in education, welfare and health care, and the Republicans to obtain larger tax cuts than earlier proposed by President Clinton—particularly as to capital gains, on which he earlier announced flexibility.¹²³ An earlier portent of the 1997 capital gains cut may be seen in President Clinton's statement in late 1995 that he raised taxes on the rich too much in 1993.¹²⁴ The end result of this first stage of the individual income tax rate wars favored the Democrats: much higher ordinary rates than they first sought and not as low a capital gain rate as the Republicans first sought.

The CBO reported that Federal effective Federal income tax rates at the top one percent for 1997 through 2000 were 23.8 percent, 23.4 percent, 24 percent, and 24.2 percent, respectively.¹²⁵

3. 1999: Dress Rehearsal for 21st Century Rate Wars

Just as the Democratic Congress' veto-friendly tax acts in 1992 presaged Clinton's 1993 ordinary rate hike,¹²⁶ the Republican-controlled Congress very narrowly passed in August 1999 a similarly veto-friendly individual tax cut which would have lowered the tax on five income tax brackets by one percentage point over 10 years, cut the capital gains tax for individuals, phased out the estate tax and eliminated the "marriage penalty"

doc356/base0398.pdf; CONG. BUDGET OFFICE, LETTER TO THE HONORABLE JOHN R. KASICH ACCOMPANYING THE MONTHLY BUDGET REVIEW DATED MAY 6, 1998 (1998)

([S]urplus for 1998 is likely to be \$43 billion to \$63 billion—\$35 billion to \$55 billion larger than the \$8 billion projected in March. In addition, the strength of revenues this year suggests that the surplus is also likely to be larger in succeeding years than was previously anticipated—by \$20 billion to \$30 billion in 1999 (resulting in a surplus of \$30 billion or more instead of the \$9 billion projected in March.))

available at <http://www.cbo.gov/ftpdocs/4xx/doc470/kasich.pdf>. Consequently, negotiators for the Clinton Administration and the Republican Congress were able to agree on the framework for a balanced budget in five years on May 2, 1997, and avoid hard choices such as entitlement reforms or adjustment to the Social Security CPI index. George Hager, *Clinton, GOP Congress Strike Historic Budget Agreement*, 55 CONG. Q. WKLY. REP. 993 (1997).

123. George Hager, *New Twist for Clinton Budget: A Cordial GOP Reception?*, 55 CONG. Q. WKLY. REP. 275 (1997); Alissa J. Rubin, *GOP Gives Mixed Reviews to Clinton Tax Proposals*, 55 CONG. Q. WKLY. REP. 332 (1997).

124. See *supra* text accompanying note 120 and source cited therein. This, in fact, does not appear to have been the case. See *supra* text accompanying note 119.

125. CONG. BUDGET OFFICE, EFFECTIVE FEDERAL INCOME TAX RATES 1979-2001, *supra* note 66.

126. See *supra* text accompanying notes 109-11 and sources cited therein.

on couples filing jointly,¹²⁷ presaging President George W. Bush's 2001 tax cuts as well as part of his 2003 tax cut.

The CBO estimated in January 1999 that over the next ten years the surplus would equal \$1.55 trillion.¹²⁸ Democrats, having curtailed spending on new programs for a number of years, had a number of pent up spending priorities as well as the goal of shoring up the Social Security system.¹²⁹ In contrast, the Republican majority in Congress wanted a large tax cut,¹³⁰ ostensibly to return the surplus to the taxpayers before Congress could spend it,¹³¹ but for some, to starve the Federal government of revenues.¹³² President Bill Clinton, however, had demanded in 1998 that Congress set aside any plans for use of the surplus until it had dealt with Social Security in order to block any substantial tax cuts.¹³³

127. Greg McDonald, *\$792 Billion Tax-cut Measure Clears Congress; Proposal Pushed by Republicans Unlikely to Survive Clinton's Veto*, HOUSTON CHRON., Aug. 9, 1999, at A1. House voted 221-206 in favor and Senate approved by a margin of one vote, 50-49. *Id.*

128. CONG. BUDGET OFFICE, THE ECONOMIC AND BUDGET OUTLOOK: FISCAL YEARS 2000-2009 xvii (1999), available at <http://www.cbo.gov/ftpdocs/10xx/doc1059/e&b0199.pdf> (predicting a cumulative surplus in the total budget projected for 1999 through 2008 of almost \$2.3 trillion—\$745 billion more than estimated in August, 1998); Richard W. Stevenson, *How to Spend a Long-Sought Surplus*, N.Y. TIMES, Jan. 4, 1999, at C10 [hereinafter *How to Spend a Long-Sought Surplus*].

129. *How to Spend a Long-Sought Surplus*, *supra* note 129.

130. Richard W. Stevenson, *Republicans to Push for a Tax Cut of Up to \$500 Billion*, N.Y. TIMES, Jan. 7, 1999, at A28 (describing how until then, projected surpluses were to come from excess Social Security taxes over current outlays).

131. Richard W. Stevenson, *House Debate on Tax Cuts Gets Under Way*, N.Y. TIMES, Jul. 14, 1999, at A19.

132. James Toedtman, *No Deficit of Rhetoric over Surplus*, NEWSDAY, Aug. 23, 1999, at C13

(Republicans have wrapped themselves in seeming indignation at the evils of government and crafted the second largest federal tax cut in history. They have combined the promise of returning to taxpayers what is properly theirs with a theme developed over the past three decades, the starve-the-beast hypothesis that the way to shrink government is to shrink tax revenues.).

See also Leo Rennert, *GOP's Bold Support of Tax Cut Could Weigh Heavily on Its Future*, STAR TRIB. (Minneapolis), Aug. 8, 1999, at A19; Daniel Schorr, *The Phony Tax-Cut War*, CHRISTIAN SCI. MONITOR, Aug. 27, 1999, at 11 (proposing tired arguments that big tax cut hurts economy versus taxpayers should get back some of their money from projected surpluses); 145 CONG. REC. S10725 (daily ed. Sept. 10, 1999) (statement of Sen. Dorgan). But see Dan Balz, *Bush Bets He Can Sell Tax Cut Where Others Have Failed*, WASH. POST, Dec. 13, 1999, at A2.

133. *How to Spend a Long-Sought Surplus*, *supra* note 129.

CBO's estimates continued to grow, but with only one third from outside social security taxes.¹³⁴ The Republicans agreed with these "rosy scenarios," and their case, or at least desire, for tax cuts grew stronger despite polls showing that defensible public outlays were far more popular than tax cuts.¹³⁵ The Clinton Administration floated the idea of investing some of the base surplus in stocks through a government-run pool—a bad idea in the eyes of Federal Reserve Chair Alan Greenspan.¹³⁶

In the truncated 1999 floor debate, both sides rounded up the usual rhetorical suspects, but the Republican side spoke less about benefiting the economy (which was still booming) than usual, and more about returning to the taxpayers their money from future surpluses before the government could spend it (also a justification for President Ronald Reagan's 1981 tax

134. CONG. BUDGET OFFICE, EXTENDED DISCUSSION OF CBO'S JULY 1999 ECONOMIC OUTLOOK (1999), available at <http://www.cbo.gov/ftpdocs/13xx/doc1387/econext99.pdf>; Richard W. Stevenson, *Republicans to Push for a Tax Cut of up to \$500 Billion*, N.Y. TIMES, Jan. 7, 1999, at A28 (reporting that the CBO estimated that about \$500 billion of the \$1.8 trillion in projected surpluses would come other than from outside social security taxes, considering across the board rate cuts); George Hager, *Senate Panel Projects Huge Budget Surpluses*, WASH. POST, Jan. 16, 1999, at A1 (describing that the \$700 billion "excess" over next decade was based upon CBO figures to be released on January 29); Joe Hallett, *Bush Defends Stance on Gun Laws GOP Front-runner also Explains Support of Huge Tax Cut*, COLUMBUS DISPATCH, Aug. 21, 1999, at A1; accord, Richard W. Stevenson, *Candidates Offer Variety of Ways to Spend Surplus*, NEW YORK TIMES, Dec. 27, 1999, at A1.

135. Robert Kuttner, *Opinion, Embarrassing Riches for Democrats*, BOSTON GLOBE, June 27, 1999, at F7; Alison Mitchell, *Democrats Again Face Voter Doubts over Party's Values*, N.Y. TIMES, Aug. 20, 1999, at A18 (noting polls favored Democrats over Republicans fifty-three percent to twenty-four percent for better improving the health care system; forty-six percent to thirty-one percent for better improving education; and forty-nine percent to twenty-eight percent on strengthening Social Security).

136. See *infra* note 170. The efficiency of U.S. capital markets was the main reason the economy had performed well despite a low national savings rate; government investment in equities would compromise that efficiency, particularly if pursuant to guidelines to promote social ends or to avoid investments in countries run by repressive governments—social investing. Kuttner, *supra* note 136. Interestingly, when President George W. Bush later pushed for "personal accounts" in Social Security, Greenspan did not object, although the government investing these funds poses the same problem. For discussions of social investing compare John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 96 (1980) (economically imprudent), with Maria O'Brien Hylton, "Socially Responsible" Investing: *Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1, 51 (1992) (may make economic sense); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005) (arguing corporate managers have a bounded discretion to sacrifice corporate profits in the public interest which is efficient largely due to social and more sanctions to behavioral regulation to which shareholders are underresponsive due to insulation and collective action problems). See generally, Brian Grow et al., *The Debate over Doing Good*, BUS. WK., Aug. 15, 2005, at 76.

cuts).¹³⁷ The Democratic side scored the excessive benefits to the rich¹³⁸ and, recalling the moral of the story of the “supply-side” 1981 Reagan tax cuts¹³⁹—don’t count your chickens before they hatch lest deficits come home to roost¹⁴⁰—pointed to the future deficit dangers if the surplus failed to occur and/or the out year tax costs exploded.¹⁴¹

III. A SECOND SUPPLY SIDE TAX REVOLUTION AND MUCH MORE: PRESIDENT GEORGE W. BUSH’S TAX CUTS

A. 2001 ORDINARY INCOME RATE CUTS AND ESTATE TAX REPEAL

Citing CBO projections of a \$1 trillion surplus over the next ten years,¹⁴² Governor George W. Bush began his first Presidential campaign by advocating a tax cut (1) to make sure the projected surplus did not get spent while growing the baseline of government spending; and (2) more importantly, as an insurance policy against economic slowdown.¹⁴³ In the

137. *E.g.*, 145 CONG. REC. H6101 (daily ed. Jul. 21, 1999) (statement of Rep. Camp); *id.* at H5988 (daily ed. Jul. 20, 1999) (statement of Rep. Schaffer). *See also* 141 CONG. REC. S2441 (daily ed. Feb. 10, 1995) (statement of Sen. Packwood) (arguing that between January 1980-July 1981 every CBO, OBM, JCT, and private economist projected between a \$150 billion-\$200 billion surplus by 1985 from assumed continued high inflation and bracket creep; Reagan Administration proposed 1981 tax cuts in that amount so Congress wouldn’t add new spending programs; then Congress added on many more tax cuts).

138. *E.g.*, 145 CONG. REC. H8005 (daily ed. Sept. 9, 1999) (statement of Rep. DeLauro).

139. *Id.* at S10296 (daily ed. Aug. 5, 1999) (statement of Sen. Wellstone) (“[George H. W. Bush] at the time famously derided Mr. Reagan’s supply side fantasies as ‘voodoo economics.’”); Larry Summers, a respected economist and Secretary of the Treasury during President Clinton’s second term, simply refers to the claimed economic efficiencies of the flat tax as “deja voodoo economics.” Lee A. Sheppard, *Flat Tax and Politics at NYSBA*, 70 TAX NOTES 488 (1996).

140. *See* 146 CONG. REC. S8621 (daily ed. Sept. 15, 2000) (statement of Sen. Dorgan, quoting column by Paul Krugman) (“The most likely prospect is that those big surpluses won’t materialize. And when the chickens that didn’t hatch come home to roost, we will rue the days when, misled by sloppy accounting and rosy scenarios, we gave away the national nest egg.”); *id.* at H7252 (daily ed. Aug. 5, 1999) (statement of Rep. Jones).

141. *E.g.*, 145 CONG. REC. at S10313 (daily ed. Aug. 5, 1999) (statement of Sen. Lieberman); *id.* at H6194 (daily ed. Jul. 21, 1999) (statement of Rep. Jackson-Lee).

142. CONG. BUDGET OFFICE, THE ECONOMIC AND BUDGET OUTLOOK: AN UPDATE 2 (1999) (“Cumulative on-budget surpluses are projected to total nearly \$1 trillion between 1999 and 2009.”), available at <http://www.cbo.gov/ftpdocs/13xx/doc1386/e&b07-99.pdf>.

143. *Governor Bush Meets With New Hampshire High-Tech Leaders to Share His Low-Tax Message, Presidential Campaign Press Materials, December 9, 1999*

(Governor George W. Bush today promoted his plan for reducing taxes on working families and entrepreneurs as a powerful tool to encourage entrepreneurship and expand economic opportunity for all Americans. . . . But he

early stages of his 2000 Presidential campaign, Governor Bush, in an attempt to show his conservative “compassion,”¹⁴⁴ combined relief targeted toward lower-income groups, e.g., such as expanded child tax credits, with rate cuts (down to thirty-three percent as the top rate) and the repeal of the estate tax, purportedly to spur investment and entrepreneurship. His proposal would also give something to both the social conservatives and enterprisers factions of the GOP.¹⁴⁵

Bush maintained that half of the costs of his plan would benefit moderate and low-income families, thereby manifesting his “compassion.”¹⁴⁶ Many commentators concluded, however, that Bush’s

will warn that tax cuts are needed as an insurance policy should the economy take a downturn.);

Joe Hallett, *Bush Defends Stance on Gun Laws GOP Front-runner also Explains Support of Huge Tax Cut*, COLUMBUS DISPATCH, Aug. 21, 1999, at A1; Richard W. Stevenson, *Candidates Offer Variety of Ways to Spend Surplus*, N.Y. TIMES, Dec. 27, 1999, at A1

(Bush says his tax plan [the centerpiece of his domestic agenda], which would most likely use up nearly all of the non-Social Security surplus over 10 years, or perhaps even more, would provide benefits to workers across the income spectrum. Moreover, he said, by putting money back in the hands of taxpayers it would keep Washington from spending it on ever-larger government programs.).

144. Owen Ullmann, *Bush Campaign Searches for Balance in Tax-cut Blueprint*, USA TODAY, Aug. 24, 1999, at A5; Eric Pianin & Terry M. Neal, *Bush to Offer \$483 Billion Tax-Cut Plan; Working Poor, Middle Class Would Get Much of Relief*, WASH. POST, Dec. 1, 1999, at A1 (reporting that the tax package proposed was far more generous than the one passed by Congress; tax cuts to be paid for with projected budget surpluses, excluding those generated by the Social Security payroll tax); Richard W. Stevenson, *Bush to Propose Broad Tax Cut in Iowa Speech*, N.Y. TIMES, Dec. 1, 1999, at A1 (describing the cuts: over phase-in period, top income tax rates reduced to thirty-three percent from thirty-six percent and 39.6%; twenty-eight percent and thirty-one percent rates consolidated at twenty-five percent; much of fifteen-percent bracket; child credit doubled to \$1,000 and more affluent families allowed to claim the credit; many married couples benefited by reviving a deduction based on the lower-earning spouse’s income; added incentives for charitable contributions, and tax on large estates phased out over eight years).

145. See Dan Balz, *Disparate Coalitions Now Make Up Two Parties, Study Finds*, WASH. POST, May 16, 2005, at A15. The same pattern continued in the 2003 tax cuts. Richard Simon, *With Economic Plan Not Yet Out of Bag, Barbs Fly*, L.A. TIMES, Jan. 4, 2003, at 1-10. For a discussion of the enterpriser and social conservative factions, see *infra* Part III.

146. Editorial, *An Empty Drawer*, WASH. POST, Dec. 2, 1999, A38 (claiming that one half of revenue costs designed to help poor enter middle class (ten percent bracket and doubled child tax credit) exaggerated—more than one third of benefits would go to top one percent; three-fourths to the highest twenty percent; and about four percent to the lowest-income forty percent; surplus based on the unlikely assumption that a future Congress would cut most domestic spending by more than twenty percent in real terms; this unlikelihood coupled with proposed increases in defense spending “make it even less likely such a surplus will occur.”); Michael M. Weinstein, *Editorial Observer; Dividing Up the Money From the Bush Tax Cut*, N.Y. TIMES, Dec. 18, 1999, at A22 (explaining Bush’s view of his own plan, costing \$480 billion over five years, saying it focuses “on low- and moderate-

plan “would use nearly all of the non-Social Security surplus for the next five years . . . [and] would primarily benefit wealthier taxpayers, . . . but he presented it as an effort to make it easier for the working poor to reach the middle class.”¹⁴⁷ Commentators asserted that tax cuts of the magnitude Bush proposed (\$743 billion over the budget window) would “force the government back into a policy of borrow-and-spend.”¹⁴⁸

income families,” and provides the “greatest help for those most in need” (His description exaggerates benefits to the poor.); Michael Tackett, *Bush Calls for Tax Rate Overhaul; Working Poor, Estate Heirs Would Benefit Under Plan*, CHI. TRIB., Nov. 30, 1999, at N1. Governor Bush was referring to the first year costs; Democrats referred to the benefits when fully phased in. Also note that by reducing the lowest tax rate and doubling the child tax credit, Bush “freed millions of families with modest incomes from paying income taxes altogether.” While middle-income families benefited from lower ordinary rates of 2001 cut, “they reap little or nothing from one of the most controversial tax cuts Bush pushed through - on dividends and capital gains.” Moreover, these tax cuts will, as a practical matter, be eliminated by the rapid spread of the alternative minimum tax (AMT). Elizabeth Auster, *GOP Inattention to Middle Class Could Help Dems*, PLAIN DEALER, Mar. 13, 2005, at H3. See also David Cay Johnston, *Report Says Bush's Tax Cuts Will Cause Some to Pay More*, N.Y. TIMES, Sept. 24, 2005, at C2 (reporting that the Joint Committee on Taxation letter said Bush tax cuts reduced regular income taxes for millions to a level where they would be subject to the alternative minimum tax, reducing their tax savings from 2001 and 2003 tax cuts by \$739.2 billion over next ten years; the Administration claimed inflation not tax cuts cause this effect (the Joint Committee on Taxation said two thirds was attributable to cuts), but an expert it relied on said that design of Bush tax cuts, not inflation, was the major reason the alternative tax produced more revenue after 2001); Letter to Editor dated Sept. 21, 2005 from House Ways & Means Committee Democratic Staff Chief Tax Counsel John Buckley, *AMT Explosion: Bush Cuts Still to Blame*, 108 TAX NOTES 1581 (2005) (including attached letter from JCT Chief George Yin). This issue is discussed in a work-in-progress—*Selling of Bush II Income Tax Cuts*.

147. Richard W. Stevenson, *Economic Debate Emerging in Race*, N.Y. TIMES, Dec. 5, 1999, at 1-50 (“There is a consensus in both parties that the two-thirds of the projected federal budget surplus generated by the Social Security system should be off limits for tax cuts or general government spending.”). Vice President Al Gore called George W. Bush’s tax cut plan reckless. Gerard Baker & Deborah McGregor, *Bush Eager To Keep the Good Times Rolling Economic Program*, FIN. TIMES, Aug. 2, 2000, at 10; Jon Sawyer, *Bush's Goal This Week Is To Show "Different" GOP; Convention Will Tout Diversity, Play Down Rancor, Attacks Candidate's Staff; Mirrors Tone*, ST. LOUIS POST-DISPATCH, Jul. 30, 2000, at A1.

148. Editorial, *An Empty Drawer*, supra note 146; Ronald Brownstein, *Bush Aims Squarely at GOP's Right Wing with Tax Cut Plan*, L.A. TIMES, Dec. 2, 1999 at A5; *Texas Governor Takes a Risk with Sweeping Proposal Designed to Align Himself More with Conservative Thinking. It Also Promises to Sharpen Ideological Differences with Democrats*, L.A. TIMES, Dec. 2, 1999, at A5.

Governor Bush continued to rely on his tax cut proposal on the stump throughout the 2000 campaign.¹⁴⁹ Meanwhile, as the “surplus” allowed Congress to effectively gut the pay-go restrictions,¹⁵⁰ legislators spent extra billions “for highways and bridges, water projects, emergency farm aid, school construction and scores of other projects.”¹⁵¹ Governor Bush’s math did not add up: to both implement the tax cuts and protect the Social Security “fund” needed for when the “Baby Boomers” began to retire was implausible,¹⁵² since two thirds of the projected surplus was attributable to

149. E.g., Raja Mishra, *Campaign 2000: Tax-Cut Plans; Bush, Gore Philosophies Differ Widely*, B. GLOBE, Nov. 20, 2000, at A35 (noting that Bush’s cuts were more sweeping, tend to benefit the rich more [than the poor]); Dave McKinney, *Candidates Use Tax Cuts to Woo Voters*, CHI. SUN-TIMES, Oct. 29, 2000, at 30.

150. See Alan Greenspan, Testimony Before the Committee on the Budget, U.S. House of Representatives on Economic Outlook and Current Fiscal Issues (Feb. 25, 2004), available at <http://federalreserve.gov/board/docs/testimony/2004/20040225/default.htm> (For about a decade, the rules laid out in the Budget Enforcement Act of 1990, and the later modifications and extensions of the act, provided a procedural framework that helped the Congress make the difficult decisions that were required to forge a better fiscal balance. However, the brief emergence of surpluses eroded the will to adhere to those rules, and many of the provisions that helped to restrain budgetary decisionmaking in the 1990s—in particular, the limits on discretionary spending and the PAYGO requirements—were violated more and more frequently and eventually allowed to expire.).

The “pay-as-you-go” or “paygo” procedures of OBRA 1990, as extended by OBRA 1993, required revenue decreases to be offset by: (1) increases in revenues (unlikely due to the Republican aversion to tax increases), or (2) decreases in spending, so there would be no net increase in the deficit. Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501, 514 (1998). Paygo expired in 2002 and the Senate attempted in 2004 to reinstitute it as to taxes as well as discretionary spending while the House and the Administration were opposed as to application to taxes because they wanted to make the 2001 and 2003 cuts permanent. Richard A. Oppel Jr., *Panel Vote Draws Battle Lines for Pay-as-You-Go Tax Cuts*, WASH. POST, Mar. 18, 2004, at A30.

151. Eric Pianin, *Binges Becoming Regular Budget Fare; As Spending Annually Exceeds Congressional Plans by Billions, Hawks Warn That Surplus and Process Are at Risk*, WASH. POST, Oct. 25, 2000, at A29; *Feb. 25, 2004 Greenspan Testimony*, *supra* note 150

(In recent years, budget debates have turned to choices offered by those advocating tax cuts and those advocating increased spending. To date, actions that would lower forthcoming deficits have received only narrow support, and many analysts are becoming increasingly concerned that, without a restoration of the budget enforcement mechanisms and the fundamental political will they signal, the inbuilt political bias in favor of red ink will once again become entrenched.).

See Richard W. Stevenson, *Budget Threatens Candidates’ Plans to Spend Surplus*, N.Y. TIMES, Oct. 27, 2000, at A1.

152. Glenn Kessler, *Cabinet Opens up on Bush; Treasury Secretary Says Social Security Math Doesn’t Add up*, WASH. POST, Oct. 25, 2000, at A1.

projected wage tax payments in excess of current outlays.¹⁵³ Vice President Gore's criticism along these lines was undercut by the fact that he proposed cuts equal to seventy-five percent of Bush's proposals,¹⁵⁴ albeit his were *targeted* tax cuts¹⁵⁵ on education, health care and the military, and intended to shore up Medicare as well as to reduce the national debt.¹⁵⁶

President George W. Bush began his Presidency with a proposal to use the surplus both for his tax cut and to pay down part of the deficit, and, to the surprise of both parties, the latter became popular in opinion polls.¹⁵⁷ Opinion polls also suggested a preference for spending on top domestic priorities.¹⁵⁸ President George W. Bush soon adopted a two-pronged approach: the surplus was big enough to accommodate both, and the now \$1.6 tax trillion cut was necessary to spur a faltering economy.¹⁵⁹ The

153. Richard W. Stevenson, *Candidates Offer Variety of Ways to Spend Surplus*, N.Y. TIMES, Dec. 27, 1999, at A1 (reporting that \$2 trillion of the current surplus forecast of three trillion dollars over the next decade would come from excess Social Security revenues).

154. Mishra, *supra* note 150. Gore's tax breaks for college tuition, retirement, energy-efficient technology, and a host of other things implementing the active government strategy of using the tax code to reward good behavior; whereas Bush advocated putting money back in the hands of taxpayers and by reduction of revenues limiting government; however, reflecting the distribution of pre-tax income and the slight progressivity of the individual income tax as much as sixty percent of Bush's tax cuts would go to top ten percent of earners, those making \$92,500 or more, according to an analysis by the Citizens for Tax Justice. *Id.* President Bill Clinton had also pushed a number of incentives at relatively low costs to provide a little something, but not much, for as many constituent groups as possible within pay-go strictures. Lee & Seago, *supra* note 32, at 632.

155. Mishra, *supra* note 150.

156. Richard W. Stevenson, *Budget Threatens Candidates' Plans to Spend Surplus*, N.Y. TIMES, Oct. 27, 2000, at A1; McKinney, *Supra* note 149, at 30.

157. Richard W. Stevenson, *President to Seek Cuts of \$2 Trillion of Debt in Decade*, N.Y. TIMES, Feb. 27, 2001, at A1.

158. Dan Balz, *President Begins His Toughest Sell*, WASH. POST, Feb. 28, 2001, at A1; Andrew Taylor, *Tax Fight Energizes Democrats*, 59 CONG. Q. WKLY. 465 (2001) (noting that public and private polls suggest the public believes tax cuts less are important than education, Medicare and Social Security). Bush tried to balance contrasting themes: (a) increasing layoffs, rising energy prices, too many failing schools, persistent poverty, etc., and (b) balanced budget, big surpluses, technology that is revolutionizing the world, etc.—but “neither picture is complete in and of itself.” Craig Gilbert, *Bush Pitches “Urgent” Tax Relief to Congress; Budget Seeks to Slash Taxes, Shrink Debt*, MILWAUKEE J. SENTINEL, Feb. 28, 2001, at A1.

159. Daniel J. Parks, *Bush Faces Concern That Tax Cuts Will Be Too Much, Too Late*, 59 CONG. Q. WKLY. 419 (2001); Balz, *supra* note 141. See also David Leonhardt, *3 New Reports Show Evidence Of Weakness In the Economy*, N.Y. TIMES, Feb. 28, 2001, at C-1; William Neikirk, *Projected Surplus Is Among Question Marks in Tax Plan*, CHI. TRIB., Feb. 28, 2001, at N-9 (CBO cited major uncertainties in its estimates of a surplus based on

public listened as Democrats challenged Bush's numbers and warned that the tax cut could lead back to an era of deficits.¹⁶⁰

Early factors seemed to militate against success of the tax cut: Some Republican leaders urged a capital gains tax cut, not staying on message,¹⁶¹ and polls indicated a high approval rating of President George W. Bush but increasing concern over the economy.¹⁶² Democrats' internal polling indicated that a tax cut, even one tilted to millionaires, was more popular than debt reduction, but that using the surplus on social spending—for

assumed average economic growth of 3 percent a year from 2002); Richard W. Stevenson, *Bush Team Sensed Economic Slump Early*, N.Y. TIMES, Apr. 22, 2001, at 1-20 (Cheney, a director of Union Pacific, heard that loading of freight cars was down; which was consistent with other soundings that the economy was deteriorating; so Cheney in December 2000 declared in a televised interview, "We may well be on the front edge of a recession here." The game plan then became to avoid appearing out of touch with the economic worries of voters and to assert that policy proposals developed and debated during a period of confidence and optimism remained the right prescriptions for an era of uncertainty.). George W. Bush actually sounded the dual themes of taxpayers' money and need for stimulus in late 1999. See *supra* note 144 and accompanying text.

160. Alison Mitchell, *The President's Budget: The Democratic Response; Democrats Cite Deficit Fears in Opposing Bush's Tax Plan*, N.Y. TIMES, Feb. 28, 2002, at A14.

161. Mike Allen, *GOP Leaders Urge Cut in Capital Gains Rate*, WASH. POST, Mar. 12, 2001, at A5; David E. Rosenbaum, *G.O.P. Aides Considering Capital-Gains Tax Rate Cut*, N.Y. TIMES, Apr. 21, 2001, at A12.

162. Richard L. Berke & Janet Elder, *60% in Poll Favor Bush, but Economy Is Major Concern*, N.Y. TIMES, Mar. 14, 2001, at A1. Some opined that the increase in the projected surplus would make it easier for President George W. Bush to turn his tax cut plan into legislation. *Id.*; Heidi Glenn, et al, *Bush Tax Cut to Get Boost from increased CBO Estimates*, 2001 TAX NOTES TODAY 21-1 (2001) (noting that on the eve of the CBO official surplus release, Democrats and Republicans scrambled January 30 to fortify their positions on tax cuts and the budget, while President George W. Bush invited lawmakers to the White House for more strategy sessions); Daniel J. Parks & Lori Nitschke, *CBO Update Bolsters Tax Cut Plans*, 59 CONG. Q. WKLY. 276 (2001). Others thought the facts that the 2000 Presidential election was so close and did not appear to have turned on policy proposals would make this task more difficult. Mark Z. Barabak, *Campaign 2000; One Vote Result Already In: Neither Will Get a Mandate; Projections: The Close Election Means the Next President Won't Persuade Congress That He's Acting on the Will of the People*, L.A. TIMES, Nov. 3, 2000, at A22 (discussing conclusions based on agreement of experts and analysts in both parties). Here, too, commentators split with some concluding that Governor Bush had changed the public agenda from putting tax cuts at the bottom of possible uses of the surplus to the top ahead of deficit reduction. Robin Toner & Janet Elder, *The 2000 Elections: The Polling; An Electorate Largely Split Reflects a Race So Very Tight*, N. Y. TIMES, Nov. 8, 2000, at B-1 (relying on exit questionnaires as voters left polling places on November 7, 2000 and noting public sentiment that Governor Bush's argument that government's role in public life needed to be reduced clearly resonated). This is the hallmark of a successful policy entrepreneur. Lee & Seago, *supra* note 32, at 639 (arguing that legislation results under a political science "garbage can" theory of governance when a policy entrepreneur connects a proposed policy with a perceived problem in a window of political opportunity).

education, health, science, and housing—was more popular than either cutting taxes or retiring debt.¹⁶³ Shortly after the 2000 Presidential Election, the CBO indicated that its January 2001 estimation of the surplus¹⁶⁴ would be even bigger—perhaps as much as \$1 trillion bigger—at \$5.7 trillion over 10 years.¹⁶⁵

But those surpluses proved illusory as the U.S. economy slipped into recession in March 2001. Both CBO and OMB grossly overestimated tax revenues. Instead of \$5.6 trillion, a better surplus projection—more accurately predicting the performance of the economy and the level of tax receipts—would have been \$2.4 trillion, as CBO acknowledged later. On top of the bad surplus projections came surplus-draining tax cuts. Finally, an explosion in spending in response to the Sept. 11 assaults and in connection with the invasion of Iraq combined to turn the budget picture on its head.¹⁶⁶

Fate took a hand. Federal Reserve Chair Alan Greenspan virtually endorsed tax cuts in testimony before a January 25, 2001 Senate Budget Committee hearing¹⁶⁷ due to CBO's estimation of zero debt by the end of the decade.¹⁶⁸ In that event, Greenspan believed reduction of the surplus

163. Robert Kuttner, Opinion, *Bush Paid Dearly for Arrogance*, BOSTON GLOBE, May 27, 2001, at D-7.

164. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2002-2011 (2001), available at <http://www.cbo.gov/ftpdocs/27xx/doc2727/entire-report.pdf>.

165. Peter G. Gosselin, *Decision 2000: America Waits; the Bigger the Surplus, the Easier the Politics; Budget: A Projection of up to \$1 Trillion More Will Aid Bush or Gore's Programs and Attract Legislative Support*, L.A. TIMES, Nov. 13, 2000, at A1; David Westphal, *Greenspan Endorses Tax Cuts; Some Democrats Warn That Amid Economic Slowdown, Deficits Could Follow*, STAR TRIB. (Minneapolis), Jan. 26, 2001, at A1 (reporting that despite polls showing a majority against tax cuts, Bush stuck to his plan; Greenspan's virtual endorsement marked a stunning turnaround).

166. The Nonpartisan Concord Group concluded that as of September 2003 only one third of the deterioration of the Federal balance sheet was attributable to the Bush tax cuts. Andrew Taylor, *Next Presidency: A Future of Shortfalls*, 62 CONG. Q. WKLY. 2230 (2004); Gebe Martinez, *The GOP's Internal Divide*, 62 CONG. Q. WKLY. 166 (2004).

167. Alan Greenspan, Testimony Before the Committee for the Budget, U.S. Senate on the Outlook for Federal Budget and Implications for Fiscal Policy (Jan. 25, 2001) [hereinafter *January 25 Greenspan Testimony*], transcript available at <http://www.federalreserve.gov/boarddocs/testimony/2001/20010125/default.htm>.

168. *January 25 Greenspan Testimony*, supra note 168

(The most recent projections, granted their tentativeness, nonetheless make clear that the highly desirable goal of paying off the federal debt is in reach before the end of the decade. This is in marked contrast to the perspective of a year ago when the elimination of the debt did not appear likely until the next decade.)

Greenspan also indicated that even a retroactive a tax cut would have little effect on the recent downturn in the economy. *Id.*; Patti Mohr, *Greenspan Backs Tax Cuts, Social*

was needed to avoid Treasury having enough left over after retirement of the public debt to invest in private assets¹⁶⁹—an earlier proposal of the Clinton Administration.¹⁷⁰ He warned, however, that economic growth had slowed very close to zero, which suggested tax cuts to some, but cuts would not generate an immediate stimulus.¹⁷¹ Moreover, sixty-four percent of individual taxpayers, accounting for thirty-eight percent of reported taxable income, would have received no reduction in marginal rates.¹⁷² Greenspan added that if Congress would otherwise use the surplus for open-ended spending programs, as 2000 indicated probably would be the case, then tax cuts were preferable.¹⁷³ Notwithstanding the slowing economy, Greenspan argued that CBO's budget surplus projections were probably accurate, partially because the jump in productivity during the

Security Privatization, 90 TAX NOTES 564 (2001); Eric Pianin & John Lancaster, *Tax Cuts Gain Momentum; Gramm-Miller Plan Like Bush's; Daschle's Package Smaller*, WASH. POST, Jan. 23, 2001, at A2 (reporting that the tax cut increased in resonance as the economy weakened and federal budget remained in surplus).

169. *January 25 Greenspan Testimony*, *supra* note 168

(At zero debt, the continuing unified budget surpluses currently projected imply a major accumulation of private assets by the federal government. . . . [T]he federal government should eschew private asset accumulation because it would be exceptionally difficult to insulate the government's investment decisions from political pressures. Thus, over time, having the federal government hold significant amounts of private assets would risk sub-optimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living than would be achieved otherwise.);

Daniel J. Parks, *How Much Debt Is Too Much*, 62 CONG. Q. WKLY. 141 (2004); David R. Francis, *Greenspan Gives Tax Cut Big Push*, CHRISTIAN SCI. MONITOR, Jan. 26, 2001, at 1.

170. President Clinton had proposed just that, which Greenspan had strongly criticized. *See supra* note 137 and accompanying text.

171. *January 25 Greenspan Testimony*, *supra* note 168 (“Lately there has been much discussion of cutting taxes to confront the evident pronounced weakening in recent economic performance. Such tax initiatives, however, historically have proved difficult to implement in the time frame in which recessions have developed and ended.”); Robert J. Caldwell, Editorial, *President Bush Starts Out Fast, Wins Debate over Tax Cut*, SAN DIEGO UNION-TRIB., Feb. 11, 2001, at G-1 (“With annual budget surpluses piling up and the economy slowing if not stalled, the debate about whether to cut taxes is over.”).

172. William G. Gale & Samara R. Potter, *An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act of 2001*, 55 NAT'L TAX J. 133 (2002) (citing Donald Kiefer et al., *The Economic Growth and Tax Relief Reconciliation Act of 2001: Overview and Assessment of Effects on Taxpayers*, 55 NAT'L TAX J. 89, Table 2 (2002)).

173. *January 25 Greenspan Testimony*, *supra* note 168

([I]f long-term fiscal stability is the criterion, it is far better, in my judgment, that the surpluses be lowered by tax reductions than by spending increases. The flurry of increases in outlays that occurred near the conclusion of last fall's budget deliberations is troubling because it makes the previous year's lack of discipline less likely to have been an aberration.).

past five years would continue.¹⁷⁴ The “jump in productivity” was significantly overstated.¹⁷⁵ Moreover, this “jump” was concentrated in thirty percent of the private economy.¹⁷⁶

Hindsight would show, as astute observers warned, that the 1998-2000 increased federal income tax collections from individuals were mostly due to realizations of capital gains in the stock market boom by investors and day-traders and ordinary income revenues reporting by corporate officers upon the exercise of stock options¹⁷⁷—all of which would dry up with the

174. *Id.*

(The key factor driving the cumulative upward revisions in the budget picture in recent years has been the extraordinary pickup in the growth of labor productivity experienced in this country since the mid-1990s. . . . Since 1995 . . . productivity growth has accelerated markedly, about doubling the earlier pace, even after taking account of the impetus from cyclical forces. Though hardly definitive, the apparent sustained strength in measured productivity in the face of a pronounced slowing in the growth of aggregate demand during the second half of last year was an important test of the extent of the improvement in structural productivity. These most recent indications have added to the accumulating evidence that the apparent increases in the growth of output per hour are more than transitory.)

See also 147 CONG. REC. S9327 (daily ed. Sept. 10, 2001) (statement of Sen. Hollings) (Where are we? From 41 percent of the workforce in manufacturing down to 12 making what? Nothing. I was sort of amazed at Alan Greenspan saying in February that we have so much productivity we have a surplus as far as the eye can see, and so we ought to have a tax cut when the productivity has gone overseas.)

175. Louis Uchitelle, *Notions of New Economy Hinge on Pace of Productivity Growth*, N.Y. TIMES, Sept. 3, 2001, at A1 (indicating that the boom had collapsed despite Greenspan's faith that ever-greater efficiencies of the information age would continue raising profits, incomes and employment; that productivity calculations for peak boom years (1999-2000) were revised down from 3.4 percent to 2.6 percent; and that late 1990's rapid productivity gains were caused in part by unsustainable business investment leading to a spurt in growth that temporarily forced more efficient use of labor).

176. Louis Uchitelle, *Deepening Wrinkles in the New Economy*, N.Y. TIMES, Oct. 17, 2001, at C2 (“[N]early all the surge from 1995 through 2000 occurred in six sectors: retail, wholesale, telecommunications, securities, the assembly of computers and the manufacture of semiconductors.”).

177. Taxpayers reporting \$200,000 or more sold huge quantities of ever-more-valuable stock during the boom years and cashed in hundreds of billions of dollars in stock options taxed as ordinary income. Cash bonuses, commissions and fees augmented their share of household income from 14.6% in 1994 to 18.1% in 1996. Meanwhile, their share of income taxes rose from 14.6% to 37.2%. These increases were equal to the 1999 surplus. Overvalued stock prices were vulnerable to a collapse that would bring down the budget surpluses as well. Louis Uchitelle, *A Surplus Built on Bricks of Income Inequality*, N.Y. TIMES, Feb. 28, 1999, at 3-4. See also, e.g., Richard W. Stevenson & Michael M. Weinstein, *Is \$1 Trillion Windfall As Ephemeral As a Breeze?*, N.Y. TIMES, Jul. 3, 1999, at A8 (indicating that estate taxes were up substantially, reflecting the rising stock market and

collapse of the stock market bubble. They were so right. Ominously, at the end of 2000 the Dow Jones Industrial Average closed 6.8 percent lower than it had begun the year, after five straight years of double digit increases.¹⁷⁸

Chair Alan Greenspan prudently recommended a trigger on the 2001 Act tax cuts to suspend them if that part of the surplus otherwise dedicated to Social Security and Medicare would be invaded due to the cuts.¹⁷⁹ The

the big holdings of public stocks and bonds by taxable estates); Robert Barbera, *America's Bubble Budget: The Federal Surplus Will Not Look So Big Once Tax Revenues From Stock Options Start to Fall*, FIN. TIMES (London, USA Ed.), Oct. 27, 2000, at 19; Anatole Kaletsky, *Victory for Bush Could Prove Disastrous All Round*, TIMES (London), Nov. 7, 2000 (indicating that the question of whether the budget surplus was shrinking, and the threat of a bear market on Wall Street, were much debated during the campaign). SOI data for 1999 shows for all individual returns reporting capital gains from stock sales almost twice as many short term as long term transactions, although the amount of long term gain was over twice the amount of short term gain. SOI Tax Stats - *Sales of Capital Assets Reported on Individual Tax Returns*, at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96649,00.html>. The ratios of short term to long term transactions was even greater for returns reporting AGI of \$200,000 and greater; Short term gains, however, were eighty percent of long-term gains for AGI from \$200,000 to \$500,000; Long-term gains were twice short term gains for \$500,000 to \$1,000,000 and around four times for \$1,000,000 or more. *Id.* See also Philip Coggan, *Financial Models Predicting Market Behaviour Are Often Based on Assumptions That Do Not Always Correspond with the Real World*, FIN. TIMES, Feb. 14, 2005, at 32 (noting behavioral economics has shown that investors are not so rational being more averse to losses than to reductions in profits. "They value short-term gains more highly than long-term.").

178. The Dow Jones Industrial Average opened 2000 at 11,356.51 and closed at 10,785.85 for a 6.19% decline; 1999 had increased 25.22%; 1998, 16.10%; 1997, 22.64%; 1996, 26.05%; and 1995, 33.45%. Dow Jones Industrial Average, available at <http://averages.dowjones.com/downloads/xlspages/DJIA-Hist-perf.xls>.

179. *January 25 Greenspan Testimony*, *supra* note 168

(In recognition of the uncertainties in the economic and budget outlook, it is important that any long-term tax plan, or spending initiative for that matter, be phased in. Conceivably, it could include provisions that, in some way, would limit surplus-reducing actions if specified targets for the budget surplus and federal debt were not satisfied. Only if the probability was very low that prospective tax cuts or new outlay initiatives would send the on-budget accounts into deficit, would unconditional initiatives appear prudent. The reason for caution, of course, rests on the tentativeness of our projections. What if, for example, the forces driving the surge in tax revenues in recent years begin to dissipate or reverse in ways that we do not now foresee? Indeed, we still do not have a full understanding of the exceptional strength in individual income tax receipts during the latter 1990s. To the extent that some of the surprise has been indirectly associated with the surge in asset values in the 1990s, the softness in equity prices over the past year has highlighted some of the risks going forward.)

See 147 CONG. REC. H752 (daily ed. Mar. 8, 2001) (statement of Rep. Roukema) (indicating that Chairman Greenspan "outspokenly supported" a trigger in testimony both before House

Senate rejected any trigger, maintaining that resulting uncertainty would undermine the long-term stimulative effect of the cuts.¹⁸⁰ Senate Finance Chair Grassley assured opponents of the rate cut that “if things go south on the projections, you can be sure that Congress will raise taxes,” as it had in 1982, 1984, 1990 and 1993.¹⁸¹ He failed to note that in those tax acts one or both of the chambers of Congress had been controlled by Democrats and the ballooning deficit had been of great concern to Congress and the President at the time.¹⁸² When the projections did go South, Congress, at the urging of President George W. Bush, cut taxes further instead of raising them.¹⁸³

As the economy began to look more like a recession and consumer confidence fell, deficits began to reemerge as an acceptable policy on the theory that surpluses hold money back from the economy.¹⁸⁴ By May, it appeared that the CBO would report in the summer that the projected surpluses were over; accordingly, President George W. Bush and congressional proponents of the tax cuts pressed hard to pass such a bill

and Senate Committees); *see also* 147 CONG. REC. S5683 (daily ed. May 24, 2001) (statement of Sen. Stabenow)

([W]e had an amendment we tried twice to pass—a budget trigger which says if the phase-in of the tax cut dips into Social Security and Medicare to pay for it, if we go back into debt, we will suspend that action, further tax cuts or spending, until the revenue comes in.);

Paul Krugman, Opinion, *The Awful Truth*, N.Y. TIMES, Jan 13, 2004, at A13

(In May 2001 Mr. Greenspan gloomily told Mr. O’Neill that because the first Bush tax cut didn’t include triggers—it went forward regardless of how the budget turned out—it was ‘irresponsible fiscal policy.’ This was a time when critics of the tax cut were ridiculed for saying exactly the same thing.).

180. Lori Nitschke, *Proposals to Alter Bush’s Tax Plan Multiply Despite White House Appeals for Unity*, 59 CONG. Q. WKLY. 377, 378 (2001) (demonstrating that the trigger has less support in Congress than would appear on its face).

181. 147 CONG. REC. S5091 (daily ed. May 17, 2001) (statement of Chair Grassley).

182. After the 1981 “riverboat gamble” tax cut, the Reagan administration agreed to (a) deficit-reducing tax increases in 1982 and 1984, and (b) the bipartisan 1983 Social Security changes, improving the fiscal posture of both Social Security and the government as a whole. Daniel L. Shaviro, *Reckless Disregard: The Bush Administration’s Policy of Cutting Taxes in the Face of an Enormous Fiscal Gap*, 45 B.C.L. REV. 1285, 1329 (2004). The surplus that the government ran in 1998-2000 arose mainly from the unanticipated boom in the economy and the stock market, the increase in productivity, and the slowdown in the rise of health spending due to managed care. David E. Rosenbaum, *The Deficit Disappeared, but That Was Then*, WASH. POST, Sept. 21, 2003, at 4-3.

183. *See infra* notes 185-86 and accompanying text.

184. Accordingly, the Senate pushed successfully for an immediate stimulus through retroactive individual tax refunds. Lori Nitschke, *House Presses Bush’s Tax Agenda While Senate Talks of Stimulus*, 59 CONG. Q. WKLY. 707 (2001).

before that time since “any softening of surplus projections lends credence to the main argument of opponents: the predictions of the nation’s long term financial solvency are not certain enough to make such a deep tax cut prudent.”¹⁸⁵

Under the Economic Growth and Tax Relief Reconciliation Act of 2001,¹⁸⁶ the maximum individual rate would be gradually reduced over a six-year period, e.g., from 39.6% to 39.1% in 2001, and was scheduled to be 35% in 2006 and thereafter.¹⁸⁷ The high income PEP and Pease phase-out of personal exemptions and haircut of non-business itemized deductions¹⁸⁸ were scheduled to be phased out in the years beginning after 2005. To fit within budgetary constraints,¹⁸⁹ Congress repealed the Estate Tax only as to persons dying after December 31, 2009. Furthermore, absent additional congressional action, the Estate Tax will rise from the

185. Daniel J. Parks, *Tax Cut Backers Hurry to Beat a Touch of Surplus Pessimism*, 59 CONG. Q. WKLY. 1253 (2001).

186. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub.L. No. 107-16, 115 Stat. 38 (2001)[hereinafter “2001 Act”]; see generally Susan Kalinka, *Highlights of the 2003 Jobs and Growth Tax Reconciliation Act: Economic Stimulus or Long-term Disaster?*, 64 LA. L. REV. 219, 265-66 nn. 248-35 (2004).

187. See 2001 Act, § 101(a), I.R.C. § (i) (2005). See also STAFF OF THE JOINT COMM. ON TAXATION, SUMMARY OF PROVISIONS CONTAINED IN THE CONFERENCE AGREEMENT FOR H.R. 1836, THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (JCX-50-01) (Comm. Print 2001).

188. See 2001 Act, § 102(a), I.R.C. § 151(d)(3)(E) and (F) (2005); § 103(a), I.R.C. § 68(f) (2005); see also Fessler, *supra* note 93

(Don J. Pease, D-Ohio, . . . “has long thought that raising the top rate or imposing a surtax on the rich would be ‘the cleanest way to make the tax system more progressive.’” But recognizing the impending political logjam, he came up with a plan [in OBRA 1990] that allowed both sides to claim some victory. It would limit a taxpayer’s itemized deductions by 3 percent of the amount his or her adjusted gross income exceeded \$100,000. While a taxpayer’s top rate would not be raised overtly, the change would have the effect of increasing the top marginal rate of high-income taxpayers by almost one percentage point. . . . Another key piece of the final compromise—phasing out the personal exemption—was embraced primarily as a way to break an impasse over Democrats’ insistence that a 10 percent surtax be imposed on millionaires, a change the administration found too close to a rate hike for comfort. Under the plan, the value of the personal exemption, now \$2,050 per taxpayer and dependent, would be gradually phased out for individuals with adjusted gross incomes from \$100,000 to \$225,000 and for married filers with incomes from \$150,000 to \$275,000. The effect would be to increase a taxpayer’s marginal rate by as much as half a percentage point for each exemption; that could mean an effective top marginal rate of 34 percent for a couple with four children in that income range.).

189. This and other gimmicks are discussed in a work-in-progress—*Selling of Bush II Income Tax Cuts*.

dead in 2011.¹⁹⁰ Thus, Congress may well have shifted costs to future legislators by creating tax cuts which would be politically, though not legally, impossible to repeal.¹⁹¹ The 2001 Act also carved out of the old lowest (fifteen percent) bracket a new ten percent bracket applicable to the first \$12,000 of taxable income for married couples (\$6000 for singles and \$10,000 for heads of households) through 2007.¹⁹² The maximum taxable income level at which the fifteen percent bracket ends was raised for joint filers as part of the marriage penalty relief provisions.¹⁹³ The 2001 Act raised the alternative minimum tax exemption by \$2000 for single taxpayers and \$4000 for married taxpayers through 2004.¹⁹⁴

B. 2003: PARITY OF CAPITAL GAINS AND DIVIDENDS RATE AT 1938 LEVEL

1. Historical Background of Dividends

During most of the 20th Century dividends were important: from 1926 to 1993, blue-chip stocks produced an average return of about ten percent a year, 5.4% a year from capital appreciation and 4.9% from dividends.¹⁹⁵ By the 1980s, dividend income began to fade in importance as the long-term capital gains rate was cut while dividends remained taxed as ordinary

190. Transitional provisions leading to complete abolition of the Estate Tax in 2010 addressed a number of significant issues. The top Estate Tax rate would be gradually reduced from the pre-2001 Act fifty-five percent to forty-five percent for decedents dying in 2007. See 2001 Act § 511(a)-(c), 115 Stat. 70 (codified at I.R.C. § 2001(c) (2005)). The Estate Tax exemption amount would be gradually increased from the pre-2001 Act \$675,000 to \$3.5 million for decedents dying in 2009. See *id.* § 521(a), 115 Stat. at 71 (codified at I.R.C. § 2010(c) (2005)).

191. David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2628 n.314 (2005); Shaviro, *supra* note 183, at 1300

(The main reason for these 'sunsets'—which proponents of the two Acts insisted would not be permitted to take effect—was to lower the official ten-year estimates of the Acts' revenue cost by more than fifty percent. Thus, looking at either what the proponents openly intended or at the likely resolution of the politically unrealistic policy path suggested by the sunsets, the sunsets result is a significantly higher estimate of the fiscal gap.)

192. 2001 Act § 101(a)(1), I.R.C. § 1(i) (2005). The limit was scheduled to rise to \$14,000 in 2008 and to be indexed for inflation starting in 2009. *Id.*

193. See *id.* § 101(c), I.R.C. § 1(f)(8) (2005).

194. See *id.* § 701(a)(1), I.R.C. § 55(d)(1) (2005).

195. Tom Petruno, *The President's Economic Plan; Dividends' Role Gains Currency*, L.A. TIMES, Jan. 8, 2003, at 1-1.

income.¹⁹⁶ The capital gains tax rate was cut again in 1997, to a maximum of twenty percent, coinciding with and helping to fuel the surge of money into the stock market. With the top tax rate on dividend income nearly twice the capital gains tax rate and annual double digit growth in the stock market, there was little reason for many investors to want dividends and thus little incentive for many firms to pay or raise the amount of dividends.¹⁹⁷ Management used the retained profits for expansion or to buy back shares of stock, which allowed executives to set aside millions of shares they awarded to themselves as part of their compensation and to help increase the stock price by reducing the supply.¹⁹⁸ By 2000, the average dividend yield of the Standard & Poor's 500 corporations fell to a record low of 1.1%.¹⁹⁹ During the late 1990's stock market bubble, dividend-paying stocks fared poorly compared to non-dividend paying stocks. For instance, in 1999, the value of 402 stocks in the Standard & Poor's Industrial 500 paying dividends rose an average of 2.1%, while the value of 98 non-dividend paying companies in the index rose an average of 89.8%.²⁰⁰

2. Bursting of the Stock Market Bubble in 2000

With the bursting of the stock market bubble in March 2000, and the market's continued decline for three straight years thereafter as well as the ceaseless parade of corporate accounting scandals, investors began to reward (or at least punish less severely) dividend-paying corporations,

196. *Id.*

197. Jeffery Brown et al., *Executive Financial Incentives and Payout Policy: Firm Responses to the 2003 Dividend Tax Cut* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 11002, 2004) ("[D]ividend payout ratios fell substantially and share repurchases increased rapidly over past 2 decades."), available at <http://www.nber.org/papers/w1102>.

198. Floyd Norris, *Reversing Trend, Number of Dividend Increases Grows*, N.Y. TIMES, Jan. 3, 2003, at C-3; David Leonard & Claudia H. Deutsch, *Few Officials at Companies Expect Surge in Dividends*, N.Y. TIMES, Jan. 8, 2003, at C-1.

199. Petruno, *supra* note 195. Historically, about one half of S&P corporation profits were paid out as dividends; this has fallen to thirty-five percent. William Patalon III, *Dividends Sail Back From Land of Disdain; Microsoft's Surprise, Bush's Proposal Look like Good Things for Investors*, BALTIMORE SUN, Jan. 18, 2003, at C9

(Until recently, at any point in history, only about 50 of the 500 largest U.S. public companies did not pay dividends. . . . Now, however, 139 members of the Standard & Poor's 500 index do not pay dividends . . . [a]nd even those payouts are at their nadir.)

200. Norris, *supra* note 199, at C3.

many of which led the market in 2001-2003.²⁰¹ For example, in 2002, the Standard & Poor's 500 companies paying dividends declined by an average of 18.4%, while the stocks of such non-dividend paying companies fell by an average of 30.3%.²⁰²

While many economic indicators by the beginning of 2003 indicated an economic recovery, jobs continued to be lost and unemployment continued to be high—a “jobless recovery.”²⁰³ Moreover, in 2002 the stock market had seen the worst percentage decline in value since 1974 and the deepest three straight years of stock-market declines—the first such losing streak since 1939-1941.²⁰⁴

201. Leonhard & Deutsch, *supra* note 199; Petruno, *supra* note 195; Andrew Countryman & Janet Kidd Stewart, *Dividend Comeback; The Administration's Push to Eliminate Taxes on Dividends Could Help Fuel a Rebound in the Number of Companies Making Payments to Shareholders*, CHI. TRIB., Jan. 7, 2003, at N-1.

202. Norris, *supra* note 199.

203. 149 CONG. REC. S10890 (daily ed. Aug. 1, 2003) (statement of Sen. Reed) (noting that more than 3.2 million private sector jobs were lost, with 1.2 million jobs lost even after the “end” of the recession twenty months earlier, and that the slight decrease in unemployment (6.4% to 6.2% of the civilian labor force) in July did not represent a growth in jobs, only a drop in the number of people looking for jobs); ECONOMIC POLICY INSTITUTE, STATE OF WORKING AMERICA 2004/2005: RECOVERY YET TO ARRIVE FOR WORKING FAMILIES (2004), available at http://www.epinet.org/books/swa2004/news/swa2004_release_final.pdf; Warren Rojas, *Bush Claims Tax Cuts Are Working, Critics Point Out People Are Not*, 100 TAX NOTES 875 (2003); Alex Berenson, *Is There Such a Thing as a Jobless Recovery?*, N.Y. TIMES, Jan. 26, 2003, at 4-3 (lack of job growth downside of the productivity boom); Ron Scherer, *For Unemployed, Statistics Tell Only Part of Story*, CHRISTIAN SCI. MONITOR, Apr. 30, 2003, at 1 (indicating that the long-term unemployed constituted the fastest growing groups and that “people [were] so discouraged by the job search that they’ve just quit looking.”); John M. Berry, *Economy Lost 100,000 Jobs In December; Unemployment Rate Remains at 8-Year High*, WASH. POST, Jan. 11, 2003, at A1; David Leonhardt, *Hiring in Nation Hits Worst Slump in Nearly 20 Years*, N.Y. TIMES, February 6, 2003, at A1; Warren Vieth, *Jobless Rate Slips to 5.7% in January; Fewer Holiday Workers Are Laid Off. But It's Too Early to Celebrate Job Growth, Economists Say*, L.A. TIMES, Feb. 8, 2003, at 3-1; David Leonhardt, *108,000 Jobs Lost in March, U.S. Says*, N.Y. TIMES, Apr. 5, 2003, at C-1. Job creation finally began to surge in February 2004, prompting presidential candidate John Kerry, to shift his emphasis from job losses to “the apparently accurate claim that the new jobs pay less, on balance, than the ones that have been lost—\$9,000 a year less, on average.” Louis Uchitelle, *It's the Economy, Right? Guess Again*, N.Y. TIMES, July 4, 2005, at 3-1.

204. Danielle DiMartino, *Good Riddance; Year Offered Investors Little to Hang onto; Although Rallies Helped, Stock Indexes Turned in Their Third Annual Loss*, DALLAS MORNING NEWS, Jan. 1, 2003, at D-1. See also <http://averages.dowjones.com/mdsidx/downloads/2000-2009.pdf>. The Dow Jones Industrial Average first touched 10,000 on March 16, 1999; it first closed above 10,000 on March 29, 1999, at 10,006.78. The Dow Jones Industrial Average reached its highest point on January 14, 2000, closing at

3. Bush II Proposal of Exclusion of Individual Dividends

In early January 2003, the George W. Bush Administration released a trial balloon “stimulus” package with the three most significant proposed tax cuts being (1) exclusions of a large portion of individual dividend income from taxation²⁰⁵—the largest element (\$364 billion) in the \$674 billion tax cut over 10 years; (2) increases in the amount of currently deductible small businesses equipment purchases; and (3) an acceleration of the individual rate cuts originally scheduled by the 2001 Act for 2004 to 2003.²⁰⁶

The Administration’s earliest trial balloons would have excluded only one-half of dividends to reduce the revenue costs and to counter the

11,722.98. At the beginning of 2003, it had last closed above 10,000 on May 27, 2002, at 10104.26. Since January 14, 2000, the Dow Jones Industrial Average had its lowest close on October 9, 2002, at 7286.27. The Dow again crossed the 10,000 level on Dec. 9, 2003. Dow Jones Index News Release December 10, 2003, *available at* http://www.djindexes.com/mdsidx/html/pressrelease/press_hist2003.html.

205. The original Bush proposal excluded 100% of dividends paid out of current year earnings to individual taxpayers. Robert F. Manning & David F. Windish, *A Concise Explanation of the Administration’s Tax Proposals*, 98 TAX NOTES 902 (2003); Jonathan Weisman, *In House, Fight Brews Over Bush Tax Plan; Ways and Means Panel Targets President’s Centerpiece—Dividend Cut—for Overhaul*, WASH. POST, Apr. 27, 2003, at A5 (noting that companies would record fully taxed profits in an “excludable dividend account,” then inform shareholders which dividends are tax-free (or taxable), and that complexity has raised quiet concerns among corporate accountants). Bush’s proposal would have also required a showing of taxes paid by the corporation distributing the dividend which they might be loath to disclose since this often would reveal a low effective income tax rate. Tom Petruno & Josh Friedman, *Wall St. Expected to Hail Investment Tax Cuts; Though Less Than Expected, the Reductions Could Make Stocks More Appealing, Bolstering the Market’s Nascent Recovery*, L.A. TIMES, May 22, 2003, at 1-17 (reporting that the Administration’s plan was criticized as skewing Internal Revenue Code and corporate behavior too far in favor of dividend payments and that some analysts feared that technology companies “might fail to retain enough earnings to fund long-term growth.” In response, the Treasury Department proposed allowing corporations to effectively give shareholders a capital-gain tax cut over time by increasing their stock basis by retained earnings, an approach that was criticized as “way too complicated”). For estimates of reductions in effective rates of high income individual taxpayers under the President’s dividend exclusion proposal see Samuel C. Thompson, Jr., *President’s Dividends Plan Undertaxes High-Income Taxpayers*, 98 TAX NOTES 389, 393-95 (2003). Note that the GAO estimated that the average individual effective income tax rate in 2004 of the top twenty percent was 14.2%. GAO, *supra* note 6, at 32 table 3. Given the fact that most of the income of the wealthiest one percent of taxpayers consists of capital gains and dividend income, their average effective income tax rate is probably lower than 14%. See *supra* notes 7, 15, and 17 and *infra* note 360.

206. Edmund L. Andrews, *Too Many Pennies from Heaven?* N. Y. TIMES, Feb. 16, 2003, at 3-15.

appearance that the tax cut package was tilted to the wealthy,²⁰⁷ but “officials said George W. Bush decided to end the tax to provide a greater boost to the economy.”²⁰⁸ Actually, the George W. Bush Administration was careful at first not to call the dividend tax cut package a stimulus proposal²⁰⁹ as many economists posited that the tax cut would not have the effect of increasing investment.²¹⁰ The Administration did maintain that increasing the value of the stock market would make the cost of capital cheaper to public corporations.²¹¹ Here too, most economists disagreed,²¹² and the future would prove them right—“[n]et equity issuance has stayed negative so far this year [first half of 2005], and share retirements have been boosted by considerable stock buy backs and cash-financed merger and acquisition activity.”²¹³ One would think that any cheaper cost of capital would have led to more public offerings.

207. Edmund L. Andrews, *White House Aides Push for 50% Cut in Dividend Taxes*, N. Y. TIMES, Dec. 25, 2002, at A1. The Administration also floated in December the idea of not covering top bracket individual taxpayers from a proposed acceleration of ordinary rate cuts for the same reason, but dropped that idea due to opposition of Senate Finance Chair Charles Grassley (R-Ia.) because he did not want small business owners to be taxed at a higher top marginal rate than large corporations. Jill Barshay & Alan K. Ota, *White House Must Keep Delicate Balance When Drafting Latest Tax Cut Package*, 61 CONG. Q. WKLY. 31 (2003).

208. Bob Kemper & Frank James, *Battle Begins on Rival Stimulus Plans; Democrats, GOP Argue over How to Boost Economy*, CHI. TRIB., Jan. 7, 2003, at N-1.

209. Dana Milbank, *Bush Outlines Economic Plan; \$674 Billion Package Would End Tax on Dividends, Accelerate Rate Cuts*, WASH. POST, Jan. 8, 2003, at A1; Linda Feldmann, *A Presidential Roadshow to Pitch the Tax Cut*, CHRISTIAN SCI. MONITOR, Apr. 25, 2003, at 1.

210. E.g., William G. Gale & Peter R. Orzag, *Deficits, Interest Rates, and the User Cost of Capital: A Reconsideration of the Effects of Tax Policy on Investment 1* (Discussion Paper No. 27, Brookings Institution, Aug. 19, 2005) [hereinafter *Deficits, Interest Rates, and Cost of Capital*] (indicating that traditional economic formulations hold that lower capital income tax rates reduce the user cost of capital and stimulate investment. But, when a reduction in taxes generates an increase in the budget deficit, the expanded deficit raises interest rates and the opportunity cost of investment as well as the user cost of capital), available at http://www.urban.org/UploadedPDF/311211_TPC_DiscussionPaper_27.pdf.

211. See Elisabeth Bumiller, *Bush and the Economy: Genesis of a Plan; Nurturing the Tax Cut Idea Since the Era of Reagan*, N.Y. TIMES, Jan. 7, 2003, at A16.

212. See *supra* note 211.

213. BOARD OF GOV. OF THE FED. RES. SYS., MONETARY POL'Y REP. TO THE CONG. 8 (July 20, 2005); BOARD OF GOV. OF THE FED. RES. SYS., MONETARY POL'Y REP. TO THE CONG. 7 (July 20, 2004) (“[N]et equity issuance has remained negative this year. Seasoned offerings have been scarce, the pace of initial public offerings has only inched up, and share retirements have continued to be strong”); BOARD OF GOV. OF THE FED. RES. SYS., MONETARY POL'Y REP. TO THE CONG. 9 (Feb. 11, 2004) (indicating that equity issuance perked up in the second half of 2003, but still “for the year as a whole, firms extinguished more equity than they issued.”); BOARD OF GOV. OF THE FED. RES. SYS., MONETARY POL'Y

The George W. Bush Administration asserted that the dividend tax cut was intended to restore confidence in the market²¹⁴ and please the “investor class,”²¹⁵ as well as affect long-term tax reform—“the first installment in a plan to overhaul the tax system from one that taxes income to one that taxes consumption.”²¹⁶ These justifications were more or less accurate, and, as discussed below, the true reasons for this tax cut.²¹⁷ The more frequent, but less than accurate, rationale for the 100% exclusion was the

REP. TO THE CONG. 9-11 (July 15, 2003) (stating that low interest rates and a stock market rise

are helping to hold down firms’ cost of capital; [however, net equity retirements in the first quarter of 2003 were probably a shade larger than in the fourth quarter of 2002, as the decline in gross new issuance more than offset lower gross retirements. Equity retirements from cash-financed mergers were a bit below their pace in the past two years, and share repurchases appear to be running somewhat slower as well).

My colleague, Jayne Barnard, informed me that some of the equity retirements may have reflected smaller firms going private to avoid the burdens of SEC registration, particularly in light of Sarbanes-Oxley. A quick survey of the recent literature confirms her insight as to the effect of Sarbanes-Oxley on smaller public firms. *E.g.*, Larry Cata Backer, *Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley*, 2004 MICH. ST. L. REV. 327 (2005); Andrew Skouvakis, Comment, *Exiting the Public Markets: A Difficult Choice for Small Public Companies Struggling with Sarbanes-Oxley*, 109 PENN ST. L. REV. 1279 (2005); Nathan Wilda, Comment, *David Pays for Goliath's Mistakes: The Costly Effect Sarbanes-Oxley Has on Small Companies*, 38 J. MARSHALL L. REV. 671 (2004).

214. Maura Reynolds, *The President's Economic Plan; Bush Offers Tax Cuts to Spur Growth; the President Unveils a \$674-billion Plan That He Says Will Stimulate Spending and the Stock Market. Critics Say Only the Rich Will Get Relief*, L.A. TIMES, Jan. 8, 2003, at A1 (reporting Bush’s claim that the tax cuts would “boost confidence in our markets.”); Edmund L. Andrews, *Bush and the Economy: the Overview; White House Aides Launch a Defense of Bush Tax Plan*, N.Y. TIMES, Jan. 7, 2003, at A1 (detailing the CBO’s report that Bush’s tax cut and spending plan would bring only a negligible stimulus to the economy).

215. Richard W. Stevenson, *Bush and the Economy: News Analysis; The Politics of Portfolios*, N.Y. TIMES, Jan. 7, 2003 A1; Editorial, *The Charles Schwab Tax Cut*, N.Y. TIMES, Jan. 7, 2003, at A18; Alan K. Ota, *Uncertain Future in Conference Awaits Bush Tax Cut Package*, 61 CONG. Q. WKLY. 935 (2003) (indicating that the Bush Administration told Republicans that elimination of dividends fit into the Administration’s strategy of appealing to the investor class and energizing GOP business allies).

216. Alan K. Ota, *Investor Class Flexes New Political Clout in Debate over Bush's Dividend Tax Cut*, 61 CONG. Q. WKLY. 248 (2003); Andrews, *supra* note 196; R.C. Longworth, *Ultimately, an Attempt at Major Tax Reform*, CHI. TRIB., Jan. 8, 2003, at N-1; Sam Zuckerman, *Critics Question Bush Stimulus Plan; Many Argue Proposals Favoring Rich Won't Help in Short Term*, S.F. CHRON., Jan. 8, 2004, at B-1; Mark Weisbrot, Opinion, *Will New Tax Cuts Help Revive America's Sluggish Economy? No; Real Purpose Is to Rewrite Tax Code, Not Jump-Start Stalled Economy*, SAN DIEGO UNION-TRIB., May 29, 2003, at B-7 (opining that the legislation was not designed to jump-start the economy, nor to help distressed families; its purpose was to rewrite the tax code so as to shift even more post-tax income to the richest individual taxpayers).

217. *See infra* Part III.

notion of the “unfairness” of taxing income twice: once as corporate income and once as individual income.²¹⁸ When the dividend cut proved difficult to sell to Congress, the Administration changed its story and asserted that the cut would generate jobs.²¹⁹ This too was problematical.²²⁰

218. Alan K. Ota, *Investor Class Flexes New Political Clout in Debate Over Bush's Dividend Tax Cut*, 61 CONG. Q. WKLY. 248 (2003) (indicating that a leading pollster predicted that the investor class will have divided loyalties depending on income and affiliation with other groups, and that the bull market of the 1990s helped treble growth of households with investors from nineteen percent in 1983); Bob Kemper, *Bush "Old Plan" for Economy; Tax Cuts, Jobless Aid Sought; 10-Year Package Totals \$674 billion*, CHI. TRIB., Jan. 8, 2003, at N-1; Edmund L. Andrews, *Bush Budget Plan Would Eliminate Tax on Dividends*, N.Y. TIMES, Jan. 6, 2003, at A1 (detailing budget proponents' claim that it is a distortion in the tax system to tax such income twice); Michael Kinsley, *Dubya's Dividend Delight*, WASH. POST, Jan. 17, 2003, at A23; Jill Barshay & Alan K. Ota, *White House Must Keep Delicate Balance When Drafting Latest Tax Cut Package*, 61 CONG. Q. WKLY. 31 (2003) (indicating that a Republican congressional aide advocated countering populist criticism with “corporate governance reform measure,” and that companies were hoarding cash which insiders used “for their own fun and bad deals”).

219. Julie Hirschfeld Davis, *GOP Hunts Billions to Offset Tax Cuts; Lawmakers Look for Ways to Pay for Bush Proposal*, BALTIMORE SUN, Apr. 29, 2003, at A1 (“Bush argues that another round of deep tax cuts would create jobs and spur enough growth to erase those deficits in the future, essentially paying for themselves.”); Allan Sloan, *For Bush, Cutting Taxes Is the Plan for All Seasons*, WASH. POST, Apr. 29, 2003, at E3; Janet Hook, *GOP Domestic Dispute Is On; With an Intraparty Split on Tax Cuts and the 2004 Elections on the Horizon, the Pressure Is on Bush to Get His House and Senate in Order*, L.A. TIMES, Apr. 27, 2003, at A30. Commentator Thomas Oliphant dismissed the tax-free dividends stock market player's issue as “at best inconsequential and at worst a serious threat to responsible fiscal and social policy.” He also indicated tha Bush did not even refer to it in relation to the poor economy. “Instead, his rhetoric uses cover like ‘jobs package’ or ‘growth package,’ ignoring the absence of evidence that his program would affect either. Above all, he shouts to the rafters that size matters, claiming that Congress must give him a ‘package’ of at least \$550 billion.” Thomas Oliphant, Opinion, *The Real Deal on Bush's Tax Cut Plan*, BOSTON GLOBE, Apr. 20, 2003, at D-11. The unemployment rate rose to six percent in April of 2003 in light of recent reports of persistent job losses. Janet Hook, *House OKs \$550-Billion Tax Cut Bill; The Measure Includes Key Elements of Bush's Initiative. Stage is Set for a Fight with the Senate*, L.A. TIMES, May 10, 2003, at A1 (“Bush and his GOP allies have put new emphasis on selling tax cuts as an engine of job creation. In the absence of such a message, a GOP pollster said voters' concern about the growing federal budget deficit threatens to undercut support for plan.”); Peter G. Gosselin, *News Analysis; “Jobs and Growth” Plan May Not Do Much for Either; Congressional Study Raises Doubts About Effectiveness of Bush's Tax-cutting Proposals*, L.A. TIMES, May 14, 2003, at A-23.

220. Jonathan Weisman, *Bush Offers New Argument for His Tax-Cut Proposal; President Says \$550 Billion Reduction Would Create More Jobs*, WASH. POST, Apr. 29, 2003, at A4 (indicating that the Council of Economic Advisers projected that the original Bush plan would create 510,000 new jobs in 2004, but, given that the economy was losing 92,000 jobs a month, net only 192,000 jobs; virtually all the jobs so “created” in 2004 would have happened anyway in 2005-07).

Many commentators and economists believed that eliminating double taxation of corporate earnings in and of itself was sound due to the distortions such taxation was thought to create:²²¹ (1) reliance on corporate debt (interest is deductible) rather than equity financing (dividends are not deductible);²²² (2) corporate retention of earnings in cash (and perhaps

221. A few commentators criticized the fundamental assumption of double taxation of dividends. The effective rate of federal income taxation of public corporations is often stated to be fifteen percent of income. George K. Yin, *How Much Tax Do Large Public Corporations Pay?: Estimating the Effective Tax Rates of the S&P 500*, 89 VA. L. REV. 1793, 1794 n.6 and 1797 (2003) (estimating that the average effective income tax rate on world-wide income on S&P 500 corporations fell from 28.5% in 1995 to 24.20% in 2000, with great variation between industry sectors). Furthermore, only one half of dividends are subject to taxation due to the overwhelming ownership of public corporations by owners not subject to taxation on dividends, e.g., tax-exempt owners (retirement plan and charities), foreigners, and other corporations. *Paying Dividends: How the President's Tax Plan Will Benefit Individual Investors and Strengthen the Capital Markets, Hearing Before the House Committee on Financial Services Subcommittee on Oversight and Investigations*, March 18, 2003 (Testimony of Peter R. Orszag), available at <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=190>; Reuven S. Avi-Yonah & David S. Miller, Opinion, *A Tax Plan That Will Pay Few Dividends*, WASH. POST, Jan. 12, 2003, at B-2; Lee, *Critique*, *supra* note 6, at 84; Tom Petrino & Josh Friedman, *Wall St. Expected to Hail Investment Tax Cuts; Though Less Than Expected, the Reductions Could Make Stocks More Appealing, Bolstering the Market's Nascent Recovery*, L.A. TIMES, May 22, 2003, at A17 ("Although investors who own stocks in tax-deferred retirement accounts would not benefit directly from a tax cut, over time they would gain if the tax plan lifts stock prices."). Professor Kwall has made a case against elimination of double taxation to the extent it does exist. Jeffrey L. Kwall, *The Uncertain Case Against the Double Taxation of Corporate Income*, 68 N.C.L. REV. 613 (1990) (questioning the prudence of eliminating the double taxation of distributed corporate income because it may jeopardize recent tax reforms aimed at improving the efficiency and equity of our tax system); Lee, *Entity Classification and Integration*, *supra* note 7, at 100-03 (describing rough justice in partially offsetting vertical and horizontal inequities as to high income individual owners) and 97 n.152 (viewing at least for teaching purposes (pre-9-11) corporate tax as an appropriate user fee because large public corporations exploit foreign markets and therefore rely on the country's (expensive) military might in order to ensure stability in those markets).

222. Tom Saler, *Zero Tax for Dividends Puts Emphasis on Cash; Historical Perspectives; Zero Tax for Dividends Puts Emphasis on Cash, Not Promises; Federal Attention Shows Increasing Importance of Wall Street to America*, MILWAUKEE J. SENTINEL, Jan. 18, 2003, at D-2 (describing how new debt was used to expand productive capacity beyond all reason, restraining business investment); *Federal Reserve Board's Semiannual Monetary Policy Report to the Congress: Hearing Before the Sen. Comm. on Banking, Housing, and Urban Affairs*, March 7, 2002 (statement of Alan Greenspan, Chairman, Fed. Reserve Bd. Of Governors)

([E]xpenditures on computers rose at a double-digit annual rate in real terms last quarter. But investment expenditures in the communications sector, where the amount of over capacity was substantial, as yet show few signs of turning up, and

making unwise investments or encouraging empire building by corporate management); (3) skewing of the market toward stock in growth corporations retaining earnings rather than steady earners paying dividends; and (4) by discouraging pay outs requiring cash profits, encouraging “financial funny business that only looks good on paper.”²²³ The consensus, however, was that the better way of addressing these problems was a corporate level deduction for dividends in parity with deduction of interest.²²⁴

Most economists agreed that an individual shareholder level dividend tax cut would improve the stock market, but were skeptical that it would do much to increase business investment or consumer spending in the short term.²²⁵ Dividend exclusion proposals, of course, faced Democratic

business investment in some other sectors, such as aircraft, hit by the drop in air travel, will presumably remain weak this year.),
available at <http://www.federalreserve.gov/boarddocs/hh/2002/march/testimony.htm>.

223. Virginia Postrel, *Tax Policy Is Not Just an Economic Tool. It's Also a Partisan Weapon*, N.Y. TIMES, Jan. 1, 2003, at C-2.

224. *Id.* Commentators noted that a capital gains rate cut from twenty percent to fifteen percent was highly unlikely to provide a stimulus. JOEL FRIEDMAN, ET AL, CENTER ON BUDGET AND POLICY PRIORITIES, WOULD A CAPITAL GAINS TAX CUT STIMULATE THE ECONOMY? 1 (2001), available at <http://www.cbpp.org/9-20-01tax.pdf>

([A]dvocates of a capital gains tax cut have not traditionally claimed it has a stimulus effect. In the past, they have argued that it would provide long-term, rather than short-term, benefits for the economy. Even these long-run benefit arguments are weak. The Congressional Budget Office and other respected analysts have found that a capital gains tax cut would have very little impact on economic growth.).

Others believed that the Bush Administration did not choose the better way to end “double taxation” (corporate deduction for dividend payments) because the tax cost for such a deduction is far greater than the cost of an individual preference since less than one half of public stock is held by individuals (taxing tax-exempt shareholders on the receipt of dividends deductible by the distributing corporation or barring a deduction if the recipient shareholder was tax-exempt or functionally tax exempt generally was not considered). Also, in the wake of accounting scandals, cutting corporate taxes became politically more dangerous than cutting taxes on the wealthy. Jill Barshay & Alan K. Ota, *White House Must Keep Delicate Balance When Drafting Latest Tax Cut Package*, 61 CONG. Q. WKLY. 31 (2003); Richard W. Stevenson, *Bush and the Economy: News Analysis; The Politics of Portfolios*, N.Y. TIMES, Jan. 7, 2003, at A1 (“[C]ritics even question the existence of a so-called investor class as anything other than an excuse for Republicans to cut taxes again for the wealthy.”).

225. Edmund L. Andrews, *Bush Budget Plan Would Eliminate Tax on Dividends*, N.Y. TIMES, Jan. 6, 2003, at A1; Janet Hook & Lynn Marshall, *For Many, Tax Cut Windfall Will Be Socked Away; Bush's Hope That People Will Spend the Extra Cash to Give a Bounce to the Sagging Economy May Fall Victim to Tight Fiscal Times, Analysts Say*, L.A. TIMES, May 26, 2003, at A21 (indicating that in the past more taxpayers used tax windfalls to pay

opposition due to their distributional effects,²²⁶ but also Republican opposition on the grounds that a dividend exclusion would undermine tax credits intended to “encourage business investment in such pet causes as alternative energy and low-income housing,” as well as corporate investments.²²⁷

With twenty-five percent unused industrial capacity,²²⁸ a proposal for additional capital expenditures was probably misdirected,²²⁹ and arguably

off debt or increase savings rather than for new consumer spending; only twenty-five percent of those surveyed said they spent the rebate they received under Bush’s 2001 tax cut); Peter G. Gosselin, *Modest Jolt in Economy Seen From Tax Cut; People Will Have More Cash to Spend, Analysts Say, but the Package’s “Sunset” Provisions Prevent Long-term, Sustained Growth*, L.A. TIMES, May 25, 2003, at A17 (noting that independent economists, even if sympathetic to more tax cuts, doubt that cuts of the size in final bill will be enough to get the economy out of its torpor). “They’ll have some positive effect in the short run, but not much. . . . Most doubt surrounding the economic effect of the tax cut package centers on its sunset provisions.” *Id.*

226. 149 CONG. REC. S5747 (daily ed. May 6, 2003) (statement of Sen. Conrad)

(The House Ways and Means committee plans to take up a tax plan that makes President Bush’s look like a model of budget honesty, fiscal probity, and distributional fairness. The plan concocted by Chairman Bill Thomas junks the president’s proposal to end taxes on dividends in favor of a proposal to cut the top rate on both dividends and capital gains to 15 percent. The Thomas plan is more straightforward than the administration’s complicated proposal but has not much else to recommend it. First, it is tilted even more heavily to the very wealthy. An analysis by the Urban Institute-Brookings Tax Policy Center shows that households with annual incomes of more than \$1 million would see their taxes drop an average of \$42,800 under the Thomas capital gains-dividend cut, compared with \$26,800 under the Bush dividend plan. Taking the two plans as a whole, those households would receive an average tax cut in 2003 of \$105,600 under the Thomas plan and \$89,500 under the Bush plan.)

227. Alan K. Ota, *Bush Encounters Ill-Wind from Republicans on Dividend Tax Cut*, 61 CONG. Q. WKLY. 335 (2003). Corporate opposition to corporate-shareholder integration sank President Jimmy Carter’s integration proposals. Lee, *Entity Classification and Integration*, *supra* note 7, at 70.

228. Federal Reserve Statistical Release G.17, *Industrial Production and Capacity Utilization, 2002 Historical and Annual Revision* (Dec. 5, 2002)

([T]he rate of industrial capacity utilization in the third quarter of 2002, at 76.2 percent, is essentially unchanged from previously reported data (table 7). The rate was more than 5 percentage points below its 1972-2001 average and about 3 percentage points below the low in the 1990-91 recession, but 5 percentage points above the trough in the 1982 recession.)

available at http://www.federalreserve.gov/Releases/G17/Revisions/20021205/default_rev.htm. In 2005, there was still only 78.4% industrial capacity utilization, up from 77.9% at the end of 2004. *Monetary Policy Report to Congress*, Fed. Reserve Bull. (Fed. Reserve Bd., Washington, D.C.), July 2005, at 3, available at <http://www.federalreserve.gov/boarddocs/hh/2005/july/fullreport.pdf>.

unlikely to increase employment in any case.²³⁰ More important to the George W. Bush Administration was the strategy of reversing the three-year decline in the stock market since 2000.²³¹ Also reportedly important

229. Peter Orszag, *The Administration's Economic "Stimulus" Proposals, Testimony Before the Democratic Policy Committee*, 3 (Jan. 22, 2003), available at <http://www.brookings.edu/views/testimony/orszag/20030121.pdf>; Robert B. Reich, *Bush Proves He's an Upper-Class Act; Under His Tax Plan, the Only Winners Are the Economic Elite*, L.A. TIMES, Jan. 7, 2003, at B-12

(The president's plan responds to the nation's two overarching economic problems—overcapacity and widening inequality—by worsening both. It's a remarkable achievement, made all the more remarkable by the utter cynicism with which it's being marketed. It's not a plan for 'growth and jobs.' It's a plan for rewarding the rich when what the economy needs is more spending by people of modest means. And it further concentrates wealth and power at a time when wealth and power are already in fewer and fewer hands.);

George Hager, *Recovery Not Likely to Be Robust*, USA TODAY, Dec. 10, 2001, at B-1 (indicating that 74.6% of industrial capacity utilization was the lowest figure in more than eighteen years); Steven Pearlstein, *Impasse on Stimulus Could Deepen Downturn*, WASH. POST, Nov. 8, 2001, at E-1 (stating that business tax cuts were unlikely to persuade businesses to make additional investments in plants and equipment if sales are falling and businesses already have more productive capacity than they can profitably use).

230. Tom Petruno, *On Wall St., Economy Returns to Center Stage*, L.A. TIMES, Apr. 13, 2003, at 3-1. (showing that seventy-three percent of CEO's were expected to maintain or increase capital expenditures within six months, but only nine percent planned more hiring in the next six months); Alan B. Krueger, *As Recovery Builds, the Less Educated Go to the End of the Employment Line*, N.Y. TIMES, Mar. 7, 2002, at C-2. In times of recession firms tend to restructure, which in turn tends to increase demand for skilled workers, who are more flexible. Meanwhile, when companies introduce new technology, they tend to hire skilled workers to operate the equipment and release unskilled workers whose skills become obsolete. *Id.*

231. Roland Watson, *Bush Gambles His Future on Stock Market Revival*, TIMES (London), Jan. 8, 2003, at 13 (proposed abolition of dividend taxes showed Bush pinning his re-election hopes on a stock market recovery rather than any other economic indicator); Mike Allen & Dana Milbank, *President to Seek Dividend Tax Cut; Stimulus Plan's 10-Year Cost Put at \$300 Billion*, WASH. POST, Jan 3, 2003, at A1 (recounting the argument that eliminating the taxation on dividends might help restore investor confidence and encourage investments in profitable companies); Elisabeth Bumiller, *Bush and the Economy: Genesis of a Plan; Nurturing the Tax Cut Idea Since the Era of Reagan*, N.Y. TIMES, Jan. 7, 2003, at A16 (reporting a conservative lobbying group's claim of "virtual unanimous agreement that reducing the tax on dividends would provide the most help for the stock market in the shortest period of time"); 149 CONG. REC. S15922 (daily ed. Nov. 25, 2003) (statement of Sen. Santorum) ("As a result of that tax reduction, which in part was reducing capital gains tax, but also reducing the double taxation of dividends, it has caused a \$2 trillion increase . . . in valuations of equities in this country. That is an enormous turnaround."); 149 CONG. REC. S6958 (daily ed. May 22, 2003) (statement of Sen. Finance Committee Chair Grassley)

(A major cause of the sluggish economy is the bursting of the stock market bubble created in the 1990s. This bill will address the ailing stock market. It will help create jobs. It will grow the economy. It will put money back into the hands of

to President George W. Bush was giving the impression that he cared about the economy and jobs.²³² He continued to push, however, for the dividend tax cut notwithstanding its unpopularity in the polls.²³³

In March of 2003, President George W. Bush formally proposed a tax cut of \$726 billion over 10 years, with more than one half attributable to the proposed elimination of the tax on dividends.²³⁴ In the early stages of the proposal, the Administration also proposed making the 2001 Act cut permanent.²³⁵ The Administration's firm Republican support in the House and Senate for the entire cut began to erode with its request in late March

families, consumers, investors, and businesses that will help fuel our economic engines that create those jobs that we hope will be created from this legislation.); 149 CONG. REC. S6961 (statement of Sen. Nickles) (arguing that the bill would help the stock market).

232. Edwin Chen, *Bush Turns His Attention to Ailing Economy; The Administration Plans a Big Push for His Agenda to Try to Prevent the Political Fate That Befell His Father After the Persian Gulf War*, L.A. TIMES, Apr. 20, 2003, at A26; Judy Keen, *Politics Behind Bush's Tax Reversal*, USA TODAY, May 23, 2003, at A13 ("Bush can boast to voters that he has twice fought for and won substantial tax cuts.").

233. Fifty percent of poll respondents supported and thirty-eight percent opposed the proposed tax cuts, but when "tax cuts are stacked against alternative national priorities, they score low on the list, after items such as healthcare and education." A plurality believed "Congress should not pass President Bush's tax cut plan because the federal budget is now in deficit and the costs of the war are unknown." Linda Feldmann, *A Presidential Roadshow to Pitch the Tax Cut*, CHRISTIAN SCI. MONITOR, Apr. 25, 2003, at 1. See also David L. Greene & Julie Hirschfeld Davis, *Bush Retreats on Tax-cut Proposal; With Congress Resisting, He Says He'd Accept a \$550 Billion Package*, BALTIMORE SUN, Apr. 16, 2003, at A3 ("[Seventy percent of respondents] approve of the way the younger Bush is handling his job as president, fewer than half say they approve of his management of the economy. And a majority of those surveyed say they don't think now is the time for new tax cuts."); Bob Kemper, *Bush Launching Tax-cut Blitz; Sagging Economy Becomes New War*, CHI. TRIB., Apr. 15, 2003, at C-11 (reporting Gallup poll results showing that most believe their taxes are "fair" while sixty percent believe richest taxpayers pay "too little"); Jim VandeHei, *Bush's Domestic Agenda Suffers Hill Setbacks; Actions on Tax Cut, Oil Drilling in Alaska, Faith-Based Initiative Reflect Problems*, WASH. POST, Mar. 30, 2003, at A5 (showing that sixty-five percent of poll respondents "favor cutting Bush's tax cut in half to pay for the war, shore up Social Security and shrink the deficit"). Another report indicated that public opinion represents a thicket of contradictions on taxes. Both parties privately mistrust some of what the polls reveal, but acknowledge that the public draws little connection between the kinds of tax cuts Bush supported and direct improvement in the economy. Polls show fifty-seven percent believe strengthening the economy should be at top of the president's agenda; five percent favor passing tax cuts; sixty-four percent suggest there are better ways to improve the economy than by cutting taxes. Dan Balz, *Bush's Fortunes Tied to Economy's*, WASH. POST, May 24, 2003, at A7.

234. Jim VandeHei, *GOP Liberals Are Key to Tax Cut; Fate of Bush Proposal Depends on Votes of a Few Senators*, WASH. POST, Mar. 27, 2003, at A3.

235. Alan K. Ota, *Duration of Tax Cuts, Budget has GOP on Horns of a Dilemma*, 61 CONG. Q. WKLY. 499, 500 (Mar. 1, 2003).

for an additional \$75 billion to fund military operations.²³⁶ The possibility of an invasion of Iraq increased fears of a rapidly growing deficit.²³⁷

4. Parity of Capital Gains and Dividends Ploy

The House limited its tax cut to \$529 billion over ten years; the Senate leadership, to \$350 billion.²³⁸ Neither Chamber supported the Administration's proposed significant increase in individual tax savings proposals (another backdoor consumption tax ploy).²³⁹ Bush criticized the \$350 billion tax cut as "little bitty."²⁴⁰ Under a \$350 billion ceiling, a full individual dividend exclusion, with revenue losses for the budget window estimated at around \$364,²⁴¹ would have ruled out all other tax cuts.²⁴²

236. Jim VandeHei, *supra* note 234; Jill Barshay, *GOP Tax Cutters Stumble Out of the Gate, Bloated Military Bill Pulled from House Floor*, 61 CONG. Q. WKLY. 560 (2003).

237. Alan K. Ota, *Tax Cut Agendas Compete in Senate as War Clouds Breed Deficit Fears*, 61 CONG. Q. WKLY. 610, 614 (2003).

238. Alan K. Ota, *GOP Leaders Seek the Magic Number: A Survivable Tax Cut Compromise*, 61 CONG. Q. WKLY. (2003) (indicating that the \$350 billion number was necessary to obtain the approval of two centrist Republican senators); Jim VandeHei, *supra* note 234

([A]lthough Bush enjoys solid support for his tax cut from ninety-five percent of House and Senate Republicans, regardless of the pace of the war and the size of projected deficits, the ever-shrinking Rockefeller wing of the party is still large enough—and concerned enough—to join Democrats and slice it in half. . . . The Senate, under pressure from these members, yesterday passed a budget resolution calling for \$350 billion in tax cuts over 10 years.);

Jill Zuckman, *GOP Leaders Can't Get on Same Page; Disputes Erupt in Congress over Domestic Agenda*, CHI. TRIB., Apr. 22, 2003, at C-10 ("Senate Finance Committee Chairman Charles Grassley (R-Ia.), eager to win the support of moderates for a broad budget plan, promised Sens. Olympia Snowe (R-Maine) and George Voinovich (R-Ohio) he would limit the package to \$350 billion. Frist approved the deal . . .").

239. Jim VandeHei, *supra* note 234.

240. Edwin Chen & Janet Hook, *Bush Launches Tax Cut Offensive; The Least He'll Accept is \$550 Billion, President Says in a Challenge to His GOP Congressional Critics, Who He Says "Have Some Explaining to Do,"* L.A. TIMES, Apr. 25, 2003, at 1-1 ("If they agree that tax relief creates jobs, then why are they for a little-bitty tax relief package?"); Jill Barshay, *For Bush, Tax Cut Package is Next Must-Win Battle*, 61 CONG. Q. WKLY. 974 (2003).

241. Jim VandeHei, *supra* note 234.

242. Alan K. Ota, *Tax Cut Agendas Compete in Senate as War Clouds Breed Deficit Fears*, *supra* note 237, at 614.

The George W. Bush Administration then floated the idea of phasing in the dividend exclusion over ten years,²⁴³ which most proponents of a dividend exclusion for individuals opposed as tending to delay payments of dividends until shareholders would get the better deal.²⁴⁴ Commentators speculated that the Administration's proposal was an opening bid in a negotiating strategy, which it denied,²⁴⁵ though subsequent events revealed that likely was the case. The Senate's proposal, while providing a full exclusion (for one year), was especially gimmicky with yo-yo effective dates in addition to phase-ins.²⁴⁶

243. Jill Zuckman, *GOP Leaders Can't Get on Same Page; Disputes Erupt in Congress over Domestic Agenda*, CHI. TRIB., Apr. 22, 2003, at C-10 (revealing that another option considered by the White House was to implement half of the cuts immediately and the rest over a decade); Jonathan Weisman, *White House Eases Stand on Dividend Tax; Cut Could Be Phased In Gradually to Win Passage*, WASH. POST, Apr. 22, 2003, at E-1.

244. Jonathan Weisman, *In House, Fight Brews over Bush Tax Plan; Ways and Means Panel Targets President's Centerpiece—Dividend Cut—for Overhaul*, WASH. POST, Apr. 27, 2003, at A5.

245. Jonathan Weisman & Mike Allen, *Bush Will Propose Larger Stimulus; \$674 Billion Initiative Accelerates Tax Cuts*, WASH. POST, Jan. 7, 2003, at A1; Dana Milbank, *Bush Outlines Economic Plan; \$674 Billion Package Would End Tax on Dividends, Accelerate Rate Cuts*, WASH. POST, Jan. 8, 2003, at A1; Janet Hook, *Many Lawmakers Feel Bush Growth Package Needs Overhaul; Democrats Are Cold to the Plan and Even GOP Senators Signal That Its Success Isn't Assured*, L.A. TIMES, Jan. 9, 2003, at 1-1; Dana Milbank & Jim VandeHei, *Key GOP Senators Object to Bush Plan; President Has Difficult Sell on Tax Package*, WASH. POST, Jan. 11, 2003, at A1.

246. Individual taxpayers could exclude \$500 in dividends. In the first four to five years, ten percent above that amount would also qualify, rising to twenty percent in later years. The cost due to scattered effective dates was only \$81 billion, less than Administration and House proposals. Dan Morgan, *GOP Senators Reach Tax Cut Pact; Finance Committee Would Limit Relief on Stock Dividends*, WASH. POST, May 8, 2003, at A2. See also 149 CONG. REC. S7085 (daily ed. June 2, 2003) (statement of Sen. Baucus)

(The conferees have designed a tax cut that is one big yo-yo. Now you see it, now you don't. Child credit is increased for 2003 and 2004. Then it is taken away. Part of the marriage penalty is eliminated for 2003 and 2004, and then the penalty comes back. The 10-percent tax bracket is expanded for 2003. Then it reverts back. Even the dividend tax cut disappears after 2008. If accounting gimmicks and financial statement manipulations were intolerable for corporate America, then why not for the Congress?);

149 CONG. REC. H4707 (statement of Rep. Frost) ("[M]ajority leader, the gentleman from Texas (Mr. DeLay), was in the newspapers bragging about how easy it is to fudge the numbers to make their tax plan look less expensive than it really is."); Editorial, *Yo-Yo Economics*, WASH. POST, May 23 2003, at A24

(Nine of the 10 tax cuts in the package are set to expire before 2013, most after just two—that's right, two—years. The point is to make the 10-year projections look affordable, and never mind the irrationality. 'A whole basket of yo-yos,' as the Senate Finance Committee's ranking Democrat, Max Baucus (Mont.), said

House Ways & Means Chair Bill Thomas (R-Cal.) came up with the winning idea: tax individual capital gains and dividends at the same rate, fifteen percent for all but the lowest bracket taxpayers who would be taxed at 5 percent,²⁴⁷ as “a better stimulus to the economy than trying to eliminate dividend taxes.”²⁴⁸ Unlike the partisan 2001 Act largely following President George W. Bush’s proposals, Chair Thomas was forced to opt for a strategy of compromise, much like President Bill Clinton in 1997, in order to meet the Senate’s \$350 billion ceiling on tax cuts.²⁴⁹ President George W. Bush first favored the Senate approach because it “embraced the principle of repeal,” but then switched to the House approach since it could meet the \$350 billion Senate budget ceiling on tax cuts once the sunsets were advanced, thus shortening the periods the cuts would be in

yesterday. Congress has resorted to this sort of trickery before, but never on such an audacious scale.)

Such trickery is discussed in a work-in-progress: *Selling of Bush II Income Tax Cuts*.

247. Stephen J. Norton, *Bush Determined Not to Repeat Father’s Politically Fatal Errors*, 61 CONG. Q. WKLY. 976 (2003) (indicating that Thomas proposed eight percent (lower income taxpayer’s) and eighteen percent for both capital gains and dividends); Jonathan Weisman, *In House, Fight Brews over Bush Tax Plan; Ways and Means Panel Targets President’s Centerpiece—Dividend Cut—for Overhaul*, WASH. POST, Apr. 27, 2003, at A5 (indicating that Thomas originally proposed an eighteen percent dividend tax rate, cutting the top individual rate on dividends almost in half); Jonathan Weisman, *Simpler Tax Cut Is Floated; House Leaders Offer Uniform Rate on Dividends, Capital Gains*, WASH. POST, May 1, 2003, at A4 (indicating that Thomas’s draft proposal would increase (1) the \$600 child credit to \$1,000 but for as little as one year; (2) increase the amount of investments that small businesses could write off to \$75,000 from the current \$25,000, but again only a year or two; and (3) immediately eliminate the marriage penalty, but only temporarily. Bush’s corresponding proposals would have been permanent. Thomas’s plan did include Bush’s immediate cut in income tax rates to levels previously scheduled to take effect in 2006.). This simplified the Code as to capital gains by eliminating the eighteen percent after five-year holding period. 149 CONG. REC S7072 (daily ed. May 23, 2003) (statement of Chair Grassley). At an earlier stage, Chair Grassley had floated a proposal to provide a fifty percent rate cut for both dividends and capital gains. Alan K. Ota & Jill Barshay, *Bush’s Dividend Plan at Center Stage as Tax Cut Negotiations Begin*, 61 CONG. Q. WKLY. 668, 669 (2003). See also Alan K. Ota, *GOP Leaders Seek the Magic Number: A Survivable Tax Cut Compromise*, 61 CONG. Q. WKLY. 812 (2003).

248. Jonathan Weisman, *In House, Fight Brews Over Bush Tax Plan; Ways and Means Panel Targets President’s Centerpiece—Dividend Cut—for Overhaul*, WASH. POST, Apr. 27, 2003, at A5 (indicating that foregone revenue would “cost the Treasury considerably less through 2013: about \$234 billion, compared with Bush’s \$396 billion.”); Jonathan Weisman, *White House Eases Stand on Dividend Tax; Cut Could Be Phased In Gradually to Win Passage*, WASH. POST, Apr. 22, 2003, at E-1.

249 Alan K. Ota, *Deadlocked Tax Cut Proposals Expose Rift in GOP Ideology*, 61 CONG. Q. WKLY. 1029 (2003).

effect.²⁵⁰ This greatly angered Senate Finance Chair Grassley, who felt undercut by President George W. Bush.²⁵¹

The Jobs and Growth Tax Relief Reconciliation Act of 2003²⁵² cut dividend and capital gains to fifteen percent (five percent and zero percent in 2008 for taxpayers in the fifteen percent and below bracket), a rate not

250. Janet Hook, *House, Senate Reach a Deal on Tax Cuts; GOP Negotiators Back a \$350-billion Plan to Slash Dividend and Capital Gain Levies While Aiding States. Bush Could Get the Bill This Week*, L.A. TIMES, May 22, 2003, at A1; Jonathan Weisman, *White House Bends on Tax Cut; House GOP Compromise Gets Administration's Support*, WASH. POST, May 2, 2003, at A4; Carolyn Lochhead, *Bakersfield Republican Has Winning Tax Plan; Bush, Senate Outfoxed with Compromise*, S.F. CHRON., May 22, 2003, at A3 (House plan far more popular among rank-and-file Republicans); Jonathan Weisman, *Bush Backs House Version of Tax Cut; Plan Seeks to Cut Rate on Dividends to 15%*, WASH. POST, May 21, 2003, at E1; Janet Hook, *Congress OKs \$350-Billion Tax Cut Bill; If Its Many Temporary Provisions Are Made Permanent, the Bill Could Provide a Bigger Cut Than Bush Sought—Up to \$1 trillion*, L.A. TIMES, May 24, 2003, at A15; David E. Rosenbaum, *A Tax Cut Without End*, N.Y. TIMES, May 23, 2003, at A1; Dana Milbank & Jim VandeHei, *Bush Retreat Eased Bill's Advance*, WASH. POST, May 23, 2003, at A5. At the last minute the Conference omitted child tax credits for the working poor. 149 CONG. REC S7453 (daily ed. Jun. 5, 2003) (statement of Sen. Rockefeller); 149 CONG. REC H4845 (daily ed. Jun. 3, 2003) (statement of Rep. Brown). A subsequent act added them back. See Janet Hook, *A Push to Revive Child Tax Aid for Poor; Amid Criticism, 2 GOP Bills Now Seek to Give Refunds to Low-income Families, Benefits That Had Been Dropped From the Tax Cut Law*, L.A. TIMES, June 3, 2003, at A14 (indicating that the bills provide child tax credit refunds to 6.5 million families earning between roughly \$10,500 and \$26,625 a year, for whom refunds were quietly dropped from the tax cut measure as part of final congressional jockeying to keep its total cost at \$350 billion); Paul Krugman, *Opinion, Duped And Betrayed*, N.Y. TIMES, Jun. 6, 2003, at A33 (“As in 2001, the administration softened the profile of a tax cut mainly aimed at the wealthy by including a credit for families with children.”).

251. Grassley came away from a meeting with Thomas, House and Senate leaders and President Bush

convinced the final bill would feature a limited version of Bush's plan to make dividends tax-free. And he reacted angrily when Thomas and the White House agreed the following day to drop the dividend plan in favor of a variation on the House's approach. Thomas, a former political science professor, explained to Bush that while the Senate bill stayed true to the president's vision, 'the structure didn't make sense.' The tax break would end too soon, and it would fail to require companies to pay income taxes before distributing dividends tax-free. That last oversight would do more than end double taxation of corporate profits—Bush's goal—it would allow them to be tax-free altogether. Worse still, Thomas informed the president, Senate rules would forbid inserting a new provision in conference to fix the problem.

Alan K. Ota, *Tax Cut Package Clears Amid Bicameral Rancor*, 61 CONG. Q. WKLY. 1245 (2003). See also Jill Barshay, *A Rough but Steady Hand at Helm of Ways and Means*, 61 CONG. Q. WKLY. 1668, 1669 (2003) (indicating that Thomas misstated Senate rules).

252. Pub. L. No. 108-27, 117 Stat. 252.

seen for capital gains since 1941 under the 1939 Code.²⁵³ These capital gains/dividend rate cuts provided an extremely disproportionate benefit to top income taxpayers²⁵⁴ which, unlike the 2001 cut, was not deferred. At the same time, the 2003 Act adopted a number of tax cuts which also disproportionately benefited the top income taxpayers: accelerating the effective date of the 2001 Act rate reductions by putting into effect for all tax years after 2002 and before 2011 the twenty-five percent, twenty-eight percent, thirty-three percent, and thirty-five percent brackets originally scheduled to take effect in 2006; and *temporarily* increasing cuts targeted at middle and lower income taxpayers: (a) the standard deduction and the upper limit of the fifteen percent regular income tax rate bracket for married taxpayers filing joint returns to twice the upper limit of the fifteen percent regular income tax rate bracket for single taxpayers taxable years beginning in 2003 and 2004; and (b) the upper limit of the ten percent rate bracket from \$6000 to \$7000 for single taxpayers and from \$12,000 to \$14,000 for married taxpayers filing joint returns (indexed for inflation in 2004), previously scheduled to take effect in 2008, effective in 2003 and 2004. The reduction to thirty-five percent at the top was almost twice as great a reduction as the reduction of the three lower brackets—“[f]or the middle three income brackets . . . rates would drop by two percentage points, but the top rate will fall by 3.6 percentage points.”²⁵⁵ The top one

253. Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 13, 21.

254. *See supra* note 15.

255. 149 CONG. REC. S7079 (daily ed. Jun. 2, 2003) (statement of Sen. Leahy); 149 CONG. REC. at S7072 (statement of Sen. Dayton)

(It uses every trick in the budget book to line the pockets of the upper class. It cuts the top tax rates immediately, retroactively, and permanently. It lowers the top rate by almost twice as much as the next three. That gives the most rate reduction to people who are making over \$370,000 a year, only half of that rate reduction to people making over \$150,000 a year, and no rate reduction at all to people in the bottom two brackets—the 10 and 15 percent rates. There is just a tweaking of the bottom 10-percent bracket, which provides \$100 a year to couples and \$50 a year to individuals. That is also the only change to a tax bracket which is temporary. The top rate cuts are all permanent.).

percent was projected to garner sixty-four percent of the benefits of the 2003 Act tax cuts in 2005.²⁵⁶

These 2003 rate accelerations forced “the Democrats toward a stark choice they had hoped to avoid: either accepting the Bush cuts or explicitly proposing to increase taxes.²⁵⁷ The first option would leave them with little money to fund the initiatives they [were] proposing; the second would

256. McMahon, *supra* note 7, at 1063. The distribution of dividends is as follows:

Income	Share of all returns	Share of returns with dividends	Share of all dividend amounts	Average dividend for those with dividends
Under \$50,000	71.8%	16.8%	18.5%	\$796
\$50,000 to \$100,000	19.8%	41.5%	18.5%	\$1,428
\$100,000 to \$1,000,000	8.2%	71.9%	41.8%	\$4,511
Over \$1,000,000	0.2%	96.3%	21.2%	\$75,463
All Returns	100.0%	26.4%	100.0%	\$2,411

JOEL FRIEDMAN & ROBERT GREENSTEIN, CENTER ON BUDGET AND POLICY PRIORITIES, EXEMPTING CORPORATE DIVIDENDS FROM INDIVIDUAL INCOME TAXES 21 (2003), available at <http://www.cbpp.org/1-6-03tax.pdf>; Leonard E. Burman & David Gunter, *17 Percent of Families Have Stock Dividends*, 99 TAX NOTES 1261 (2003) (2000 data)

(3.8 percent of families with income above \$200,000 received 47 percent of all dividends, and families with incomes over \$100,000 accounted for 72 percent. Similarly, households with large amounts of dividends accounted for most dividends. The 0.7 percent of households with dividends larger than \$25,000 accounted for about half of all dividends. . . . 42 percent of total reported ‘dividends’ in 2000 were actually interest paid through mutual funds.);

see also Robert B. Reich, Opinion, *Bush Proves He’s an Upper-Class Act; Under His Tax Plan, the Only Winners Are the Economic Elite*, L.A. TIMES, Jan. 7, 2003, at 213; Mike Meyers, *Bush’s Tax Cuts Split Economists; Consequences Difficult to Gauge*, STAR TRIB. (Minneapolis), Jan 7, 2003, at D-1. Due to their higher ordinary income brackets, more than half of the tax benefit of eliminating dividend taxes would flow to the top five percent of taxpayers. Edmund L. Andrews, *Bush Budget Plan Would Eliminate Tax on Dividends*, N.Y. TIMES, Jan. 6, 2003, at A1. The final provision of a fifteen percent rate on dividends (and capital gains) similarly benefited the high income taxpayers disproportionately. Jonathan Weisman, *Bush Blunts “Fairness Question” on Taxes; President’s “Class Warfare” Rhetoric Brings Support for Cuts Skewed to the Wealthy*, WASH. POST, May 13, 2003, at A6 (“About 80 percent of dividend income goes to higher-income households.”).

257. Mark Z. Barabak, *Once Again, Democrats Take On Tax Issue; Presidential Candidates See the Debate As One of Choices. However, 20 Years Ago, They Flamed out in a Similar Attack on a Popular President*, L.A. TIMES, June 25, 2003, at A12 (“The key—and it is tricky, party strategists acknowledge—is turning the tax debate into a discussion of fairness and making voters feel the pain that Democrats anticipate from a downsized federal government.”).

increase their vulnerability to GOP charges of reverting to tax-and-spend economics.”²⁵⁸

Commentators disagreed as to the potential economic effects of the Bush 2003 treatment of dividends paid to individuals as capital gains.²⁵⁹ Many predicted that the cut would boost the appeal of dividend-paying stocks compared with interest-paying investments, thereby lifting the stock market overall.²⁶⁰ Furthermore, the cut was expected to force corporate managers to think more about returning profit directly to investors via dividends rather than parking corporate earnings for their own pet projects or empire building, thereby allowing the marketplace to decide the best use of money.²⁶¹

258. Ronald Brownstein & Janet Hook, *The Nation; 2004 Race May Pivot on Details of Tax Bills*, L.A. TIMES, May 11, 2003, at A1; Ronald Brownstein, *Tax Cut Is a Victory and a Risk for Bush*, L.A. TIMES, May 24, 2003, at A1

(The passage of this year’s bill, beyond underscoring an image of effectiveness, may offer Bush several other political benefits. Tax cuts excite his core GOP base, and could help him replicate in 2004 the heavy turnout among these loyalists that keyed the party’s gains in 2002. By accelerating into 2003 cuts in income tax rates that were scheduled for 2004 and 2006, the new bill creates a political headache for Democrats. Several of the party’s presidential contenders had hoped to finance their agenda not by repealing the tax breaks that took effect in 2001, but by merely blocking the future reductions—a nuance that would allow them to argue they were not raising taxes. Now, to fund their initiatives, those Democrats may have to propose raising taxes—at least on affluent families—by repealing the rate cuts that will be advanced into this year. Such Democratic proposals could activate the Republican base even more than Bush proposals to cut taxes.)

259. Tom Petrino, *Dividend Tax Cut Effect Mixed; The Experts Differ on Whether the Reality of the Rate Reduction Has Lived up to the Hype*, L.A. TIMES, Dec. 29, 2003, at C1; James Bernstein & Jeff Meyer, *The Dividend Bust; Investors Snub Heftier Company Payouts and Instead Are Gambling on Short-term Gains*, NEWSDAY, Oct. 5, 2003, at F-6; Tom Petrino, *Markets; Dividends on a Hot Streak; The Tax Cut Has Spurred More Companies to Boost Their Payouts. But Are Investors Paying Attention?*, L.A. TIMES, Oct. 2, 2003, at C1.

260. See, e.g., Tom Petrino, *Dividend Tax Cut Effect Mixed; The Experts Differ on Whether the Reality of the Rate Reduction Has Lived up to the Hype*, L.A. TIMES, Dec. 29, 2003, at C1.

261. *Id.*

The 2003 Act capital gains/dividend cut did increase the level of the stock market substantially,²⁶² and to some degree dividend payouts,²⁶³ although the data was skewed by a one-time \$32 billion dividend paid by Microsoft.²⁶⁴ As much as forty percent of the firms paid one-time special dividends,²⁶⁵ which “mitigates the positive effects that regular dividends are believed to yield in terms of improved corporate governance and economic efficiency over the long run.”²⁶⁶ Furthermore, about half of the corporations introducing or increasing dividends apparently substituted such payments for share repurchase programs, thereby failing to increase total payout to shareholders.²⁶⁷

262. See *supra* note 205 and accompanying text for an account of stock market woes preceding the 2003 Act. “The firms which have historically paid large dividends and which had a large fraction of individual shareholders experienced larger stock market gains in response to the proposal and enactment of the tax cuts.” Brown et al., *supra* note 198.

263. JOEL FRIEDMAN, CENTER ON BUDGET AND POLICY PRIORITIES, DIVIDEND AND CAPITAL GAINS TAX CUTS UNLIKELY TO YIELD TOUTED ECONOMIC GAINS (2005), available at <http://www.cbpp.org/3-10-05tax.pdf>; Allan Sloan, *For Bush, Cutting Taxes Is the Plan for All Seasons*, WASH. POST, April 29, 2003, at E-1 (describing a fourteen percent increase from March 11 to April 28, 2003); Chris Gaither, *Microsoft Announces Dividend Software Giant Is Flush with Cash as Profits Jump 12%*, BOSTON GLOBE, Jan. 17, 2003, at D-1 (reporting that cries from investors became even louder after announcement of President George W. Bush’s proposal to exclude dividends from individual income).

264. FRIEDMAN, *supra* note 264, at 11-12; Ariana Eunjung Cha, *Microsoft to Pay Dividends for the First Time; Profit Uptick, Legal ‘Clarity’ Provide Backdrop for a Move That Analysts Call Politically Astute*, WASH. POST, Jan. 17, 2003, at E-1 (reporting that industry analysts thought Microsoft’s announcement of a dividend was financially and politically astute.

Microsoft’s cash stockpile wasn’t growing as quickly as it might have liked. And by distributing dividends the company gives an indirect nod to Bush’s proposal at a time when some other technology companies have criticized it. ‘It shows support for an administration that has shown a tremendous amount of support for them’ by settling the federal antitrust case.’)

Bill Barnhart, *First-ever Microsoft Dividend Well-timed*, CHI. TRIB., Jan. 17, 2003, at N1.

265. FRIEDMAN, *supra* note 264, at 13.

266. FRIEDMAN, *supra* note 264, at 2 (citing Raj Chetty & Emmanuel Saez, *Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut* (National Bureau of Econ. Research Working Paper 10841, 2004); and Jennifer Blouin et al., *Did Dividends Increase Immediately After the 2003 Reduction in Tax Rates* (Nat’l Bureau of Econ. Research, Working Paper No. 10301, 2004)).

267. FRIEDMAN, *supra* note 264, at 3 (citing Jeffery Brown et al., *Executive Financial Incentives and Payout Policy: Firm Responses to the 2003 Dividend Tax Cut* (Nat’l Bureau of Econ. Research, Working Paper No. 11002, 2004), available at <http://www.nber.org/papers/w1102>).

Corporations most likely to respond to the 2003 Act cuts were those in which top executives had greater stock ownership,²⁶⁸ but corporations were less likely to increase dividends both before and after the 2003 Act reduction in tax in dividends paid to individual shareholders where executives had large holdings of stock options (the value of which is negatively related to the amount of dividends paid).²⁶⁹ A speculative bubble in high tech arguably arose again.²⁷⁰ Moreover, as an unintended consequence, the rise in stock, bond and house prices, and the jump in household wealth relative to income, contributed to the low savings rate and rise in household debt.²⁷¹ An intended consequence of the rate cuts was a substantial increase in Wall Street contributions to Republicans.²⁷²

268. FRIEDMAN, *supra* note 264, at 4 and 12 (citing Brown et al., *supra* note 197); Floyd Norris, *In Various Ways, the New Tax Law Affects How Companies Handle Their Dividends*, N.Y. TIMES, July 2, 2003, at C-11

(Just how much the new tax law affected those decisions is impossible to say, especially since the number of companies raising dividends had been growing for much of the last year, as the economy gradually strengthened. . . . [C]ompanies where insiders own large blocks of stock might be more inclined to raise dividends. They might decide it was better to pay a dividend)

269. Brown et al., *supra* note 198.

270. Ben White & Amy Joyce, *Decide to Run With the Bulls; With Economy Shaky, Some Analysts Whisper "Irrational Exuberance,"* WASH. POST, June 7, 2003, at A1; Tom Petrino, *Aim of Tax Cuts: Boost Risk-Taking; Reduced Capital Gains and Dividend Levies Would Encourage Stock Investing. But What If the Bear Market Isn't Over?*, L.A. TIMES, May 25, 2003, at 3-1.

271. Chairman Alan Greenspan, *Reflections on Central Banking*, Address at a symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming (Aug. 26, 2005), available at <http://federalreserve.gov/boarddocs/speeches/2005/20050826/default.htm>

(The steep rise in the ratio of household net worth to disposable income in the mid-1990s, after a half-century of stability, is a case in point [of policy becoming increasingly driven by asset price changes]. Although the ratio fell with the collapse of equity prices in 2000, it has rebounded noticeably over the past couple of years, reflecting the rise in the prices of equities and houses. Whether the currently elevated level of the wealth-to-income ratio will be sustained in the longer run remains to be seen. . . . The lowered risk premiums—the apparent consequence of a long period of economic stability—coupled with greater productivity growth have propelled asset prices higher. . . . Such an increase in market value is too often viewed by market participants as structural and permanent. . . . But what they perceive as newly abundant liquidity can readily disappear. Any onset of increased investor caution elevates risk premiums and, as a consequence, lowers asset values and promotes the liquidation of the debt that supported higher asset prices. This is the reason that history has not dealt kindly with the aftermath of protracted periods of low risk premiums.);

C. 2004 AND 2005: EXTENSIONS, EXTENSIONS AND PLEAS FOR PERMANENCY

1. 2004

President George W. Bush opened 2004 calling for Congress to make permanent the expiring provisions of his 2001 Tax Act.²⁷³ Due to massive revenue costs of extending all of the tax cuts at once,²⁷⁴ Republicans pushed a series of more narrow measures extending popular tax cuts in the run-up to the November elections.²⁷⁵ Early candidates for extension were

Philip Aldrick, *Greenspan Warns of the Dangers from Capital Gains*, DAILY TELEGRAPH (London), Aug. 29, 2005, at 28.

272. Glen Justice, Patrick McGeehan & Landon Thomas Jr., *Once at Arm's Length from Bush, Wall Street Is Now Biggest Donor*, N.Y. TIMES, Oct. 23, 2003, at A1

(After winning Congressional approval for cuts in taxes on dividends, capital gains and for certain business investments, and after navigating a raft of corporate accounting scandals that shook the investment community, President Bush seems to have won over many financial executives, who are now strongly supporting his re-election campaign. A study to be released today shows that the financial community has surpassed all other groups, including lawyers and lobbyists, as the top industry among Mr. Bush's elite fund-raisers.)

CEOs were also very pleased. See Bradley Meacham, *CEO Pay Often Gets Big Boost from Dividends*, SEATTLE TIMES, Jun. 8, 2003, at N-18; Dana Milbank & Jonathan Weisman, *In GOP Holdout's State, Bush Pitches Tax Cut*, WASH. POST, Apr. 25, 2003, at A2 (indicating that Timken's top four executives would have received as much as \$955,000 tax-free last thirteen-cents-per-share quarterly dividend checks; Chairman William R. Timken would have received \$50,440 tax-free in a single quarter, with \$879,560 in quarterly tax-free dividend income going to his foundations and other trusts tax-free in a single quarter; Timken has contributed more than \$260,000 to Republican candidates and party organizations since the 2000 election cycle).

273. Alan K. Ota, *Bush Stands Behind Tax Cuts*, 62 CONG. Q. WKLY. 200 (2004) (describing a split in Republican ranks in Congress over whether to pay for making tax cuts permanent and estimating the cost of making the cuts permanent through 2013 at \$1.6 trillion. The article quotes George W. Bush as stating,

[w]hat the Congress has given, the Congress should not take away. . . . For the sake of job growth, the tax cuts you passed should be permanent." The president argued that lawmakers have a choice between moving forward with his domestic agenda, or trying to reverse course and go "back to the old 'policies and old divisions.);

see *infra* note 357 and accompanying text; Andrew Taylor, *Next Presidency: A Future of Shortfalls*, 62 CONG. Q. WKLY. 2230 (2004) (indicating that the CBO used Spratt assumptions to project annual deficits in the \$300 to 400 billion range).

274. See *infra* note 358.

275. Alan K. Ota, *A New Tax Cut Equation*, 62 CONG. Q. WKLY. 342 (2004)

(The tax cuts Bush pushed through Congress in 2001 and 2003 begin expiring at the end of this year and are scheduled to be gone at the end of 2010. The expiration dates were necessary to allow the tax cuts to move through the Senate

maintaining the child tax credit at \$1,000, extending the ten percent bracket and the marriage penalty relief, and extending for one more year the then-current AMT exemption.²⁷⁶ The bill passed by the House, however, tended to follow the permanency tack as to some, but not all, of the 2001 tax cut provisions.²⁷⁷ Republican majorities in both Chambers began to push extension bills just before the Democratic National Convention to force Democrats “to cast potentially awkward votes.”²⁷⁸ Then Senate Finance Committee Chair Grassley stalled the extensions by making them hostage to a corporate tax cut (designed to offset for a companion repeal of a

under budget reconciliation procedures providing protection from filibusters. Republicans have long planned to make the tax cuts permanent law, calculating that it would be politically difficult for Democrats to resist extending them. But a combination of factors has changed the equation. In addition to growing deficit worries, lawmakers in both parties are concerned that new tax cuts could make it impossible to provide enough money for their other priorities, including defense and homeland security. Another factor is the desire among lawmakers to revise the alternative minimum tax (AMT) to prevent it from denying upper-middle-income taxpayers the benefits of tax breaks already on the books.).

276. Andrew Taylor, *Tough Tests Lie Ahead for Plans to Trim Spending, Deficit*, 62 CONG. Q. WKLY. 505, 526 (2004); Andrew Taylor, *Details of Expiring Tax Cuts*, 62 CONG. Q. WKLY. 1675 (2004).

277. Alan K. Ota, *Democrats Hone Their Demands as Tax Cut Bills Hit the Senate*, 62 CONG. Q. WKLY. 1013 (2004) (reporting that House Vote 138 made the repeal of the marriage penalty permanent while including a Democratic quid pro quo of making permanent refundable EITC credits (even if individuals paid no income taxes)); Alan K. Ota, *House Renews AMT Extension, Puts Long-term Fix on Hold*, 62 CONG. Q. WKLY. 1074 (2004) (describing a House ploy to show bipartisan support for making permanent popular provisions, actually expecting only extensions); see also, Alan K. Ota, *It's All About Sunsets and Offsets as Parties Sell Their Tax Plans*, 62 CONG. Q. WKLY. 1673 (2004).

278. Alan K. Ota, *It's All About Sunsets and Offsets As Parties Sell Their Tax Plans*, 62 CONG. Q. WKLY. 1673 (2004) (reporting how Democrats sought an offset for extending middle class cuts through a surtax on incomes above \$200,000); Alan K. Ota, *GOP Readies Intense Pre-Election Push for Five-Year Extension of Tax Breaks*, 62 CONG. Q. WKLY. 2047 (2004)

(Bush might have had an easy victory in July on extending the tax cuts. But the president and his senior aides urged GOP leaders to jettison a bipartisan deal for a \$75 billion, two-year extension of the expiring tax breaks. They include the \$1,000 per-child tax credit, a tax benefit for married couples and the current higher income limit for the 10 percent tax bracket. The package also would have extended for one year the current exemption from the alternative minimum tax. . . . Bush mentioned his ultimate goal—permanently extending the tax breaks—in his nomination acceptance speech Sept. 2. . . . Having been poised to support the earlier two-year extension proposal, Democrats are divided on whether to back the five-year measure.).

subsidy for exports which had triggered European trade sanctions).²⁷⁹ In the end, Congress renewed four family tax breaks set to expire at the end of 2004, extending the \$1,000 per child tax credit for five years and tax benefits for married couples through 2008; the expanded ten percent tax bracket through 2010; and a one-year extension of current income exemptions from the alternative minimum tax for one year.²⁸⁰

2. 2005

Republicans and the President again started with a push to make permanent many of the 2001 and 2003 Acts' tax cuts.²⁸¹ The House again passed a permanent repeal of the estate tax, but

with a growing federal deficit in the background, the Senate outlook remain[ed] unpredictable. Leaders appear[ed] short of the 60 votes necessary to stop an expected Democratic filibuster, and [had] been discussing a compromise with some Democrats who want[ed] to permanently restructure the estate tax, but [did not] want to take it off the books forever.²⁸²

The House and the Senate adopted a budget plan for 2006 permitting \$105 billion in tax cuts over the next five years,²⁸³ approximating the President's proposed 2006 budget, which called for extending through 2010 all of the 2001 and 2003 Acts' tax cuts scheduled to expire in the next four years,

279. Alan K. Ota & Jill Barshay, *Grassley Stalls Tax Cut Extension, Vexing Fellow Republicans*, 62 CONG. Q. WKLY. 2097 (2004) (indicating that Grassley was worried about the effect of trade sanctions on agricultural exports).

280. Alan K. Ota, *GOP Faces Tough Tax Choices After Easy Renewal of Some Cuts*, 62 CONG. Q. WKLY. 2250 (2004); Alan K. Ota & Jill Barshay, *Floor Action in Both Chambers Planned for Tax Cut Extensions; Wide Democratic Support Likely*, 62 CONG. Q. WKLY. 2162 (2004) (noting that at this stage the legislation also included extending the upper limit of the fifteen percent income tax bracket at double the tax bracket's cutoff point for single filers for three more years).

281. Alan K. Ota, *Issues to Watch in 2005: Taxes*, 63 CONG. Q. WKLY. 32 (2005); Joseph J. Schatz, *This Year's Fight: Tax Extenders*, 63 CONG. Q. WKLY. 788 (2005); Jill Barshay, *Tax Cuts: When the Fix is Not in*, 63 CONG. Q. WKLY. 376 (2005) (indicating that the President's Budget for 2006 proposed permanently extending the 2001 and 2003 tax cuts, at a ten-year cost of \$1.1 trillion, but with no AMT fix (the AMT will reach 20.5 million in 2006, up from 3.8 million in 2005; the cost of revamping the AMT would cost from \$600 billion to \$1.2 trillion over a ten-year period)).

282. Joseph J. Schatz, *House Hits 4-0 on Estate Tax Repeal*, 63 CONG. Q. WKLY. 1013 (2005).

283. Andrew Taylor, *Fiscal 2006 Plan Narrowly Adopted*, 63 CONG. Q. WKLY. 1148 (2005).

including the capital gains and dividends rate cut, but no extension of the AMT exemption increase.²⁸⁴

The Senate Finance Committee considered using about \$30 billion in offsets to put together a \$100 billion reconciliation package, including temporary extension of the reduced tax rates on dividends and capital gains, several other popular “extenders” and a one-year patch for the alternative minimum tax as in 2004, whereas the House Ways and Means Chair Thomas preferred a smaller reconciliation package addressing permanent solutions for some of the other provisions.²⁸⁵ While some commentators had earlier speculated that the cost of reconstructing the Gulf Coast after Hurricane Katrina (and the growing costs of the War in Iraq) might lead the GOP in Congress to abandon the costly project of making the 2001 and 2003 tax cuts permanent,²⁸⁶ the past history of the George W. Bush Administration and the GOP majorities in Congress suggests that

284. Schatz, *supra* note 283.

285. Dustin Stamper, *Fall Agenda Is Anything but Settled, Starting with the Estate Tax*, 108 TAX NOTES 1089, 1090 (2005); Joseph J. Schatz, *GOP Works to Extend Tax Breaks*, 63 CONG. Q. WKLY. 2332 (2005)

([The] Finance Committee . . . [is] assembling a \$90 billion package of tax breaks that would extend all the major tax cuts of 2001 and 2003 through 2010, reduce for one year the effect of the alternative minimum tax on the middle class, and renew for one year expiring business tax breaks such as the research and development tax credit. . . . To keep the package under the \$70 billion limit set in the 2006 budget resolution (H. Conf. Res. 95), they are searching for \$20 billion in revenue-raising offsets.)

286. The relief and recovery outlays will be financed almost entirely with government debt. The prospects for an estate tax repeal, \$70 billion of tax cuts proposed for the fiscal 2006 budget reconciliation package, permanent extension of the remaining 2001 and 2003 individual income tax cuts, permanent relief from the alternative minimum tax, and plans for fundamental tax reform are all diminished and will turn on handful of swing [deficit hawk] Republican Senators. Also, the economic effects of Katrina could include \$150 billion-\$200 billion projected increase in government spending for Katrina relief. Martin A. Sullivan, *Economic Analysis: Katrina's Stealth Impact on the Budget*, 108 TAX NOTES 1490 (2005). See also Shailagh Murray & Charles Babington, *GOP Agenda Shifts as Political Trials Grow; Katrina Puts Estate Tax Repeal on Ice*, WASH. POST, Sept. 6, 2005, at A6; Editorial, *Lagging Poor*, WASH. POST, Sept. 6, 2005, at A25; Carolyn Lochhead, *Hard Times In Big Easy; Efforts Intensify To Evacuate Living, Recover Dead; The Politics*, S.F. CHRON., Sept. 9, 2005, at A1 (indicating that the high price of hurricane relief threatens to wash away Bush's second-term agenda; Republicans quickly shelved plans to repeal the estate tax and delayed a big budget bill containing \$70 billion in tax cuts and \$35 billion in spending cuts mainly in Medicaid and farm programs); Dustin Stamper, *Support Slipping for Extension of Capital Gains and Dividend Cuts*, 2005 TAX NOTES TODAY 190-1 (2005); Dustin Stamper, *GOP Agenda in Turmoil*, 109 TAX NOTES 7 (2005).

they will push forward at least with the extenders.²⁸⁷ Indeed, a Wall Street Journal Editorial maintained that

Economic Leadership also means instructing Americans on the link between the economic vitality needed to fund both Katrina relief and the war on terror. Predictably, the Bush tax cuts are under attack for denying revenue and because they don't require "sacrifice" in wartime. But the truth is that federal revenues are rising by an estimated \$262 billion—or roughly 14%—this year thanks to the growth that followed the 2003 tax cuts. Republicans have been far too defensive on tax cuts, and Katrina is an opening to explain their necessity and to push for making them permanent.²⁸⁸

The actual truth is that CBO Director Douglas Holtz-Eakin explained that increased federal revenue in 2005 was driven by a forty-two percent increase in receipts from corporate income taxes and a 14.6 percent increase in receipts from individual income taxes and estimated that the rise in corporate receipts was "largely a temporary phenomenon" brought about by the American Jobs Creation Act of 2004, which allows a one-time

287. The GOP reconciliation tax package would extend several popular tax breaks, the AMT exemption, and more contentious tax cuts on dividends and capital gains in 2006. In addition, an ABC/Washington Post poll conducted September 8-11 reported that fifty-nine percent of respondents believed Congress should put off its proposed \$70 billion tax cut package while thirty-six percent believed it should go forward as proposed. This figure corresponds roughly with the percentage of the electorate that is Republican. Dustin Stamper, *Tax Package, Delayed, But Still a Go*, 108 TAX NOTES 1353 (2005). See also *infra* note 307 and accompanying text. A short time later, as the projected \$200 billion cost of reconstruction began to sink in, rumbling began among Congressional Republicans of postponing the agenda of future tax cuts. Shailagh Murray & Jim VandeHei, *Katrina's Cost May Test GOP Harmony*, WASH. POST, Sept. 21, 2005, at A1

(Conservatives are calling for spending cuts to existing programs, a few GOP moderates are entertaining the possibility of a tax increase, and many in the middle want to freeze Bush tax cuts that have yet to take effect. . . . A new Gallup poll shows a majority of Americans believe the mission in Iraq should be cut to cover the recovery costs, while only a small fraction support slashing other domestic programs, raising taxes or increasing the deficit to finance it.);

Dustin Stamper, *Fate of Spending Reconciliation Bill Key to Tax Cut Protections*, 108 TAX NOTES 1493 (2005); John Cranford, *The Deficit's Hard Truths*, CONG. Q. WKLY. 2554 (2005)

(In the latest Gallup poll, 45 percent of those surveyed expect Americans to make 'major sacrifices' so that the federal government can afford the cleanup after Katrina. Only 15 percent said they supported borrowing the money. More than half said spending on the war in Iraq should be curtailed to pay for Katrina, while the number favoring tax increases was almost three times as large as that favoring reduced domestic spending. Those sorts of views pose powerful risks for lawmakers who choose to ignore them. And the message seems to be sinking in.)

288. Editorial, *Bush and Katrina*, WALL ST. J., Sept. 6, 2005, at A28.

repatriation of international profits to the United States. He added that “maybe a quarter” of the increased revenue would continue into the future.²⁸⁹

IV. INTEREST GROUP POLITICS OF CAPITAL GAINS/DIVIDENDS RATE CUTS

President George W. Bush “raised the prospect of such [capital gains and dividend] tax cuts this summer [of 2002], but congressional Republicans put them on hold during the [mid-term elections] campaign, fearing they would enable Democrats to paint the GOP as the party of the rich.”²⁹⁰ Any such fear ultimately was outweighed by the hope of reviving the stock market.²⁹¹ The Dow Jones Industrial Average closed for 2002 at 8,341.63, a 16.76 decline for the year, following declines of 7.10 percent and 6.19 percent in 2001 and 2000, respectively.²⁹² A decline in the Dow Jones Industrial Average for three consecutive years had not occurred since 1939-1941.²⁹³

Journalists believed that revival of the stock market would serve many purposes: (1) rewarding the contributing class (the wealthy, CEOs, and stock brokers²⁹⁴); (2) heading off a revolt at the polls in 2004 by angry

289. Douglas Holtz-Eakin, Director, Cong. Budget Office, “*The Budget and Economic Outlook: An Update*,” Address at News Conference (Aug. 15, 2005), in FED. NEWS SERV.; Robert Pear, *Surge in Corporate Taxes Is Expected to Reduce the Deficit*, N.Y. TIMES, Aug. 16, 2005, at A10; Wesley Elmore, *CBO Projects Smaller Deficit for Fiscal 2005*, 108 TAX NOTES 855 (2005); CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: AN UPDATE (2005), available at <http://www.cbo.gov/ftpdocs/66xx/doc6609/08-15-OutlookUpdate.pdf>; David Cook, *Federal Deficits: A Brighter Picture for Now*, CHRISTIAN SCI. MONITOR, Aug. 17, 2005, at 2 (indicating that the CBO’s projected overrun was smaller than expected in 2005, but that the long-term outlook remained gloomy; also projecting that if Bush II’s tax cuts are made permanent, projected deficits will never dip below \$330 billion over the next ten years).

290. Bob Kemper, *Pass Security Bill Now, Bush Urges; Economic Stimulus Also on the Agenda*, CHI. TRIB., Nov. 8, 2002, at N1.

291. See Mike Allen & Dana Miller, *President to Seek Dividend Tax Cut; Stimulus Plan’s 10-year Cost Put at \$300 Billion*, WASH. POST, Jan. 3, 2003, at A1.

292. Josh Friedman, *After 3 Years of Losses, Stock Funds’ Biggest Challenge May Lie Ahead; Managers See Cause for Optimism in Year-End Stock Market Rally*, L.A. TIMES, Jan. 6, 2003, at C1 (indicating that the loss in value of mutual funds for 2002 was 22.6 percent, the worst performance since 1974 and about twice as bad as 2001, when the average fund slid 10.9 percent; the last time stock funds endured three consecutive losing years was 1939-1941).

293. Amy Feldman, et al., *How Bad Is It?*, MONEY, Sept. 2002, at 76.

294. Thomas B. Edsall & Sarah Cohen, *Bush Campaign Raises a Record \$49.5 Million; For Their Efforts, Fundraisers Also Gain*, WASH. POST, Oct. 15, 2003, at A1; Jill Barshay,

small investors;²⁹⁵ and (3) energizing the Republican Party's base.²⁹⁶ Some Democrats and other commentators asserted that the real audience of the 2001 tax rate cuts was the GOP's enterpriser base, or perhaps more its big campaign contributors base.²⁹⁷ The chief GOP fund raiser, Rep. Tom Davis (R-Va.), bragged to media that the proposed tax cut at the top "has been a big money-raiser for us."²⁹⁸ This was most important due to the

For Bush, Tax Cut Package Is Next Must-Win Battle, 61 CONG. Q. WKLY. 974 (2003) (positing that Wall Street did not expect the dividend tax cut would provide much of an economic boost, though firms themselves would have much to gain).

295. See Robert Dodge, *Will Angered Stock Market Investors Punish the GOP?*, DALLAS MORNING NEWS, July 29, 2002, at D1; Stephen J. Glain, *Dow Back Above 10,000; Rising Markets May Give Bush Lift*, RISING STOCK PRICES WOULD BE AN ASSET TO REELECTION BID, BOSTON GLOBE, Dec. 12, 2003, at B16 (indicating that the 1990s investor class became a key electoral constituency and suggesting that the capital gains/dividend rate cuts and the upturn in the stock market energized them to give money and turn out the Republican vote); see 149 CONG. REC. S6959 (daily ed. May 22, 2003) (statement of Chair Grassley, Jr.) (indicating that over the past twenty years people investing in the stock market or in pensions and 401(k) plans dependent upon the market grew from twelve percent to fifty-five percent).

296. Claudia Deane & Dan Balz, *GOP Puts Stock in 'Investor Class'; Parties Debate Impact of Rise in Voters with Money in Market*, WASH. POST, Oct. 27, 2003, at A1 (reporting a Post survey that found that "direct investors are more optimistic about the economy, more likely to identify themselves as Republicans, have a more favorable view of the GOP and are more inclined to support Bush's reelection than are non-investors of comparable income."); Richard W. Stevenson, *President Willing to Give Greenspan New Term at Fed*, N.Y. TIMES, Apr. 23, 2003, at A1 ("Many Republican strategists have identified the stock market's health as an important concern for people who tend to vote, a concern reflected in Mr. Bush's insistence on sticking by his plan to eliminate taxation of most dividends despite lukewarm support in Congress."); Jill Barshay & Alan K. Ota, *White House Must Keep Delicate Balance When Drafting Latest Tax Cut Package*, 61 CONG. Q. WKLY. 31 (2003).

297. See 145 CONG. REC. S10332 (daily ed. Aug. 5, 1999) (statement of Sen. Kerry) (stating that the bill was a political statement to service campaign contributors); 145 CONG. REC. H7699 (daily ed. Sept. 8, 1999) (statement of Rep. DeFazio) ("[The] Republican bill . . . is delivering to the people who fund their campaigns, it is delivering to the people who run the corporations that fund their campaigns."); Richard W. Stevenson, *House Panel Votes \$864 Billion Tax Cut*, WASH. POST, Jul. 15, 1999, at A21. The release of the tax-cut plan was timed to get to the right of Steve Forbes.

To make sure the purists got the point, Bush met with the editors of the Wall Street Journal editorial page—they constitute the Sacred Congregation for the Doctrine of the Faith in supply-side circles--and sold them on the idea that this tax cut was the very best they could expect in these political times.

Citizens for Tax Justice concluded that two-thirds of benefits would go to the top ten percent E.J. Dionne Jr., *Opinion, Bush's Tax Timing*, WASH. POST, Dec. 7, 1999, at A31.

298. 145 CONG. REC. H8085 (daily ed. Sept. 9, 1999) (statement of Rep. Jackson-Lee). For an excellent discussion of the political impact of wealth see James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 835, 840-49 (2001). Larry Bartels notes that Senators in the late 1980s and early 1990s were considerably more responsive to the opinions of wealthy constituents than of middle-class constituents, and that Republican

“bundling” technique used in the George W. Bush 2000 presidential and 2004 re-election campaigns to avoid the public financing system restraints.²⁹⁹ From 1998 through mid-2004, Bush raised a record \$296.3 million in campaign funds, giving him an overwhelming advantage in running against Vice President Al Gore and Sen. John F. Kerry (D-Mass.). A third to one-half of the total was raised by 631 people functioning as an extraordinarily organized and disciplined machine.³⁰⁰ This pattern of political contributions helps explain why President George W. Bush pushed for his tax cuts in 2001 and 2003, notwithstanding the lesser importance at this time of tax cuts in polls³⁰¹ (Kerry also raised huge amounts, but did not seek similar special tax benefits³⁰²).

Senators were twice as responsive as Democratic Senators to the ideological views of the wealthy. Bartels also points to a strong correlation between income and political contributions. Larry M. Bartels, *Economic Inequality and Political Representation* 4, 13-14, 28-30 (revised Aug. 2005), available at <http://www.princeton.edu/~bartels/economic.pdf>.

299. George W. Bush created a network of people who could get at least 100 friends, associates or employees to give the maximum individual donation allowed by law to a presidential candidate: \$1,000 in 2002, \$2,000 in 2004. Thomas B. Edsall, et al., *Pioneers Fill War Chest, Then Capitalize*, WASH. POST, May 16, 2004, at A1. “Pioneers” raised at least \$100,000 each; “Rangers,” \$200,000. *Id.* See also Thomas B. Edsall & Sarah Cohen, *Bush Campaign Raises a Record \$49.5 Million; For Their Efforts, Fundraisers Also Gain*, WASH. POST, Oct. 15, 2003, at A1 (indicating that at least thirty-seven Rangers and Pioneers were from the finance industry, which is vocal in its support of the Bush II administration’s economic program: “first and most important, the tax reduction in dividend income and capital gains;” that at least fourteen Rangers and Pioneers were from power and energy industries supported repeatedly by the Bush II administration with legislative and regulatory initiatives over the objection of environmentalists; that at least twenty-five executives in the real estate and construction industries were Rangers and Pioneers; and that elimination of the estate tax was particularly important to business interests); see also Julian Borger, *Why Americas Plutocrats Gobble Up Dollars 1,500 Hot Dogs: In the Final Part of a Series, Julian Borger Examines the Inequality of the Bush Era*, GUARDIAN, Nov. 5, 2003, at 14 (indicating that Bush II policy has reinforced the income gap rather than mitigating it, as evidenced by the distribution of the fully phased-in tax benefits of the 2001 and 2003 Acts. Every member of the Bush II cabinet is a millionaire and his cabinet’s aggregate net worth is more than 10 times that of Clinton’s cabinet, arguably personifying “a new plutocracy.”).

300. Edsall, et al., *Pioneers Fill War Chest, Then Capitalize*, WASH. POST, May 16, 2004, at A1; Marilyn Geewax, *Economic Stimulus Plan: Bush Bets Tax Cuts Will Spur Recovery; Democrats Question How Much It Will Help*, ATLANTA J. CONSTITUTION, Jan. 8, 2003, at A1 (indicating that half of cost of proposal was attributable to the exclusion of dividends, “leading Democrats to charge the main goal is to aid the president’s wealthy political supporters.”); Thomas B. Edsall, *Republicans Name 62 Who Gave Big Money*, WASH. POST, July 1, 2004, at A6.

301. Peter G. Gosselin, *Arguments for Tax Cuts Weaker Than in the Past*, L.A. TIMES, Jan. 17, 2003, at 3-1. E. J. Dionne characterized the plan as redistribution to the wealthy and to favored interest groups. “And when it comes to the politics of payoff,” he wrote, “the president and his allies are nothing short of brilliant. . . . By recycling a small fraction of the

Just as, if not more important, was the small direct investor as *voter* (not particularly as contributors). The Republican base—“Enterprisers” and “Social Conservatives” making up 34 percent of registered voters³⁰³—overwhelmingly vote Republican in Presidential elections. The Democratic constituencies make up forty-four percent of registered voters.³⁰⁴ The key, therefore, to Republican victory in Presidential Campaigns is to charge up their base and attract at least two-thirds of the unaffiliated voters (thirty-two percent of registered voters) when the Democratic base is equally charged up:

Republicans had gained, in part, by winning increased support from the middle of the political spectrum—a part of the electorate less inclined toward the GOP in 1999, the last time the center conducted such a broad study. Andrew Kohut, the nonpartisan [Pew] research center’s director, said the new finding was a testament to Bush’s personal popularity among many voters—even as his job approval ratings had sunk below 50%—and to the strength of his leadership on national security issues. That,

cash back to Bush and his party in the form of campaign contributions, those friends are financing the construction of a mighty political machine.” Dionne also noted that public spending per person is higher under Bush II than it was under Clinton, with a share of big increases going to defense contractors whose employees contribute heavily to the Republicans. Many of the Medicare drug bill provisions help core Republican constituencies, including private health plans that get billions to compete with Medicare. Twenty-five billion dollars goes to rural hospitals but not to urban hospitals (urban areas did not vote for Bush) and huge monopoly benefits go to pharmaceutical companies. Dionne further states that the “bill forbids Medicare from using its bargaining power to bring down the cost of drugs.” E.J. Dionne, Jr., Opinion, *Politics of Payoff*, WASH. POST, Dec. 2, 2003, at A27.

302. John Kerry created the most effective fundraising machine in Democratic Party history by tapping disparate interests—especially trial lawyers, financial services executives, social liberals, teachers, Hollywood figures and others—united by their antipathy to President Bush. Lawyers comprised twenty-five percent of Kerry’s big-dollar fundraisers, ten percent of which were plaintiffs lawyers in lawsuits seeking damages. “Much of the seed money for the Kerry presidential campaign was collected through donors to his Senate campaigns, including lobbyists with interests before two of the Senate committees on which Kerry serves.” During the previous twelve months Kerry raised \$65 million on the Internet compared with \$8.7 million for Bush.

Kerry appears to have succeeded in creating a new class of donors and fundraisers for the Democratic Party. Kerry’s donor base is overwhelmingly bicoastal, substantially out raising Bush in California and N.Y., \$39.7 million to \$28.5 million; whereas Bush has crushed the Democrats in Florida and Texas, raising \$36 million to their \$8 million.

Thomas B. Edsall, et al., *Redefining Democratic Fundraising: Kerry Has Amassed Record Sums from Disparate Groups Opposed to Bush*, WASH. POST, July 24, 2004, at A1.

303. PEW RESEARCH CENTER, THE 2005 POLITICAL TYPOGRAPHY 4 (2005) [hereinafter 2005 POLITICAL TYPOGRAPHY], available at <http://people-press.org/reports/pdf/242.pdf>.

304. 2005 POLITICAL TYPOGRAPHY, *supra* note 304, at 5.

however, raises questions about whether Republican gains will outlast Bush's presidency—or fade if the public's focus shifts from foreign to domestic policy.³⁰⁵

While currently forty-one percent of Enterprisers and of Liberals (key Republican and Democratic constituencies, respectively) each have household incomes of at least \$75,000; fifty-three percent of the former buy or trade stocks, compared to only thirty-eight percent of the latter.³⁰⁶ As for Social Conservatives (thirteen percent of electorate), thirty-five percent own or trade stocks; and forty-two percent of Upbeats (thirteen percent of the electorate) own or trade stocks,³⁰⁷ a swing constituency voting for Bush 4:1 in 2004.³⁰⁸ Enterprisers are generally affluent, mostly male, patriotic, pro-business, and very conservative.³⁰⁹ Conservative Southern Democrats, who earlier had supported a capital gains preference principally for timber, small business and farmers,³¹⁰ have since 1994 largely been succeeded by Southern Republicans, now the bastion of the Republican Party.³¹¹

305. Janet Hook, *Survey of Voters Maps Subtle Splits; A Study Finds That in Spite of GOP Gains, Republicans, Democrats and Independents Are Divided over Issues Depending on Their Type*, L.A. TIMES, May 11, 2005, at A16.

306. 2005 POLITICAL TYPOGRAPHY, *supra* note 304, at 11, 17. Note that this category is the top quintile of households. The author suspects that the top two percent or so is more heavily Republican and the lower percents more heavily Democratic since a significant portion of the top two percent consists of enterprisers (CEOs and business people).

307. *Id.*

308. Dan Balz, *Disparate Coalitions Now Makeup Two Parties, Study Shows*, WASH. POST, May 16, 2005, at A15.

309. Dan Balz, *Poll Cites GOP Gains Since 9/11; But Party's Internal Divisions Are Called an Obstacle*, WASH. POST, May 11, 2005, at A2. See also 2005 POLITICAL TYPOGRAPHY, *supra* note 304, at 4.

310. Lee, *Critique*, *supra* note 6, at 27-28.

311. Amy Hamilton, *Economist Says Wall Street Turbulence Caused By Election Anxiety*, 96 TAX NOTES TODAY 148-7 (1996) (quoting Economist David D. Hale in a July 28 speech to the National Conference of State Legislatures stating that "Republicans now have 77 of the 125 House seats in the South—and pending Democratic retirements could leave Republicans with two-thirds of the seats in the South. . . . Democrats now depend far more on the urban centers of the Northeast, Midwest, and California for their congressional membership."); Ronald Brownstein, *GOP Has Lock on South, and Democrats Can't Find Key*, L.A. TIMES, Dec. 15, 2004, at A1 ("In their midterm landslide of 1994, Republicans for the first time captured the majority of House and Senate seats from the South."); David Lightman, *Civil Rights, Political Fallout; "Momentous Act" Changed America*, HARTFORD COURANT, July 2, 2004, at A2 (noting that forty years ago today President Lyndon Johnson signed the Civil Rights Act and reportedly told an aide, "We have just lost the South for a generation." He was right.). Thus the Southern Republican Succession has been more

Professor Bartels' explanation is "unenlightened self interest." Middle and lower-income taxpayers supported tax cuts they suspected went largely to the rich, believing that they, too, would benefit if only by a small amount, and that they were overtaxed, but largely because they failed to connect the tax cuts to rising inequality, their future tax burden, or the availability of government services.³¹² Indeed, the better informed the taxpayers were, the more they were critical of the George W. Bush tax cuts, and the more pessimistic about equality in America.³¹³ As a practical matter, the 2001 and 2003 Acts' tax cuts lowering the tax burden much more on the rich than on the poor was made more palatable because so many taxpayers across income levels paid less,³¹⁴ not realizing that many of the cuts below the top had much shorter lives.³¹⁵ I have long suspected that "Unenlightened Self Interest" did underlay the traditional support of owners of small businesses or timber lots and farmers as to livestock and more rarely as to sales of farm land itself³¹⁶ (but these special interests by and large are included in the Republican "Enterpriser" constituency).

A related explanation for the critical support of "Upbeat" independents (who tend to vote Republican in National Elections) for capital gains cuts is "optimistic individualism."³¹⁷ I have called this group the capital gains "wannabes."³¹⁸ In 1995 House Hearings and on the House floor, a

successful than the Southern Democratic Secession of more than a century earlier. "Yes I believe the south is gonna rise again, oh, but not the way we thought it would back then." TANYA TUCKER, *I Believe the South Is Gonna Rise Again*, on TANYA TUCKER - GREATEST HITS (Columbia 1990). Unfortunately it is not the way the author hoped back when he first heard the song.

312. Larry M. Bartels, *Homer Gets a Tax Cut: Inequality and Public Policy in the American Mind* 4, 10, 14, 19-20, 22, 26-8, 34-5 (2003), available at http://www.princeton.edu/~policybriefs/bartels_taxcut.pdf; see also Brookings Briefing, Transcript, *Do Misperceptions Guide the Tax Policy Debate?*, available at <http://www.brookings.edu/comm/events/20031216.pdf> (presenter Joel Slemrod found that many thought the current system was unfair because the wealthy paid at a lower effective rate than the middle class and would pay more under a flat tax); Zelenak, *supra* note 16, at 94; Alan B. Krueger, *Economic Scene; Connecting the Dots from Tax Cuts for the Wealthy to Loss of Benefits*, N.Y. TIMES, Oct. 16, 2003, at C-2.

313. Bartels, *supra* note 313, at 29.

314. Andrew Balls & Christopher Swann, *Republican Radicals Eager for "Second Front" on Tax: But It Is Too Early to Say How Bold the President Intends Reforms to Be*, FIN. TIMES (London), Nov. 11, 2004, at 11.

315. This technique is discussed in a work-in-progress entitled *Selling of Bush II Income Tax Cuts*.

316. Lee, *Critique*, *supra* note 6, at 27-30.

317. 2005 POLITICAL TYPOGRAPHY, *supra* note 304, at 14; David Brooks, Opinion, *Meet the Poor Republicans*, N.Y. TIMES, May 15, 2005, at 4-14 (citing Pew Research Center).

318. Lee, *Critique*, *supra* note 6, at 31.

proponent of a proposed capital gains cut recounted a story of a seventeen-year old who favored capital gains tax cuts because some day he hoped to have capital gains.³¹⁹ Former Ways & Means Chair Sam Gibbons (D-Fla.) rejoined that a seventeen-year old would be better off playing the lottery because only eight percent ever won anything on the capital gains tax cut.³²⁰

Clinton's 1997 capital gains cut also illustrates the importance of capital gains preferences to the Republican base. All prior major capital gains cuts or changes (1921, 1934, 1938, 1942, 1978, and 1981) had occurred against a backdrop of downturn in the economy, or in the stock market, or in both. "There can be no argument, as there was in the early 1980s, that these cuts are needed for economic growth."³²¹ In 1997,

[t]he stock market has risen into the stratosphere, beyond the opening in the ozone layer. Does this sound like an economy that needs a jumpstart through a tax cut? . . . To provide a tax cut now is like encouraging someone who has just paid off a huge credit card debt, complete with whopping interest payments to go on a wild and uncontrollable shopping spree.³²²

319. *Id.*

320. *Id.* While it is true that the lower and middle income components of that eight percent tend to change every year, they still accounted in the aggregate for less than ten percent of the total realized gain over a five-year sample. *Id.* at 48; *see also* CONG. BUDGET OFFICE, PERSPECTIVES ON THE OWNERSHIP OF CAPITAL ASSETS AND THE REALIZATION OF CAPITAL GAINS 12, Table 3 (1997) [hereinafter PERSPECTIVES ON THE OWNERSHIP OF CAPITAL ASSETS] (providing data from a ten-year panel, using 1993 dollars and indicating returns reporting \$10,000 to \$50,000 (in \$10,000 increments) reported gains on the average three years out of seven, with the average gains ranging per increment from just over \$1,000 to just under \$2,000, constituting in the aggregate 2.77% of all gains reported (\$5,805 out of \$209,521) and returns with \$200,000 and over reported gains in all seven years and over 85% of the gains reported (\$179,041 out of \$209,521)), *available at* <http://www.cbo.gov/ftpdocs/3xx/doc303/capgains.pdf>.

321. 143 CONG. REC. S8444-45 (daily ed. July 31, 1997) (statement of Sen. Byrd).

322. 143 CONG. REC. S8444-45 (reporting that with a sixth consecutive year of economic growth, the stock market continues to reach record highs, that unemployment recently dipped below five percent, and that inflation has remained in check); 143 CONG. REC. H4698 (daily ed. June 26, 1997) (statement of Rep. Coyne) (claiming that the economy today is in the best shape in twenty-five years and is still growing, and that inflation is low. The statement further indicates that the federal deficit was reduced from more than six percent of national output to roughly one percent).

Thus, a capital gains rate cut was not needed, and even dangerous in that it probably encouraged the “irrational exuberance”³²³ in the bubble market, potentially leading to a greater bust. The goal of the Republicans of rewarding their enterpriser base³²⁴ with capital gains rate cuts was more openly exposed than ever before.³²⁵ A capital gains cut to twenty percent raised the risk of future deficits in the event of an economic downturn—another river boat gamble.³²⁶ And, of course, the capital gains cut delivered

323. “[H]ow do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade? And how do we factor that assessment into monetary policy?” Alan Greenspan, Remarks at the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research, Washington, D.C. on The Challenge of Central Banking in a Democratic Society (Dec. 5, 1996), transcript *available at* <http://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm>. Cutting the capital gains tax does not square with Republican laissez-faire ideology that markets, not the government, should dictate investments. The Wall Street boom in 1997 of more than fifty percent since 1993 undermined the argument that investors need special tax incentives to invest. “Federal Reserve Chairman Alan Greenspan has even warned that ‘irrational exuberance’ has sparked overinvestment in the market. *If he’s right, then it would make more sense to raise the capital gains tax.* But Archer . . . ‘views his job as protecting job makers, risk takers and investors.’” Jonathan Chait, *Lovey-Dovey*, NEW REPUBLIC, Mar. 3, 1997, at 15 (emphasis supplied); Editorial, *Stocks Continue to Break Records as Expectations of Profits Soar; Capital Gains Tax Cut, Low Interest Rates Credited with Causing Investor Euphoria*, MILWAUKEE J. SENTINEL, Aug. 7, 1997, at 2.

324. Rick Henderson, *The “Leave Us Alone” Coalition*, J. OF COM., Aug. 18, 1997, at A7 (indicating that enterprisers comprised nineteen percent of likely voters); *see also* Thomas B. Edsall, *Not Running for Preacher; Gramm Is Uneasy Ally of Religious Right*, WASH. POST, June 22, 1995, at A1 (indicating that moralists have nearly doubled in size since 1987 and have displaced enterprisers as the dominant Republican faction).

325. 143 CONG. REC. S8445 (daily ed. July 31, 1997) (statement of Sen. Byrd) (stating that the justifications for capital gain tax cuts “do not extend beyond the realm of pure unadulterated politics. . . . Tax cuts sell well on the campaign trail, magnetically drawing checkbooks out of coat pockets, but in current fiscal situation they are not sound fiscal policy.”); Jonathan Riskind, *Businesses’ Political Donations Paid Off, Report Shows*, COLUMBUS DISPATCH, Oct. 5, 1997, at A15 (citing Common Cause). Observers have noted the “striking overlap” between “the check-writing Daddy Warbucks of national politics and government influence” and “the most important owners of America profiled in the Fortune 500, the Forbes 400 and similar lists.” Kevin Phillips, Opinion, *Heading for a Fall; Clinton’s Loss on “Fast Track,” Combined with the Stock Market Drop and Sharpening Divisions in Society, All Point to Trouble Ahead*, L.A. TIMES, Nov. 16, 1997, at M-1.

326. 143 CONG. REC. E1604 (daily ed. Aug. 1, 1997) (extension of statement of Rep. Skaggs) (noting the potential for renewed and greatly increased deficits in a few years and finding the cut inherently more beneficial to high income taxpayers with resources to make investments than to those with more limited means); 143 CONG. REC. S8390 (daily ed. July 31, 1997) (statement of Sen. Campbell) (bemoaning a “return to the 1980’s when politicians stumbled over themselves to promise newer and bigger tax cuts without regard to our budget deficit”); 143 CONG. REC. S8417-18 (daily ed. Jul. 31, 1997) (statement of Sen. Moynihan)

most of its benefits to the big investors at the top of the income scale.³²⁷ The proponents' argument that the growth of mutual funds required an update of the image of who benefited from a capital gains rate cut³²⁸ was misleading.³²⁹ Proponents of the 1997 capital gains cut pointed to the

(expressing concern over whether cutting taxes might undo the astonishing progress over the last four years). OBRA 93 produced extraordinary increases in wealth "because it sent a signal to the economy that this Government was going to get hold of its financing, pay its bills in sound dollars, not . . . inflate the currency and get rid of your debt in that mode." *Id.* See also 143 CONG. REC. S8421 (statement of Sen. Wellstone); 143 CONG. REC. S8444 (statement of Sen. Byrd) (stating that losses after the ten-year budget window could propel the country back to the irresponsible 1980s: "one severe recession in the next few years coupled with the impact of these backloaded tax cuts could throw us right back into the deficit canyon."); Richard Foster, *Budget Deal Well-Intentioned, but Flawed*, MILWAUKEE J. SENTINEL, July 30, 1997, at 10; 143 CONG. REC. H4804 (daily ed. June 26, 1997) (statement of Rep. Bentsen) (warning of a "tax time bomb" causing budget deficits to explode again).

327. 143 CONG. REC. S8421 (daily ed. July 31, 1997) (statement of Sen. Wellstone) (calling the provision "unfair" and "short sighted"); 143 CONG. REC. S8441 (statement of Sen. Bumpers) (taking account of the child credit and noting that seventy-six percent of benefits still go to top twenty percent; also indicating that the tax cut is roughly \$134 billion, which would provide college education to every youngster in America wanting one). *Analysis of Distribution of Budget Agreement's Tax Cuts*, 97 TAX NOTES TODAY 148-67 (1997) (providing an analysis by the Center on Budget and Policy Priorities using a report by Citizens for Tax Justice); *CTJ Release on Tax Plan*, TAX NOTES TODAY 147-85 (1997) (reporting that the top twenty-percent garner seventy-eight percent of the tax benefits of the Act when fully phased in; the top one percent (over \$200,000) garner 32.3%; and the top five percent (over \$100,000) garner forty-four percent).

328. 143 CONG. REC. S8439 (daily ed. July 31, 1997)(statement of Sen. Dominici)

(In 1990, the typical mutual fund owner is someone in the \$35,000 to \$75,000 income bracket. The average portfolio is \$14,000. Half of these investors do not have a college degree. This is a very different image from the wealthy widow toting a pampered poodle down Fifth Avenue in New York and being the one who can take advantage of capital gains.);

143 CONG. REC. 8434 (statement of Sen. Bailey Hutchison) (noting that forty-one percent own stock and that fifty-six percent of capital gains were reported by households with income under \$50,000; one-half of mutual fund shareholders have income under \$75,000); 143 CONG. REC. S8446 (statement of Sen. Hatch) (claiming that the cut is not just for the rich because it helps anyone who invests in a mutual fund or IRA); 143 CONG. REC. H6303 (daily ed. July 30, 1997) (statement of Rep. Ganske) (citing a 1993 IRS study indicating that seventy percent of all capital gains were filed by taxpayers earning less than \$75,000). In fact, the fifty-six percent of taxpayers reporting capital gains who earned under \$50,000 realized less than ten percent of the annual gains. Lee, *Critique*, *supra* note 6, at 43-45; see also PERSPECTIVES ON THE OWNERSHIP OF CAPITAL ASSETS, *supra* note 321.

329. 143 CONG. REC. S6411 (daily ed. July 31, 1997) (statement of Sen. Conrad)

(A recent Congressional Budget Office study found that 89 percent of tax returns reporting capital gains in 1993 had gains of \$10,000 or less with the average gain being \$2,000. By contrast, the 3 percent of returns showing gains of \$200,000 or more accounted for 62 percent of the total value of capital gains.);

see PERSPECTIVES ON THE OWNERSHIP OF CAPITAL ASSETS, *supra* note 321.

number of middle income taxpayers reporting capital gains, omitting the much smaller percentage of the gain they reported.³³⁰

Proponents of the 1997 capital gains cut claimed, as usual, that it was necessary to promote economic growth³³¹ or help savings and investment,³³² with a few adding, in light of the booming economy, that cuts were needed to help maintain the strong economic growth experienced over the past number of years.³³³ The more forthright and revealing

330. 143 CONG. REC. S8404 (daily ed. July 31, 1997) (statement of Sen. Smith) (noting that fifty-six percent of taxpayers with capital gains have income of less than \$50,000). This omits that they reported less than ten percent of the capital gains. See *Unofficial Transcript of Finance Panel Hearing on Extension of Tax Cuts*, 2005 TAX NOTES TODAY 150-29 (2005) (Opening Statement of Sen. James M. Jeffords) (“The Joint Committee on Taxation estimates Americans will realize \$327 billion in capital gains this year; \$307 billion of these gains, almost 94 percent, will go to taxpayers making more than \$100,000. Taxpayers with income of under \$50,000 will see less than \$5 billion of these gains.”); *Jeffords Speaks Against Cutting Taxes at Savings and Investment Hearing*, 2005 TAX NOTES TODAY 126-19 (2005).

331. 143 CONG. REC. S8429 (daily ed. July 31, 1997) (statement of Sen. DeWine); 143 CONG. REC. S8445 (statement of Sen. Roth, Jr.); 143 CONG. REC. S8446 (statement of Sen. Hatch).

332. 143 CONG. REC. at S8433 (daily ed. July 31, 1997) (statement of Sen. Max Baucus); 143 CONG. REC. at 8434 (statement of Sen. Hutchison) (claiming the proposal was important for investing, saving and releasing hundreds of billions of dollars worth of tied-up capital); 143 CONG. REC. S8443 (statement of Sen. Coverdale). For a refutation, see Lee, *Critique*, *supra* note 6, at 108 (indicating that proponents made the totally false claim that every time capital gains were cut savings increased.); 143 CONG. REC. S8478 (daily ed. July 31, 1997) (statement of Sen. Burns). In fact, the savings rate has continued to decline from 1997 to present, notwithstanding the capital gains rate cuts in 1997 and 2003. See Peter R. Orzag, *Net National Saving*, 106 TAX NOTES 1535 (2004).

333. 143 CONG. REC. S8446 (daily ed. July 31, 1997) (statement of Sen. Hatch). Senator Hatch’s claim that capital gains cuts would increase revenues was true for the next three years only because of the continued market boom. Proponents of capital gains rate reductions had long made this claim. 149 CONG. REC. H4708 (daily ed. May 22, 2003) (statement of Rep. Dreier). Historical evidence indicates that the initial revenue increase from increased realizations due to a capital gains rate cut (or impending hike) is offset by decreased realizations in later years. See Lee, *Critique*, *supra* note 6, at 56-57, 69-72; Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 73-74; CONG. BUDGET OFFICE, CAPITAL GAINS TAXES AND FEDERAL REVENUES 3-4 (2003), available at <http://www.cbo.gov/ftpdocs/38xx/doc3856/TaxBrief2.pdf>. Historically, realizations correlate positively with changes in the stock market, not rate changes. Lee, *The Capital Gains “Sieve”*, *supra* note 10, at 17-18 nn.82-84; Eric Toder & Troy Kravitz, *Volatility of Capital Gains Realizations*, 108 TAX NOTES 1051 (2005) (“Capital gains realizations appear to track generally the S&P Index, except during the early 1980s when capital gains soared while the S&P remained stable.”). This probably reflects the Leveraged Buyout craze of that period, during which arbitrage activity resulted in the “perception that a corporation is ‘in play’ becom[ing] a self-fulfilling prophesy.” *Id.* See also *Hearings on Leveraged Buyouts and Corporate Debt Before the*

comments were that the 1997 capital gains cut “begins to roll back the President’s 1993 tax increase,”³³⁴ which many Republicans in Congress hated,³³⁵ and that “the capital gains differential has been part of what Republicans thought we should have in this Tax Code for decades.”³³⁶

V. REDISTRIBUTION FROM MIDDLE AND LOWER INCOME TO HIGH INCOME TAXPAYERS

In political discourse, the charge of redistribution of income from middle and lower income taxpayers to higher income taxpayers is often cast as “Robin Hood in Reverse.” This metaphor saw frequent use during the early and mid 1990s when capital gains cuts proposed by President George H.W. Bush, and then by Republican majorities in Congress, would have benefited the top one or two percent of families by income quite disproportionately and would have been accompanied by decreased

Senate Finance Comm., 101st Cong. 1st Sess. (Jan. 24-26, 1989) (statement of Treasury Secretary Brady)

(Arbitrators purchase the stock of corporations thought to be acquisition candidates, hoping to sell the stock at a higher price if and when the acquisition is concluded. By definition, arbitrageurs are not long-term investors, and the nature of their activity and the demand for high rates of return on their available capital require that they turn over their investments in a reasonably short period of time. . . . Once arbitrageurs buy up stock of a corporation, the willingness of the corporation shareholders to sell is established, and the management’s ability to resist an acquisition is effectively reduced. The certain knowledge that the arbitrageurs own working control of the target company’s stock in turn makes sure that the potential acquirer’s bidding for the corporation stock will surely be successful.)

The “rest of the story” is that junk bond issuers, viz., allegedly Millikin, fed tips as to targets to arbitrageurs, viz., allegedly Boesky, etc. *Id.* The usual LBO premium (the excess of tender offer above pre-offer price) was more than thirty percent. *Hearings on Tax Policy Aspects of Mergers and Acquisitions Before the House Ways & Means Comm. I*, 101st Cong. 1st Sess. 78 (May 1989) (statement of SEC Chairman Ruder) (indicating that the weighted average of premiums is 32.2% of pre-offer trading price). During this period, \$313 billion in net equity reduction occurred. STAFF OF THE JOINT COMM. ON TAXATION, NO. JCS-1-89, FEDERAL INCOME TAX ASPECTS OF CORPORATE FINANCIAL STRUCTURES (1989).

334. 143 CONG. REC. S8432 (statement of Sen. Grams); 143 CONG. REC. S8416 (statement of Sen. Roth, Jr.) (“America . . . needs this capital gains tax relief. It is long overdue.”).

335. 147 CONG. REC. S5414 (daily ed. May 22, 2001) (statement of Sen. Gramm).

336. 147 CONG. REC. S8317 (daily ed. July 30, 1997) (statement of Sen. Domenici); 147 CONG. REC. H4678 (daily ed. June 26, 1997) (statement of Rep. Christensen) (“For 26 years the gentleman from Texas [Mr. Archer] has been here fighting for capital gains, fighting for small business owners.”).

spending on social programs disproportionately benefiting middle and lower income families.³³⁷ The same charge has been leveled against President George W. Bush's actual ordinary and capital gains rate reductions accompanied by spending cuts.³³⁸ Professor Larry Bartels has

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337. 143 CONG. REC. H5897 (daily ed. July 27, 1997) (statement of Rep. Pallone) (Under the tax plan that was pushed by the GOP, families with children that make less than \$30,000 a year would not qualify for a \$500 per child tax credit. The Republicans fashioned this tax plan so that would exclude these families from eligibility for such a tax credit because they do not make enough money. It is like a reverse Robin Hood doctrine. They would penalize the poor to benefit the rich.); 142 CONG. REC. H163 (daily ed. Jan. 4, 1996) (statement of Rep. Brown); 141 CONG. REC. H10698 (daily ed. Oct. 24, 1995) (statement of Rep. Brown) ("Thousands of my constituents have told me that they are outraged at the Republicans' reverse Robin Hood tactics, stealing from the working people and the poor and giving tax breaks to the wealthy."); 141 CONG. REC. H7263 (daily ed. July 20, 1995) (statement of Rep. Brown) ("Republicans are not so stealthy that their Robin Hood-in-reverse crusade will go unnoticed by seniors."); 141 CONG. REC. S5176 (daily ed. Apr. 5, 1995) (statement of Sen. Boxer) (Where is the money going when you cut these programs [school lunches]? I have the answer. It is being voted on, as we speak, in the House. Do you know what the answer is? It is tax breaks for the wealthiest people in America. Hurt the kids, help the rich. That is the Republican contract. I will show you the chart. More than 50 percent of their tax cut goes to people over \$100,000. A third of the tax cut goes to those earning over \$200,000 a year. Who gets hurt? The kids, the middle class, the poor, Robin Hood in reverse, my friend.); Tait Trussell, Editorial, "No-Pain" Medicare Prescription Can Prevent Predicted Bankruptcy, ORLANDO SENTINEL, Sept. 11, 1995, at A9 (Democrats are blasting Republicans for trying to cut health care for the elderly 'to pay for tax cuts for the rich.' Rep. Corrine Brown, a Florida Democrat, for example, states that Florida Medicare beneficiaries could lose \$28 billion in coverage during the next seven years under Grand Old Party proposals.); Lee, *Critique*, *supra* note 6, at 54-56. For discussion of the GOP Medicare plan see Robert Pear, *Republicans Draw Plan for Slowing Medicare Growth*, N.Y. TIMES, Sept. 10, 1995, at 1-1.
338. *E.g.*, 151 CONG. REC. H5411 (daily ed. June 9, 2005) (statement of Rep. Brown) ("[Republicans] practice what I call reverse Robin Hood: robbing from the poor and working people to give tax breaks to the rich."); 151 CONG. REC. S2885 (daily ed. Mar. 17, 2005) (statement of Sen. Kennedy) ("[T]his budget doesn't reduce the deficit—it increases it over the next 5 years. Despite these harmful cuts in Medicaid, they add yet another round of tax breaks. Where is the fairness in that? It is Robin Hood in reverse[;] steal from the poor to give to [the] wealthy."); 147 CONG. REC. S5793 (daily ed. May 22, 2001) (statement of Sen. Wellstone) (describing the plan as "a Robin Hood in reverse raid on the federal treasury. When fixes to the Alternate Minimum Tax and interest costs are added in, the tax cut will cost over \$2 trillion over the next ten years."); 147 CONG. REC. H2212 (May 16, 2001) (Rep. Matsui) (This is redistribution. About 60 percent of the \$5.6 trillion [of the projected surplus] is in the form of Social Security payroll taxes. Who gets the burden of that? The average American, because it is capped at \$76,000 a year [\$90,000 for

reached an interesting empirical conclusion: “[u]nder Democratic administrations income growth has been more vigorous among the poor than among the rich; under Republican administrations the reverse has been true.”³³⁹ Historical factors appear to have been that Democratic Presidents focused more on more employment and output growth while Republican Presidents focused more on controlling inflation.³⁴⁰

A. DISPARITY IN EFFECTIVE RATE CHANGES

The most bald assertion is that when the *after tax* real income of the top one percent increases, while that of the middle or lower income taxpayers does not, the wealthy taxpayers have taken “money away from middle-income Americans.”³⁴¹ This would be true as to disproportional rate changes only if a tax cut at the top had to be made up for by tax increases at lower income levels. The pattern instead has been the cuts at the top have increased the deficit. A related and somewhat stronger position is that income redistribution from lower to upper income households occurs when effective rates drop at the top while increasing at the bottom, as is the case

2004]. So we are going to take the payroll taxes and we are going to redistribute it to those people that file income tax returns of \$1.1 million a year.); Paul Krugman, Opinion, *Dooh Nibor Economics*, N.Y. TIMES, June 1, 2004, at A19 (echoing the reverse Robin Hood theme and indicating that Congress agreed on a budget that cuts funds for Medicaid (and food stamps), even while extending tax cuts on dividends and capital gains); Christopher Swann, *President Accused of Robbing Poor to Benefit the Rich*, FIN. TIMES (London), Feb. 9, 2005, at 8 (indicating that the Bush II budget proposal to cut food stamps for low-income Americans would exclude 200,000-300,000 families from coverage; a freeze on child care funding to the States will mean that 300,000 fewer low-income children will be assisted by 2009; while extending first term tax cuts largely benefiting high income households); Jonathan Weisman, *Congressional Budget Plans Differ On Depth of Cuts; House Proposing Greater Reductions*, WASH. POST, Mar. 13, 2003, at A9 (“Democrats and their allies call the House proposal ‘Robin Hood in reverse,’ saying it would cut programs for the poor and elderly to make room for a tax cut on investment dividends that largely benefits the wealthy.”). The CBO has concluded that two-thirds of the 2004 Deficit was due to the Bush II tax cuts. Michael Olesker, *Once Again, Working Folks Get Soaked*, BALTIMORE SUN, Oct. 15, 2004, at B1; see CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: AN UPDATE (2004), available at <http://www.cbo.gov/ftpdocs/57xx/doc5773/08-24-BudgetUpdate.pdf>.

339. Larry M. Bartels, *Partisan Politics and the U.S. Income Distribution*, Feb. 2004, at 2 (taking account of cash benefits from the Government, but not effective rates), available at <http://www.princeton.edu/~bartels/income.pdf>.

340. *Id.* at 17.

341. 138 CONG. REC. S3385-86 (daily ed. March 12, 1992) (statement of Sen. Gore).

under the Bush II tax cuts.³⁴² The strongest position is that pre-tax disparities have reflected greater returns on capital than on labor.

B. INCREASING EFFECTIVE RATES AT THE BOTTOM AND DECREASING EFFECTIVE RATES AT THE TOP

The CBO has projected the effective rates for total Federal taxes and for individual income taxes per income classes 2001 to 2014 (using 2001 incomes for all years), assuming that all of the Bush II tax cuts become permanent (except for partial expensing of investment and net operating losses which the Administration does not intend to become permanent.) The following table reproduces (a) the total effective Federal tax rate and (b) effective income tax rates, respectively, for the bottom two quintiles and top ten percent, five percent and one percent for 2001 (before any of the Bush II tax cuts), 2008 (when all of the tax cuts are phased in) and 2014.³⁴³

<u>Total Effective Federal Tax Rate</u>				<u>Effective Individual Income Tax Rate</u>		
<u>Income Category</u>	<u>2001</u>	<u>2008</u>	<u>2014</u>	<u>2001</u>	<u>2008</u>	<u>2014</u>
Lowest 20%	5.4	5.8	8.3	-5.6	-5.2	-2.7
Next 20%	11.6	12.3	14.7	0.3	1.0	3.4
Top 10%	28.6	27.4	30.3	18.7	17.5	20.4
Top 5%	30.1	28.4	31.6	20.8	19.0	22.2
Top 1%	33.0	29.6	33.6	24.1	20.7	24.7

These figures reveal effective tax rates increasing at the bottom, especially for 2014, while decreasing at the top one percent for 2008 and increasing just slightly for 2014. Note that these tables do not reflect the Estate Tax cuts, the benefits of which are concentrated in the top two percent or so and especially the top one percent; and further that capital income for 2001 (which is used for all years) was down substantially at the

342. 138 CONG. REC. H620-21 (daily ed. Feb. 26, 1992) (statement of Rep. Moody, Ways & Means Committee member) (“The tax bill of 1981 and a number of subsequent measures produced what has generally been acknowledged to have been the most massive redistribution of wealth in this Nation.”).

343. CONG. BUDGET OFFICE, *supra* note 14, at 21, Table B-2.

top one percent, so that the actual decrease in effective rate at the top will probably turn out to be greater than the CBO estimates.

C. TAX CUTS FUNDED BY SOCIAL SECURITY SURPLUS

For a number of years, wage taxes have exceeded income taxes for eighty percent of individual filers.³⁴⁴ Wage taxes are the same percentage for everyone with no deductions, no personal exemptions and a cap of covered wages (or self-employment income) currently in the low \$90,000s, so that it operates like a flat tax on the masses.³⁴⁵ Looking at contributions alone, lower income workers pay a much higher percentage of their pay than higher income taxpayers pay³⁴⁶ (this is less clearly the case when Social Security benefits are taken into account³⁴⁷). Indeed, some speculate

344. 144 CONG. REC. S9389, S9403 (daily ed. July 30, 1998) (statement of Sen. Kerrey) (“[The] average household income in 1996 was \$35,492. That family, taking the standard deductions and exemptions, paid \$2,719 in Federal income tax. But they paid a whopping \$5,430 in payroll taxes—double what they paid in income taxes.” Sen. Kerrey’s comments were based on CBO data.); 145 CONG. REC. S10305 (daily ed. Aug. 5, 1999) (statement of Sen. Moynihan); 142 CONG. REC. S1410 (daily ed. Sept. 26, 1996) (statement of Sen. Nunn). As is often the case with income statistics in Congress, this morphed for some into the erroneous statement that eighty percent of Americans paid no income taxes. 150 CONG. REC. E1819 (daily ed. Oct. 7, 2004) (statement of Rep. Larson); 150 CONG. REC. S4026 (statement of Sen. Edwards).

345. Deborah A. Geier, *The Payroll Tax Liabilities of Low- and Middle-Income Taxpayers*, 106 TAX NOTES 711 (2005) (“[T]he payroll tax burden . . . [is] a large part of the revenue stream and yet is borne largely by low- and middle-income taxpayers and . . . it epitomizes the shift toward taxing labor income more heavily than capital income (which is concentrated in upper-income households.”); Laurence S. Seidman, *A Progressive Value Added Tax: Has Its Time Finally Come?*, 103 TAX NOTES 1255, 1258 (2004); Robert H. Michaelsen, *Why the New Tax Law Is a Bad Tax Law*, 92 TAX NOTES 677, 679 (2001) (describing the new tax law as the most regressive U.S. tax: a flat tax through the taxable wage base that then disappears); Gene Steuerle, *Republ-taxes and Demo-grants*, 96 TAX NOTES TODAY 128-112 (1996) (indicating that the Social Security tax is essentially a flat rate tax even less progressive than the most current flat tax proposals); Zelenak, *supra* note 16, at 90.

346. *See supra* tables in notes 99 and 116 and text accompanying note 126.

347. Historically, much of the redistribution of income to lower income couples and individuals was within couples with higher earning workers contributing to the auxiliary benefits of their low-earning spouses, but still some redistribution through the payment of benefits at a higher rate for lower lifetime earnings benefits and due to changing demographics and earnings patterns (increased earnings of married women) will become more progressive overtime. Karen Smith, et al., *Lifetime Distributional Effects of Social Security Retirement Benefits*, 2-5 (Urban Institute May 2001). *See also* Eugene Steuerle et al., *Does Social Security Treat Spouses Fairly?* (Urban Institute Nov. 30, 1999); Eduardo Porter, *Who Wins in a New Social Security?*, N.Y. TIMES, Mar. 6, 2005, at 3-6 (“Social

that this is the reason that President George W. Bush has been seeking to convert Social Security to private accounts, privatization by a more euphonious name.³⁴⁸ Additionally, the Administration may hope to capture the younger generation for the party and, of course, the GOP leaves the impact of making these tax cuts permanent for the rich out of its charge that Social Security is in serious funding troubles so that “personal accounts” are necessary for the younger workers to ever receive their benefits.³⁴⁹

Currently, less than ninety percent of individual wage taxes go to pay current social security benefits;³⁵⁰ the excess or surplus goes into the Social

Security uses taxes from the rich to bolster the retirement income of the poor through a benefit scale that now replaces about 60 percent of preretirement earnings for low-income workers but only 30 percent for the workers in the highest earning band.”).

348 Editorial, *How Not to Save Social Security*, N.Y. TIMES, Sept. 23, 2004, at A26 ([For President George W. Bush and other advocates of personal accounts,] Social Security is primarily an ideological struggle. Social Security supports retirees by shifting income from the young to the old via taxes, and from the rich to the poor via the formula for calculating benefits. To Mr. Bush and his supporters, taxation and redistribution are anathema, and Social Security is an anticapitalist ploy to squelch initiative and growth. Those same arguments were leveled against Social Security when President Franklin Roosevelt established it in 1935, and when its constitutionality was upheld by the Supreme Court in 1937.).

349. David Lightman, *Age Gap on Social Security; Bush Plan Sets off Battle for Support of Youth*, HARTFORD COURANT, Feb. 28, 2005, at A1

(There’s a generation gap in the Social Security debate, and whether it narrows could have huge political and economic consequences. The debate was triggered by President Bush’s suggestion that workers be allowed to invest part of their contributions in private accounts, and that could determine not only the system’s future, but the shape of American politics.).

350. CONG. BUDGET OFFICE, THE OUTLOOK FOR SOCIAL SECURITY, 1-2 (2004) (indicating that in 2003 the government paid out \$479 billion in Social Security benefits and collected \$534 billion in Social Security taxes, so 10.29% of these taxes—or \$55 billion—were not spent.), available at <http://www.cbo.gov/ftpdocs/55xx/Doc5530/06-14-SocialSecurity.pdf>; Douglas Holtz-Eakin, Director, Cong. Budget Office, *Option for Social Security: Budgetary and Distributional Aspects*, Address Before Senate Finance Committee (May 25, 2005) [hereinafter *Social Security: Budgetary and Distributional Aspects*], available at <http://www/cbo.gov/ftpdocs/63xx/doc6376/05-25-SSTestimony.pdf> (indicating that “[i]n 2004, the Social Security system took in \$569 billion in tax revenue and paid out \$493 billion in benefits.” $\$569 - \493 ; excess = $\$76$ billion \div $\$569$ billion = 13.36%). At the end of fiscal year 2002, Social Security trust funds held more than \$1.4 trillion in Treasury Securities. Adriel Bettelheim, *A Wide Open “Lockbox,”* 62 CONG. Q. WKLY. 157 (2004) (indicating that each year Treasury borrows billions from the funds with staggered maturity dates, which the trust funds redeem when needed to pay current benefits; further indicating that the prospect of paying off all these securities worries policy makers since Treasury would probably have to borrow to meet its obligations).

Security Trust Fund.³⁵¹ In 2006, the Social Security surplus will be \$160 billion.³⁵² That surplus is projected to continue to increase until 2009.³⁵³ The CBO forecasts that such surplus will amount to \$2.4 trillion from 2006 through 2015.³⁵⁴ It also forecasts that if the 2001 Act and 2003 Act tax cuts were made permanent, the total increase in the deficit for the same period would amount to \$1.318 trillion (plus \$195 million in debt service), and if the AMT is reformed by extending and indexing for inflation the 2004 extension, the deficit will be increased by \$398 billion (plus \$109 million in debt service)³⁵⁵ for a total of \$2.2 trillion.

According to The Center on Budget and Policy Priorities, if the sunsets of the 2001 and 2003 tax acts are repealed as to *all* of these tax cuts, as the George W. Bush Administration intended from enactment,³⁵⁶ “the total

351. See CONG. BUDGET OFFICE, FEDERAL DEBT AND THE COMMITMENTS OF FEDERAL TRUST FUNDS at 3 (Oct. 24, 2002, revised May 6, 2003), available at <http://www.cbo.gov/ftpdocs/39xx/doc3948/10-25-LongRangeBrief4.pdf>

([T]he Treasury securities held by federal trust funds are neither assets nor debts of the government as a whole. In an operational sense, most federal trust funds are simply accounting devices. As money is collected, it is deposited in the Treasury, and the appropriate trust funds are credited with federal securities to reflect the amounts. When payments are made, the trust funds' balances are reduced. Any amount not needed to cover the programs' current expenditures is used either to finance other governmental activities or to pay down the debt held by the public. What is in the trust funds is simply the government's promise to pay itself back at some time in the future.);

63 CONG. Q. WKLY. 1741 (2005).

352. *Unofficial Transcript Is Available of W&M Hearing on President's [2006] Budget*, 2005 TAX NOTES TODAY 56-28 (2005) (Colloquy OBM Director Joshua Bolton and Rep. Xavier Becerra).

353. Douglas Holtz-Eakin, Director, Cong. Budget Office, *The Role of the Economy in the Outlook for Social Security*, Testimony Before the Subcommittee on Social Security Committee on Ways & Means, U.S. House of Representatives (June 21, 2005) (“In 2009, the Social Security surplus—the amount by which the program's dedicated revenue in a year exceeds the benefits paid in that year—will start to diminish. In 2019, that surplus will disappear, and outlays for benefits will begin to exceed the system's annual revenue.”), available at <http://www.cbo.gov/showdoc.cfm?index=6492&sequence=0>. See also *Social Security: Budgetary and Distributional Aspects*, *supra* note 351, at 2.

354. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK, *supra* note 290, at 2, Table 1-1.

355. *Id.* at 16, Table 1-6.

356. Editorial, *Tax-Cut Gimmicks Portend Return to Deficit Spending*, USA TODAY, Jun. 6, 2001, at A14 (“Bush and congressional Republicans are gambling that future Congresses won't have the stomach to let the cuts expire. . . . Treasury Secretary Paul O'Neill claimed that 'All these things are going to become permanent. They'll all be fixed.' That, in turn, creates pressure to reduce the size of government and denies Democrats fuel for their agenda.”); Editorial, *House GOP Aims to Drop Tax Bill's "Sunset,"* WASH. POST, Jun. 7,

discounted revenue loss through 2080 would be roughly three to five times as much as the actuarial shortfall in Social Security over the same period.³⁵⁷ Brookings Institute and the Center on Budget and Policy Priorities projected the cost of making the 2001 and 2003 tax cuts permanent to be roughly equal to two percent of the GDP over the next seventy-five years, while the Social Security shortfall is projected as only 0.4% of GDP over the same period.³⁵⁸ Based upon these projections, the media reported that if the self-executing sunsets of these tax cuts are honored just as to the top one percent of households (reporting more than \$350,000 a year), Social Security will remain solvent for seventy-five years.³⁵⁹ “In the year 2033, using Social Security projections, expenditures

2001, at A11; Juliet Eilperin, *House GOP Resolves to Stay the Course; Despite Change in Senate, Leaders Vow “to Keep Moving” on President’s Agenda*, WASH. POST, Jun. 11, 2001, at A2 (“House Majority Leader Richard K. Arney (R-Tex.) announced on Wednesday [June 6, 2001] the House would take up legislation to make permanent the Bush tax cut, which is slated to expire at the end of 2010.”); David E. Sanger, *President’s Signature Turns Broad Tax Cut, and a Campaign Promise, into Law*, N.Y. TIMES, Jun. 8, 2001, at A22 (indicating that Lawrence Lindsey, the president’s top economist, “expected that the tax cut would be made permanent, ‘but not any time in the immediate future.’”).

357. See JOEL FRIEDMAN ET AL., CENTER ON BUDGET AND POLICY PRIORITIES, EXTENDING TAX CUTS WOULD COST \$2.1 TRILLION THROUGH 2015 (2005), available at <http://www.cpbb.org/12-2-05tax.pdf> (calculating the direct cost at \$1.8 trillion, including the costs of extending AMT relief associated with the tax act; \$2.1 trillion included related interest estimates. Friedman also notes a CBO estimate that the Social Security short fall over the next 75 years is 0.4% of GDP and that the cost of making the 2001 and 2003 Act tax cuts permanent for same period is roughly equal to two percent of GDP); William G. Gale & Peter R. Orzag, *Economic Effect of Making the 2001 and 2003 Tax Cuts Permanent* 8 (Urban Institute Discussion Paper No. 17, 2004).

358. CONG. BUDGET OFFICE, THE OUTLOOK FOR SOCIAL SECURITY (2004), available at <http://www.cbo.gov/ftpdocs/55xx/Doc5530/06-14-SocialSecurity.pdf> (last modified June 17, 2004); BDS. OF TRS., FEDERAL OLD AGE AND SURVIVORS INS. AND DISABILITY INS. TRUST FUNDS, THE 2004 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS (2004), available at <http://www.ssa.gov/OACT/TR/TR04/tr04.pdf>.

359. Gene Sperling, Editorial, *No Pain, No Savings*, N.Y. TIMES, Jan. 5, 2005, at A23 (“[The] administration’s tax cuts already save the richest 1 percent of Americans nearly \$100 billion a year, an amount that over time would keep Social Security solvent for 75 years.” Sperling was President Bill Clinton’s top economic adviser); E.J. Dionne, Jr., Opinion, *Feeding the “Crisis,”* WASH. POST, Feb. 4, 2005, at A17; Congress of the United States Joint Economic Committee (Democrats), March 25, 2004, *President Bush’s Permanent Tax Cuts for the Wealthy Would Come at the Expense of Medicare and Social Security* (reporting Medicare and Social Security trustees’ reports estimating revenue loss from permanently extending the Bush II tax cuts enacted in 2001 and 2003 as comparable to the expected combined seventy-five year shortfalls in the two programs); 2004 TAX NOTES TODAY 59-37 (2004); Peter Orszag, *The Administration’s Economic “Stimulus” Proposals, Testimony Before the Democratic Policy Committee* (Jan. 22, 2003), available at <http://www.brookings.edu/views/testimony/orszag/20030121.pdf>.

on benefits will exceed payroll tax revenues by a bit more than \$300 billion In that same year, nearly \$380 billion in income tax revenues will not be collected if the tax cuts enacted in 2001 and 2003 are permanently in place.”³⁶⁰ This, of course, provoked populist rhetoric. As Barbara B. Kennelly (D-Conn.), former member of the House Ways & Means Committee, and president of the National Committee to Preserve Social Security and Medicare, put it:

[T]he tax cuts will be paid for largely with the surpluses that Social Security and Medicare generate. . . . Baby Boomers are starting to retire in six years, the senior population will shortly double—to 77 million from 44 million—and Medicare and Social Security need the surpluses to stay afloat. According to the Center on Budget and Policy Priorities, half of the 75-year cost of the tax cuts could make Social Security and Medicare completely solvent for a full 75 years. Yet instead of helping the country’s vulnerable populations, the tax cuts callously trade the long-term stability of Medicare and Social Security for a break for the country’s wealthiest 1 percent. Worse yet, beneath the numbers lurks a dangerous undertow that could pull Social Security and Medicare in a life-threatening direction. Draining money from these now-stable programs would leave them weakened and make them easy targets for privatizers. The privatizers would change the programs’ “all-for-one and one-for-all” principle of social insurance to one of “sink-or-swim.”³⁶¹

Social Security currently depends on revenue from current workers to finance benefits, but the number of workers per Social Security beneficiaries is projected to drop from 3.3 in 2005 to 2.0 in 2050.³⁶² These demographics and the projected demands on the system from the wave of Baby Boomer retirements commencing in 2015 are why wages tax base and rate were increased in 1983 to build up a trust fund to take care of the future excess of promised payments over current wage taxes collected.³⁶³

360. Thomas Oliphant, Opinion, *Beyond Social Security*, BOSTON GLOBE, Feb. 6, 2005, at E-11 (relying on the Center on Budget and Policy Priorities).

361. Barbara B. Kennelly, Commentary, *Save Social Security, Medicare Programs*, CHI. TRIB., Apr. 7, 2003, at C-23.

362. *Social Security: Budgetary and Distributional Aspects*, supra note 351, at 1. See Zelenak, supra note 16, at 91.

363. Republican Senator Bob Dole and Democratic Senator Daniel Patrick Moynihan headed the Social Security Commission in 1983, of which Alan Greenspan was the Chair. 149 CONG. REC. S7089-90 (daily ed. May 23, 2003) (statement of Sen. Baucus) (indicating that the the Commission was established because “[s]ince at least the last year of the Carter Administration, it had been apparent to both Social Security experts and a growing number of policy experts that the [Social Security] system was drifting into deep trouble.”). Forrest P. Chisman, *Social Security Reserves and the Budget Deficit*, SOCIAL SECURITY AND

That trust fund is currently invested in special Treasury bonds (and not counted as part of the deficit).³⁶⁴ If the 2001 and 2003 Acts' sunsets were repealed so these tax cuts became permanent (which CBO forecasts would increase the Deficit by \$1.318 trillion 2006-2015 plus \$195,359,879 in debt service³⁶⁵), the Treasury would likely be unable to honor this debt plus interest, which Social Security will need to draw upon to pay annual benefits promised, which are projected to exceed the then-current year's wage tax collections commencing 2012 or so.³⁶⁶ (The much discussed

ECONOMIC WELL-BEING ACROSS THE GENERATIONS 30, 42 (John R. Gist ed., 1988) ("The trouble arose primarily from the economic 'stagflation' of the 1970s and early 1980s, when inflation and recession occurred simultaneously. 'Stagflation' is precisely the type of economic environment that creates the greatest difficulties for Social Security."). In 1983, Congress addressed the short and long-term needs of Social Security, agreeing to "pre-fund" the Social Security Baby Boom generation by allowing the program to take in more taxes than it needed to pay current benefits. Social Security Amendments of 1983, Pub. L. 98-21, 97 Stat. 65 (1983); 1983 CONG. Q. ALMANAC 218; 145 CONG. REC. S3162 (daily ed. Mar. 24, 1999) (statement of Sen. Kerrey) (indicating that when Treasury starts paying back the money it borrowed from the Trust Fund in 2013, it will pay these IOUs with general revenues. Thus, beneficiaries from the Baby Boom generation will have a claim on \$6.85 trillion of income tax revenues (the borrowed amounts plus interest) in addition to the payroll tax claim they already have on tomorrow's workers.). In Senator Kerrey's words,

[w]hen the Congress voted to support the payroll tax increases to protect the integrity of the Social Security fund in 1983, it never intended for the surplus in the fund to mask the deficit. On the contrary, a vote cast in 1983 was a vote to ensure the soundness of the Social Security Program, not a vote for new revenues to fund non-Social Security Programs. Unfortunately, we all know that the surplus has not been used to assure the future of retirees. Nor has it been used to invest in the future of this country. Instead, it has been and continues to be spent on unrelated programs. With this in mind, the only right thing to do is to return some of the surplus from the payroll tax to working Americans.

137 CONG. REC. S5113 (daily ed. Apr. 25, 1991) (statement of Sen. Dodd). Senator Moynihan agreed. 144 CONG. REC. S9389 (daily ed. July 30, 1998) (indicating that, excluding interest, the Social Security Trust Funds will generate \$698 billion over the next ten years, about enough to reduce regressive wage taxes by two percentage points).

364. The federal securities held in the Social Security Trust Fund "represent the government's promise to pay money to itself." CONG. BUDGET OFFICE, THE IMPACT OF TRUST FUND PROGRAMS ON FEDERAL BUDGET SURPLUS AND DEFICITS 1 (2002), available at <http://www.cbo.gov/ftpdocs/39xx/doc3974/11-04-LongRangeBrief5.pdf>. In 2003, the Social Security Trust Fund surplus was \$171 billion. *Id.* at 2, Table 1.

365. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: AN UPDATE 17 (2005), available at <http://www.cbo.gov/ftpdocs/66xx/doc6609/08-15-OutlookUpdate.pdf>. CBO forecasts that reforming AMT would increase the deficit \$395 million (plus \$109 million in debt service) over the same period. *Id.* See also CONG. BUDGET OFFICE, BUDGETARY PROJECTIONS INCORPORATING ASSUMPTIONS SPECIFIED BY RANKING MEMBER SPRATT (2005), available at <http://www.cbo.gov/ftpdocs/66xx/doc6633/09-08-SprattLetter.pdf>.

366. See Alan Greenspan, Testimony Before the Committee on the Budget, U.S. House of Representatives on Economic Outlook and Current Fiscal Issues (Feb. 25, 2004)

future actuarial shortfall assumes that the Treasury has been able to pay the Social Security Trust Fund amounts it borrowed plus interest and that such shortfall arises only after repaid Trust fund is exhausted). If Treasury is unable to pay that debt from general revenues, then in a real sense income has been redistributed from middle income and perhaps lower income wage taxpayers to top income taxpayers.³⁶⁷ How likely is such a Treasury default?

To pay full benefits, the Social Security system will eventually have to rely on interest on government bonds held in its trust funds—and ultimately, on the redemption of those bonds. In the absence of other changes, bonds can continue to be redeemed until the trust funds are exhausted, which will occur in 2044, CBO projects. But where will the Treasury find the money to pay for the bonds? Will policymakers cut back other spending in the budget? Will they raise taxes? Or will they borrow more?³⁶⁸

(indicating that (i) between 2008 to 2011 baby boomers will begin to retire; (ii) CBO budget scenarios show growing deficits in future years; (iii) federal outlays under Social Security and Medicare would increase from less than seven percent of GDP to twelve percent by 2030; and (iv) if the longevity of the elderly continues to rise, so will the elderly proportion of population. Greenspan noted, “[i]f this fundamental change in the age distribution materializes, we will eventually have no choice but to make significant structural adjustments in the major retirement programs.” Greenspan also mentioned the changing Social Security cost of living measure and retirement age, and Medicare.), transcript available at <http://federalreserve.gov/board/docs/testimony/2004/20040225/default.htm>; CONG. BUDGET OFFICE, *THE IMPACT OF SOCIAL SECURITY AND MEDICARE ON THE FEDERAL BUDGET* (2002), available at <http://www.cbo.gov/ftpdocs/39xx/doc3982/11-14-LongRangeBrief6.pdf>; see also Joseph J. Schatz & Siobhan Hughes, *Greenspan’s Solutions Raise Eyebrows*, 62 CONG. Q. WKLY. 527 (2004)

(Democrats were displeased that the Fed chairman called for reducing Social Security benefits without addressing the role tax cuts played in widening the deficit. . . . Politicians tend to pick and choose among Greenspan’s statements, highlighting the parts that support their own positions. However, Republicans who exulted when Greenspan endorsed cutting taxes three years ago and Democrats who have used his recent warnings about deficits to attack GOP fiscal policies both wasted no time distancing themselves from the Fed chief’s statement about Social Security [to scale back benefits to help tame the deficit].);

Edmund L. Andrews, *To Trim Deficit, Greenspan Urges Social Security and Medicare Cuts*, N.Y. TIMES, Feb. 26, 2004, at A1.

367. Zelenak, *supra* note 16, at 91-92.

368. *Social Security: Budgetary and Distributional Aspects*, *supra* note 351, at 2; CONG. BUDGET OFFICE, *FEDERAL DEBT AND THE COMMITMENTS OF FEDERAL TRUST FUNDS*, at 3 (Oct. 24, 2002, revised May 6, 2003)

(Nor will the balances in trust funds now and in the future by themselves provide resources to meet the government’s future commitments. Indeed, the mechanisms of trust funds and the accumulation of federal securities in them do not mitigate the future strains that such programs as Social Security will impose on the federal

D. BETTER PRE-TAX RETURNS ON CAPITAL AND DECLINE IN PAY AT BOTTOM

The most blatant example of a return on capital at the expense of labor is where Wall Street rewards, through value per share increases,³⁶⁹ a public company for downsizing, i.e., laying off permanent employees, whom it often hires back to the same desk as independent contractors with no benefits, job security, or withholding.³⁷⁰ The top management's compensation often reflects such value per share increases.³⁷¹

budget and the economy. When trust fund balances are drawn down, the government will not be using resources that have been saved for a rainy day. It will be using resources generated at that time—either by running a surplus in the rest of the budget or by borrowing from the public.), available at <http://www.cbo.gov/ftpdocs/39xx/doc3948/10-25-LongRangeBrief4.pdf>; Alan Greenspan, Testimony Before the Committee on the Budget, U.S. House of Representatives on Economic Outlook and Current Fiscal Issues (Feb. 25, 2004), transcript available at <http://federalreserve.gov/board/docs/testimony/2004/20040225/default.htm>.

369 Frank Lalli, *Why You Should Invest in Companies that Invest in Their Workers*, MONEY, Mar. 1996, at 11

(The payoff [of investing in workers] may not be instantly obvious. At least, it's certainly eluded Wall Street, which continues to pump up the share prices of any corporation with a CEO who can spell 'downsize.' For example, AT&T's stock rose \$2.50 a share to \$67.25 in early January when the company announced its intention to discard 40,000 of its employees.)

370. Jay Mathews, *Their Riches Were Your Command; Demands That Executive Pay Be Tied to Performance Are What Led to Downsizees' Bonuses*, WASH. POST, Mar. 24, 1996, at H1; Jay Mathews, *For Love or Money?; Behaviorists Debate What Really Makes People Work Hard*, WASH. POST, Dec. 5, 1993, at H1; David Kirkpatrick, *The New Executive Unemployed*, TIME, Apr. 8, 1991, at 36

(A new survey of 1,005 corporations conducted jointly by FORTUNE and the Wyatt Co. consulting firm has found that 86% of the companies have reduced their managerial ranks in the past five years, 52% of them in 1990. Managerial downsizing has taken even deeper hold in companies with more than 5,000 employees—90% of these outfits have slashed the white-collar payroll over the past five years; 59% in 1990. . . . In a relatively new wrinkle, after discharging managers, many companies will hire them back as part-time consultants.);

Donald R. Doser, *Distribute Wealth More Fairly*, ENGINEERING NEWS-REC., Jan. 17, 2000, at 59 (indicating that widespread tactics to squeeze every possible dollar of profits from front-line workers include turning long-term employees into temps and independent contractors to avoid paying costs of health insurance and pensions.); Joseph Weber, et al., *Chicago Blues*, BUS. WK., Oct. 16, 2000, at 162; see generally Robert B Reich & Jim Hightower, *Broken Faith: Why We Need to Renew the Social Compact; First Principles*, THE NATION, Feb. 16, 1998, at 11 (noting that profitable companies routinely downsize their workforce or down-wage and down-benefit by replacing full-time workers with independent contractors, temporary workers and part-timers; they are bringing in new full-time workers at lower wage scales than current workers. The authors also indicate that layoffs in the current expansion are occurring at a higher rate than in the 1980's expansion. In the mid-1990s, employees terminated on account of "downsizing" accounted for twenty percent of

A study of the compensation of the top five executives of public corporations reveals that their aggregate compensation grew from 4.8 percent of the aggregate net income of corporations in 1993-1995 to 10.3 percent of net income in 2001-2003.³⁷² Growth in firm size and performance explains at most forty percent of the actual increase.³⁷³ Equity-based compensation (restricted stock and stock options)³⁷⁴ grew from thirty-seven percent of total compensation to the top executives of the S&P 500 corporations in 1993 to fifty-five percent by 2003 (not surprisingly peaking in 2000 with the end of the stock market boom).³⁷⁵

unemployment, exacerbated with the downsized corporation then 'renting' twenty percent to thirty percent of those laid off as "independent contractors" with perhaps higher wages but no benefits or security.); accord, Louis Uchitelle, *More Downsized Workers Are Returning As Rentals*, N.Y. TIMES, Dec. 8, 1996, at 1-1.

371. Ramon G. McLeod, *CEOs Being Rewarded for Dropping the Ax; Study Says Layoffs Bring Big Bucks*, S.F. CHRON., May 1, 1997, at A8 (indicating that an executive with stock options does better when jobs are cut and that Wall Street rewards CEO for announcing layoffs). "For the top 30 companies that announced layoffs in 1996, the average CEO earned \$4.6 million in direct compensation that included \$2.1 million in salaries and bonuses and an additional \$2.5 million in stock options. The 30 men who ran these companies oversaw the layoffs of 209,000 people." *Id.*

372. Lucian Bebchuck & Yaniv Grinstein, *The Growth of Executive Pay*, 1 (Harvard John M. Olin Discussion Paper No. 510, 2005), available at http://www.papers.ssrn.com/abstract_id=648682. The authors' data set includes all S&P 500, Mid-Cap 400 and Small-Cap 600, which in the aggregate constitute more than 80% of the total market capitalization of U.S. public firms. *Id.* at 2.

373. *Id.* at 8.

374. The importance of stock options in the 1990s arose as an unintended consequence from the tax rule (I.R.C. §280A) that a corporation could not deduct more than \$1 million in compensation of any executive unless it was performance-related. William J. McDonough, *The Fourth Annual A.A. Sommer, Jr. Lecture on Corporate, Securities & Financial Law*, 9 FORDHAM J. CORP. & FIN. L. 583, 602-03 (2004).

Stock options are performance-related, and so the stock option industry came in [saying:] 'Okay, here's a peer group, which just happens to be a group that is very well paid, and since you're just so damn smart, you've got to make in the top 25 percent of the peer group.' That, I think, was more insidious than the instrument of the stock option.

Id. McDonough is Chairman of the Public Company Accounting Oversight Board.

375. Bebchuck & Grinstein, *supra* note 373, at 10 (indicating a Mid-Cap 400 increase from forty-one percent to fifty-one percent and a Small-Cap 600 increase from thirty-four percent to forty-one percent).

In the wake of Sarbanes–Oxley,³⁷⁶ the Financial Accounting Standards Board proposed in 2003 (and finalized in 2005) a new Statement of Financial Accounting Standards requiring corporations to report as an expense the value of options granted to employees, thus reducing revenues on their financial statement.³⁷⁷ This ended the stock *option* gold rush with *restricted* stock (a grant of stock that generally passes to the executive over a period of time) now often being used instead.³⁷⁸

376. Pub. L. 107-204, 116 Stat. 745 (2003).

The change was introduced after the collapse of the 1990s stock market bubble, when it became clear that some executives had used share option schemes to loot their companies. One estimate is that more than Dollars 1,000bn (Pounds 550bn) was transferred to executives from shareholders in Standard & Poor's 500 companies. Longer-term damage was wrought in many companies whose management was manipulated to maximise the gains from share options. Previously, share option details had to be disclosed in footnotes to financial statements. But few investors appeared to have understood the value of such options until it was exposed after the bubble burst. New accounting standards on both sides of the Atlantic have since been drafted that require the value of options to be deducted as an expense in the profit and loss account.

Shrinking Share Options: Their Popularity Is Slipping as Their Cost Becomes Clearer, FIN. TIMES (London), Aug. 13, 2005, at 8.

377. Joseph Nocera, *Stock Options: So Who's Counting?*, N.Y. TIMES, Aug. 6, 2005, at C1 (noting that a surprising number of Wall Street analysts and companies believe that, despite the GAAP requirement to include them, they can persuade investors to look the other way); Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 123(R) (Rev 2004) Financial Accounting Series No 263-C (FASB 2004), available at <http://www.fasb.org/pdf/fas123r.pdf>; Floyd Norris, *U.S. Rejects Cisco Plan on Options*, N.Y. TIMES, Sept. 10, 2005, at C1. The SEC has agreed with the FASB. Staff Accounting Bulletin No. 107, 17 CFR Part 211 (Mar. 9, 2005), available at <http://www.sec.gov/interp/account/sab107.pdf>.

378. Shirleen Holt & Kristi Heim, *5 Years After the Bust, A Sober, New Reality; Dot-coms and Tech Startups—“Web 1.0: Arrogance. Web 2.0: Humility,”* SEATTLE TIMES, Aug. 21, 2005, at A1 (“Microsoft, which minted millionaires by the thousands in the 1990s, stopped granting employee stock options altogether, replacing them with outright stock grants given more sparingly.”); FIN. TIMES, *supra* note 377 (indicating that the percentage of the largest firms issuing stock options decreased from thirty-six percent to twenty-one percent while the percentage granting restricted stock increased from fifty-seven percent to sixty-eight percent); Harry Wessel, *Pinning Down the Big Bucks; Stock Options, Restricted Shares Gave Many Executives a Pay Windfall in '04*, ORLANDO SENTINEL, July 3, 2005, at H1; David S. Hilzenrath, *A Popular Reward: Restricted Stock; Job Performance Link Is Debatable*, WASH. POST, June 27, 2005, at D12; Ross Kerber, *Meet the New Stock Option; Stock Options Were once the Rage, but Now Companies Are Offering Executives Restricted Stock As a Way to Tie Compensation to Performance*, BOSTON GLOBE, Apr. 17, 2005, at E1. Restricted stock is subject to much the same policy criticisms as stock options. Claudia H. Deutsch, *An Early Advocate of Stock Options Debunks Himself*, N.Y. TIMES, Apr. 3, 2005, at 3-1. Moreover, assuming level amounts of say three year vesting restricted stock grants, by the last year of vesting the aggregate book expense would be the same as if the entire

Cash compensation for large, mid-size and small cap firms grew over forty percent between 1993 and 2003.³⁷⁹ The epitome of this trend has been the CEO superstar, in the widely quoted words of William McDonough, Chairman of the Public Company Accounting Oversight Board (mandated by Sarbanes-Oxley):

We saw confusion about the role of the CEO. We saw the advent of the CEO superstar, and an explosion in compensation that made those superstar CEOs actually believe that they were worth more than 400 times the pay of their average workers. Twenty years before, they had been paid an average of forty times the average worker, so the multiple went from forty to 400—an increase of ten times in twenty years. That was thoroughly unjustified by all economic reasoning, and in addition, in my view, it is grotesquely immoral.³⁸⁰

Compensation to other high level professionals increased far less during this period.³⁸¹

year three grant had been expensed, viz, in year one, one-third of the year one grant would be a book expense; in year two, one-third of year one grant and one-third of year two grant would be a book expense, and on year three, one-third of year one grant, one-third of year two grant, and one-third of year three grant would be a book expense. Thus, there is only a short-term accounting “advantage” to restricted stock grants. *Id.*

379. Bebchuck & Grinstein, *supra* note 373, at 12, 18.

380. McDonough, *supra* note 375, at 590; Art Pine, *Corporate Profit Climbs 87% While Worker Pay Rises 4.5%*, CHI. TRIB., May 11, 2004, at C4; 150 CONG. REC. H3690-91 (daily ed. June 2, 2004) (statement of Rep. Emanuel) (indicating that the economy has created the largest income disparity since the 1900s. Merrill Lynch chief economist said,

[t]he income from the recovery has been locked up in the corporate sector. We have had a redistribution of income to the corporate sector.” Emanuel further claimed that President George W. Bush’s economic and tax policies accelerated concentration of wealth at the top: “[a] study cited by N.Y. Times found that Americans are being taxed more than twice as heavily from earnings from work as they are from investment income, even though more than half of all investment goes to the wealthiest 5 percent of taxpayers.);

see Edmund L. Andrews, *Big Gap Found in Taxation Of Wages and Investments*, N.Y. TIMES, May 8, 2004, at C2 (relying on a study by Citizens for Tax Justice, a liberal nonprofit research organization, finding that federal income taxes on wages and other earnings average about 10.7% and wage taxes take another 12.7%, while federal taxes on investment income (not subject to wage taxes) average about 9.6%. Extrapolating from IRS data, the study estimated that 43% of all investment income goes to the top 1% of households and 60% goes to top 5%). The disparity is even greater in the case of the highest paid CEO’s. “Thirty years ago the average real annual compensation of the top 100 chief executives was \$1.3m: 39 times the pay of the average worker. Today it is \$37.5m: over 1,000 times the pay of the average worker.” *Ever Higher Society, Ever Harder to Ascend - Meritocracy in America*, THE ECONOMIST, Jan. 5, 2005, at 22.

381. Bebchuck & Grinstein, *supra* note 373, at 24 n.6 (indicating that high-level lawyers saw an increase of 15%; high-level engineers, 18%; and high-level accountants, 3%).

National income growth in the current economic recovery also evidences increased returns on capital coupled with decreased returns on labor. The share of national economic growth (adjusted for inflation) for 2000-2004 going to wages and salaries is twenty-three percent and to corporate profits is forty-four percent; in contrast, average post-World War II economic recoveries went forty-nine percent to wages and eighteen percent to corporate profits.³⁸² Half of the share going to wages and salaries was captured by corporate executives. The Federal Reserve Report to Congress discloses that for the first half of 2005 (1) corporate profits were up 13%, a slower rate than for 2003 and 2004, and (2) labor compensation per hour (excluding stock option income) rose 3.5% (about one half a percentage point less than the 2003-2004 averages), but, with stock option and bonus income, [largely payable to higher income workers] the increase was seven percent.³⁸³ Thus, increase as to workers was

382. DAVID KAMIN & ISAAC SHAPIRO, CENTER ON BUDGET AND POLICY PRIORITIES, CORPORATE PROFITS CONTINUES TO RECEIVE RECORD SHARE OF GAINS FROM RECOVERY, WHILE WORKERS' SHARE LAGS FAR BEHIND (2003) (relying on Commerce Department data); ANDREW SUM ET AL., CENTER FOR LABOR MARKET STUDIES NORTHEASTERN UNIVERSITY THE UNPRECEDENTED RISING TIDE OF CORPORATE PROFITS AND THE SIMULTANEOUS EBBING OF LABOR COMPENSATION: GAINERS AND LOSERS FROM THE NATIONAL ECONOMIC RECOVERY IN 2002 AND 2003 10, 16-24 (2004), available at <http://www.nupr.neu.edu/4-04/corporate-profits.pdf>; ISAAC SHAPIRO, ET AL., CENTER ON BUDGET AND POLICY PRIORITIES, HOW DOES THIS RECOVERY MEASURE UP? (2005) (indicating that employment and wage and salary growth were especially slow—less than one half the average in other post World War II recoveries—whereas corporate profits experienced 15.1% average annual growth compared with 9.5% for other comparable post-war periods); see also Economic Policy Institute, Economic Snapshots, Productivity Growth and Profits Far Outpace Compensation in Current Expansion (Apr. 21, 2005), available at http://www.epinet.org/printer.cfm?id=2013&content_type=1&nickname=webfeatures_snaps_hots_20050421.

383. [C]ompensation per hour in the nonfarm business sector . . . rose 7 percent over the four quarters ending in the first quarter of this year, having registered a particularly large bulge in the final quarter of 2004. Much of this sharp rise may be the result of the exercise of a large number of stock options late last year, a development perhaps induced by an increase in equity prices that boosted the number of options that were 'in the money' and by a proposed change in accounting regulations that led some companies to accelerate the vesting of options that had been previously granted. In addition, the strong performance of profits in 2004 may have been associated with sizable nonproduction bonus payments at the end of last year.

Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress* 8, 16 (July 20, 2005)), available at <http://www.federalreserve.gov/boarddocs/hh/2005/july/fullreport.pdf>; see also Alan Greenspan, Testimony Before the Senate Joint Economic Committee on Economic Outlook (Apr. 21, 2004)

equaled in the aggregate by bonuses and equity based compensation at the top. Economic growth is going “to corporate profits, to rising health care costs and to a surge in the salaries and other compensation of executives. (Forbes reports that the combined compensation of the chief executives of America’s 500 largest companies rose 54% last year [2004].)”³⁸⁴ Even a resident scholar at the American Enterprise Institute, a conservative research group, concluded that “[i]t looks like the gains from the recovery haven’t really filtered down. . . . The gains have gone to owners of capital and not to workers.”³⁸⁵ As the Toles September 6, 2004, political cartoon inspired by the Census Report discussed below put it: “It’s not trickle-down economics. We got the plumbing fixed.”³⁸⁶

Tellingly, the same week that a 2005 Census Report revealed that median family income in 2004 had failed to increase for a record fourth straight year (average income of middle class households fell 0.7 percent

(Most of the recent increases in productivity have been reflected in a sharp rise in the pretax profits of nonfinancial corporations from a very low 7 percent share of that sector’s gross value added in the third quarter of 2001 to a high 12 percent share in the fourth quarter of last year. The increase in real hourly compensation was quite modest over that period. The consequence was a marked fall in the ratio of employee compensation to gross nonfinancial corporate income to a very low level by the standards of the past three decades.),

available at <http://www.federalreserve.gov/boarddocs/testimony/2004/20040421/default.htm>.

384. Paul Krugman, *Summer of Our Discontent*, N.Y. TIMES, Aug. 26, 2005, at A21.

385. David Leonardt, *Poverty in U.S. Grew in 2004, While Income Failed to Rise for 5th Straight Year*, N.Y. TIMES, Aug. 31, 2005, at A1 (noting the first time on record household incomes failed to increase for five straight years. “[E]conomists say technology and global trade appear to be holding down pay for many workers. The rising cost of health care benefits has also eaten into pay increases. . . . Last year, households kept income from falling by working more hours than they did in 2003.”). See also Steven Greenhouse, *Falling Fortunes of the Wage Earner*, N.Y. TIMES, Apr. 12, 2005, at C1; Nell Henderson & Amy Joyce, *U.S. Ended 2004 with Gains in Payrolls; Job Increase First Since Recession*, WASH. POST, Jan. 8, 2005, at A1; John Bound & George Johnson, *Changes in the Structure of Wages in the 1980’s: An Evaluation of Alternative Explanations*, 82 AMER. ECON. REV. 371, 381, 383-84, 388 (1992) (indicating that the disparity was primarily attributable to changes in technology, viz., the computer revolution). “Skill bias” resulted in growing pay premium for the most skilled workers, particularly computer users. David M. Cutler & Lawrence F. Katz, *Macroeconomic Performance and the Disadvantaged*, 16-9, 48-50 (published in William C. Brainard & George L. Perry, BROOKINGS PAPERS ON ECONOMIC ACTIVITY 1991-2) (indicating that labor’s share of types of income that makes up types of income did not decline, but its share of *personal* income did over the 1980s as the percentage of all individual income attributable to dividends, capital gains and interest grew; wage shifts reflected “skill bias” resulting in young families, and particularly the less educated, faring worse during the 1980s than older, more educated families).

386. WASH. POST (Sept. 6, 2005).

while the top five percent rose 1.7 percent from 2000-2004),³⁸⁷ New Orleans flooded due to Hurricane Katrina and the whole world saw the

387. Carmen DeNavas-Walt et al, U.S. Census Bureau, *Current Population Reports, P60-229, Income, Poverty, and Health Insurance Coverage in the United States: 2004* (Aug. 2005); see also News Release, *Economy up, People down, Declining Earnings Undercut Income Growth* (Economic Policy Institute Aug. 31, 2005) (relying on the Census Report to indicate that output per hour went up fifteen percent from 2000 to 2004, but these productivity gains failed to reach the typical household.

While the average real income of middle-income households fell slightly (down \$300 or 0.7%—from \$44,759 to \$44,455), that of households in the top 5% grew by over \$4,000 (+1.7%), from \$260,045 to \$264,387. . . . [T]he changes in the economy—globalization, fewer unions, lower minimum wages, shifting norms in taxation and regulation favoring investors over wage-earners, and recoveries without adequate job growth—have significantly increased the time it takes for working families to reap the benefits of growth.),

available at http://www.epinet.org/content.cfm/webfeatures_econindicators_income20050831; Editorial, *Life in the Bottom 80 Percent*, WASH. POST, Sept. 1, 2005, at A22 (stating that the Census Report showed income inequality was near all-time highs in 2004, with 50.1% of income going to the top 20% of households.

[A]dditional census data obtained by the Economic Policy Institute show that only the top 5 percent of households experienced real income gains in 2004. Incomes for the other 95 percent of households were flat or falling. Income inequality is an economic and social ill, but the administration and the Congressional majority don't seem to recognize that. When Congress returns from its month long summer vacation next week, two of the leadership's top priorities include renewing the push to repeal the estate tax, which affects only the wealthiest of families, and extending the tax cuts for investment income, which flow largely to the richest Americans. At the other end of the spectrum, lawmakers have stubbornly refused to raise the minimum wage: \$5.15 an hour since 1997. They will also be taking up proposals for deep budget cuts in programs that ameliorate income inequality, like Medicaid, food stamps and federal student loans. They should be ashamed of themselves.);

William Neikirk, *U.S. Poverty Rises for 4th Year in Row; Global Competition for Jobs and Corporate Resistance to Higher Pay Are Possible Causes*, CHI. TRIB., Aug. 31, 2005, at C17 (“Analysts cited a number of possible reasons—such as intense global competition for jobs, the slow growth in employment from the 2001 recession and corporate resistance to higher wages and more hiring.”); Ceci Connolly & Griff Wine, *Poverty Rate Up 3rd Year in a Row*, WASH. POST, Aug. 27, 2004, at A1 (citing the 2004 Census report (as to 2003)); Jared Bernstein & Lee Price, *An Off-Kilter Expansion; Slack Job Market Continues to Hurt Wage Growth*, EPI Briefing Paper # 164 (Sept. 2, 2005) (indicating that the job market continues to be too slack to generate the pressure needed to raise the wages of many to at least the level of inflation, if not inflation plus productivity.

Since mid-2003, payrolls have been expanding on a monthly basis, but the rate of growth has been well below that of prior recoveries. This has led many analysts to note that a significant gap has developed between the actual number of jobs created and the number the labor market would have if it were operating closer to its full potential” (citations omitted). Unemployment rates remain low while job

poor left behind, while many newspapers associated the two.³⁸⁸ “The Republicans profess belief in trickle-down, but what they’ve given us is the Flood.”³⁸⁹

Stagnant wages appear attributable in part to immigrants contributing at least sixty percent of growth in labor force 2000-2004 (equal to the net job growth) with a very high percentage being relatively young,

growth remains weak because millions have dropped out of the labor market and their absence has helped dampen the growth of unemployment.)

388. Jason Deparle, *Broken Levees, Unbroken Barriers*, N.Y. TIMES, Sept. 4, 2005, at 4-1 (What a shocked world saw exposed in New Orleans last week wasn’t just a broken levee. It was a cleavage of race and class . . . Hydrology joined sociology . . . from the settling of the flood-prone city, where well-to-do white people lived on the high ground, to its frantic abandonment. . . . ‘a pretty graphic illustration of who gets left behind in this society—in a literal way.’)

New Orleans was unusually poor (27.4% below the poverty line in 2000 almost two and a half times national average) and disproportionately black.); Edward Alden, Comment & Analysis, *Bush’s Policies Have Crippled Disaster Response Capabilities*, FIN. TIMES (London), Sept. 3, 2005, at 9 (indicating that (i) the “deep tax cuts enacted in 2001—which President George W. Bush now wants extended permanently—left no room for government initiatives that might have prevented the catastrophe and increased capacity to respond;” (ii) the military, and especially the National Guard, was stretched too thin; and (iii)

the storm has ruthlessly exposed the poverty that still afflicts a substantial minority of Americans, and has grown worse since Mr. Bush pushed through tax cuts that overwhelmingly benefited the well-to-do. The US Census Bureau reported this week that another 1.1m Americans slipped below the poverty line last year. After falling for most of a decade, since 2000 the number of Americans in poverty has grown from 11.3 per cent to 12.7 per cent of the population—a higher percentage than in the 1970s despite 30 years of generally robust economic growth.);

Hurricane Exposes Issues of Class, Race, USA TODAY, Sept. 2, 2005, at A20; William Raspberry, Opinion, *Two Storms, Ample Warning*, WASH. POST, Sept. 5, 2005, at A25; Editorial, *Lagging Poor*, WASH. POST, Sept. 6, 2005, at A25; Nicholas D. Kristoff, Opinion, *The Larger Shame*, N.Y. TIMES, Sept. 6, 2005, at A31 (claiming that it was not only that funds went to Iraq rather than to New Orleans’s levees, “it’s also that money went to tax cuts for the wealthiest rather than to vaccinations for children”).

389. Harold Meyerson, Opinion, *The “Stuff Happens” Presidency*, WASH. POST, Sept. 7, 2005, at A25.

uneducated, and employed in low-wage occupations.³⁹⁰ Jobs created 2001-2004 paid twenty-one percent less than the jobs that were lost during that

390. ANDREW SUM ET AL., CENTER FOR LABOR MARKET STUDIES NORTHEASTERN UNIVERSITY, FOREIGN IMMIGRATION AND THE LABOR FORCE OF THE UNITED STATES: THE CONTRIBUTION OF NEW FOREIGN IMMIGRATION TO THE GROWTH OF NATION'S LABOR FORCE AND ITS EMPLOYED POPULATION, 2000-2004 10, 16-24 (2004), *available at* http://www.nupr.neu.edu/7-04/immigrant_04.pdf [hereinafter SUM, FOREIGN IMMIGRATION]; ANDREW SUM ET AL., CENTER FOR LABOR MARKET STUDIES, NORTHEASTERN UNIVERSITY, THE IMPACTS OF THE RECESSION OF 2001 AND THE JOBLESS RECOVERY OF 2003 ON THE NATIVE BORN AND IMMIGRANT WORKFORCE OF THE UNITED STATES 5 (2003) [hereinafter SUM, IMPACTS] (indicating that from 2000 to 2002, the native-born workforce increased by 633,000; the foreign-born workforce increased by 1.057 million), *available at* http://www.nupr.neu.edu/3-03/immigration_march.pdf; *accord*, CONG. BUDGET OFFICE, A DESCRIPTION OF THE IMMIGRANT POPULATION 1 (2004) [hereinafter IMMIGRANT POPULATION]

(The skill distribution among the foreign-born population is bifurcated, with both a much larger fraction than natives lacking a high school diploma, yet a slightly higher than average percentage having an advanced degree. Immigrants from Asia more frequently possess a bachelor's or higher degree, while less than half of those from Latin America have completed high school. Nearly half of the growth in the labor force since 1995 is attributable to immigrants. Foreign-born men are active participants in the labor market, with those from Latin America more heavily represented in service and blue-collar occupations and those from Europe and Asia in professional occupations. However, foreign-born women are less likely to participate in the labor force than are women born in the United States. The earnings of foreign-born workers, particularly non-U.S. citizens, are on average well below those of natives. Immigrants from Latin America are predominantly at the low end of the earnings distribution. That circumstance translates into below-average incomes and a higher incidence of poverty in households with foreign-born heads.),

available at <http://www.cbo.gov/showdoc.cfm?index=6019&sequence=0>; Carolyn Lochhead, *Immigration Hurts American Workers, Lawmaker Says; New Arrivals Account for All Job Growth in U.S. From 2000 to 2004*, *Studies Report*, S.F. CHRON., May 5, 2005, at A4; David R. Francis, *Why the New Jobs Go to Immigrants*, CHRISTIAN SCI. MONITOR, Mar. 10, 2005, at 17; Robert J. Samuelson, *Opinion, Discovering Poverty (Again)*, WASH. POST, Sept. 21, 2005, at A23.

period.³⁹¹ Moreover, compared to past recessions and recoveries, the current cycle has had an exceptionally poor job market.³⁹²

The degree of pre-tax income inequality increased, especially over the previous forty years.³⁹³ The CBO recently reported that between 1979 and

391. Jared Bernstein & Lawrence Mishel, *Weak Recovery Claims New Victim: Workers' Wages*, EPI Issue Brief, Feb. 5, 2004, available at <http://www.epinet.org/issuebriefs/196/ib196.pdf>; Lawrence Mishel, et al., *Less Cash in Their Pockets: Trends in Income, Wages, Taxes and Health Spending of Middle-Income Families, 2000-03*, EPI Briefing Paper, Feb. 5, 2004, available at <http://www.epinet.org/content.cfm/bp154>; Louis Uchitelle, *It's Not New Jobs. It's All The Jobs*, N.Y. TIMES, Aug. 29, 2004, at 3-6

(There were 9.86 million wage earners who lost full-time jobs from 2001 through 2003, the Bureau of Labor Statistics reported That dwarfs the recent job creation, and the survey captures only people who acknowledge having been laid off. It misses the disguised layoffs, like forced early retirements, which are proliferating. Forty-five percent of the 9.86 million were back in another full-time job by the time of the survey, or 4.4 million people. Of those, 52 percent earned less than they had at their last jobs. The 1994 and 1984 surveys covered similar periods of recession and recovery, yet the percentages of the re-employed earning less in their new jobs were lower—47 percent in 1994 and 42 percent in 1984. *Losing ground* is a disheartening experience. On a broader plane, it contributes to the wage stagnation and income inequality that have characterized the last 30 years. Both are reappearing after a hiatus that started in the mid-1990's and lasted more or less until 2002.).

392. Mark Schwitzer & Guhan Venkatu, *Employment Surveys are Telling the Same (Sad) Story*, Federal Reserve Bank of Cleveland Research Department (May 15, 2004), available at <http://www.clevelandfed.org/Research/Com 2004/05-15.pdf>.

393. CONG. BUDGET OFFICE, HISTORICAL EFFECTIVE FEDERAL TAX RATES: 1979 TO 2002 (2005), available at <http://www.cbo.gov/ftpdocs/61xx/doc6133/03-01-EffectiveTaxRates.pdf>; Isaac Shapiro, *What New CBO Data Indicate About Long-term Income Distribution Trends*, Center on Budget and Policy Priorities (Mar. 7, 2005) (indicating that the average after-tax real income of the top one percent grew 111% between 1979 and 2002; the middle twenty percent grew fifteen percent; and the bottom twenty percent grew five percent); Eduardo Porter, *How Long Can Workers Tread Water?*, N.Y. TIMES, July 14, 2005, at C1 (noting that income gains go mostly to the affluent; wages for ordinary workers barely keep up with inflation, but the overall income went up sharply due to growing number of jobs and higher pay at the top); Jonathan Krim & Griff Witte, *Average Wage Earners Fall Behind*, WASH. POST, Dec. 31, 2004, at A1; see also DeNavas-Walt, *supra* note 388, at 3 Figure 1 (indicating that the median family income remained unchanged since 2000); Leonhardt, *supra* note 386 (“[The] first time on record that household incomes failed to increase for five straight years”). Current trends are a continuation of the 1980s retreat from progressivity, first fueled by the 1981 tax cut at the top and the 1983 Social Security revisions at the bottom, which exacerbated the income gap effects of underlying economic growth at the top only. STAFF OF THE HOUSE WAYS & MEANS JOINT COMM., 102D CONG., TAX POLICY AND THE MACROECONOMY: STABILIZATION, GROWTH AND DISTRIBUTION 55 (Comm. Print 1991) (“[I]ncome growth in the United States has slowed considerably since the mid-1970s, in contrast to the rate of growth in the previous 25 years.”); Marjorie

2002, the top one percent enjoyed a 111 percent increase in real income.³⁹⁴ “The top fifth enjoyed a 48 percent gain during the same period while the bottom fifth got only a 5 percent income hike.”³⁹⁵ Additionally, Republican administrations decreased the level of transfer payments to lower income individuals over this period.³⁹⁶

Working spouses proved a two-edged sword: middle class families on the surface appeared to be keeping up for the 1980s and 1990s only because more and more women entered the work force producing second earners for many households.³⁹⁷ At the same time growth of two-earner high income households with rising correlation in the spouses’ pay

Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male - Reaction*, 86 MICH. L. REV. 465, 467 n.7 (identifying the three main causes of the reduction in progressivity as being: (1) the fact that rate reductions for the wealthy were not offset by base broadening, (2) increased social security taxes, and (3) large increases in real income for the wealthy).

394. CONG. BUDGET OFFICE, HISTORICAL EFFECTIVE FEDERAL TAX RATES: 1979 TO 2002, *supra* note 394, at Table 1C (reprinted below).

Average Income (2002 dollars)

	1979	1990	1993	2000	2002
Bottom 20%	14,300	14,100	14,100	16,300	14,400
Next 20%	31,000	31,200	30,700	34,700	36,000
Top 10%	157,700	199,900	200,700	298,700	244,500
Top 5%	214,500	281,500	280,800	483,000	350,700
Top 1%	474,300	713,600	700,700	1,345,500	938,100

Pre-tax Share of Income (percent, 2002 dollars)

	1979	1990	1993	2000	2002
Bottom 20%	5.8	4.8	4.5	4.0	4.2
Next 20%	11.1	10.0	9.8	8.6	9.3
Top 1%	9.3	12.1	11.9	17.8	13.4

395. David R. Francis, *How Social Security Could Narrow Rich-Poor Gap*, CHRISTIAN SCI. MONITOR, Mar. 28, 2005, at 17; CONG. BUDGET OFFICE, HISTORICAL EFFECTIVE FEDERAL TAX RATES: 1979 TO 2002, *supra* note 394, at Table 1C.

396. KEVIN P. PHILLIPS, THE POLITICS OF RICH AND POOR 86-9, 204-05 (Random House 1990); see Sharon Parrot & Isaac Shapiro, *House Budget Resolution Cuts Key Low-Income Programs Yet Budget Finds Room for Further Tax Cuts for the Wealthy*, Center on Budget and Policy Priorities (Mar. 10, 2005).

397. Leonhardt, *supra* note 386. The fact that immigrant wives are less likely to participate in the work force accordingly contributed to lower household income. IMMIGRANT POPULATION, *supra* note 391, at 1.

contributed about one-seventh of income disparity 1979-1996.³⁹⁸ Not surprisingly the poverty rate rose in 2004.³⁹⁹

Nor are only the rich and poor affected. For example, the gap between the best- and worst-paid college graduates has increased. The same is true (to take one well-paid occupation) of lawyers; the gap between the top and bottom is growing. Something unplanned is happening on a massive scale.

But what? Economists have yet to find a conclusive answer. One theory blames new technologies—mainly the computer. Computers have, it's said, thrown low-skilled workers out of jobs and made them a glut on the market. Meanwhile, the demand for highly skilled workers rises, and so do their wages. Another popular villain is global trade. Unskilled workers, competing against low-paid workers abroad, have their wages driven down.⁴⁰⁰

398. Gary Burtless, *Has Widening Inequality Promoted or Retarded US Growth?* 29 CANADIAN PUBLIC POLICY, Supplement S185 (2003), available at <http://www.irpp.org/events/archive/jan01/burtless.pdf>.

399. David Leonardt, *Poverty in U.S. Grew in 2004, While Income Failed to Rise for 5th Straight Year*, N.Y. TIMES, Aug. 31, 2005, at A1.

400. Robert J. Samuelson, Opinion, *Clinton Needs "Trickle Down Economics,"* WASH. POST, Dec. 9, 1992, at A23 (providing a simpler explanation—the “economic climate got rougher.”); Louis Uchitelle, *Like Oil and Water: A Tale of Two Economists*, N.Y. TIMES, Feb. 16, 1997, at 1 (noting that Paul Krugman focuses more on new technology, Lester Thurow focuses more on globalization as the cause of the growing gap in income); James P. Pinkerton, Op-Ed, *When the GOP Has It All, Will It Be Enough?; Republicans Carving Up the Spoils of Victory Must Save More than Scraps for the Poor*, L.A. TIMES, Nov. 24, 1994, at B5

([The] vast expansion of the global market divides Americans into two groups, those who must compete with the world and those who can sell to the world.”); see generally Martin McMahon & Alice Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 FLA. TAX REV. 1 (1998); Jonathan Krim & Griff Witte, *Average-Wage Earners Fall Behind; New Job Market Makes More Demands but Fewer Promises*, WASH. POST, Dec. 31, 2004, at A1; Ron Scherer, *US Job Machine In High Gear, but Wages Move Slowly*, CHRISTIAN SCI. MONITOR, Jan. 27, 1994, at 1 (“Labor economist Audrey Freedman says the economy can still see lower unemployment without inflation because companies no longer copy one another’s labor pacts. ‘They do raise wages when looking for a particular employee, or certain skills, but it does not mean it goes through the whole country,’ says Ms. Freedman. Other factors she cites that are helping to keep wages in check include the ‘flexible’ hiring practices of many companies, such as using outside contractors or temporary workers.”); Derrick Z. Jackson, *Raging Bulls on Wall Street*, BOSTON GLOBE, Apr. 2, 1999, at A21 (“Without a strong return on their labor, Americans are saving less to keep up with costs that have risen way beyond inflation for housing and college. Americans saved only 0.5 percent of their income last year, compared to 8.6 percent in 1984.”).

The premium in lifetime earnings for college graduates fell during the 1970s, rose sharply in the 1980s, leveled off in 1990s and may be falling again in current decade; yet it is still forty-five percent more on average than with only a high school degree.⁴⁰¹ These trends partially reflect losses of high wage jobs in manufacturing in 1980s and more recently a quarter of immigrants (principally Asians) having a college degree and concentrating in certain white collar jobs.⁴⁰² Free trade agreement protections for domestic and foreign workers did not live up to the rhetoric.⁴⁰³

401. Louis Uchitelle, *College Degree Still Pays, but It's Leveling Off*, N.Y. TIMES, Jan. 13, 2005, at C1.

402. *Id.*; Louis Uchitelle, *In This Recovery, a College Education Backfires*, N.Y. TIMES, Mar. 14, 2004, § 3, at 3 (identifying lower employment rates and wages among twenty-five to thirty-five year-old college graduates; factors the bursting of high tech bubble and off shoring); see CONG. BUDGET OFFICE, A DESCRIPTION OF THE IMMIGRANT POPULATION 13 (2004)

(Half of Asian immigrants possessed at least a bachelor's degree, including 19 percent with an advanced degree, while the percentage lacking a high school diploma was comparable to that of the U.S.-born population. . . . Asians are significantly more likely than either those born in the United States or other foreign-born residents to be in professional occupations."); see also Sum, *Foreign Immigration*, *supra* note 390, at 23 (indicating that the heavy majority of new immigrants were undereducated and employed in low pay industries, but 28.4% of new immigrants had bachelor's degree and higher and largely the same new immigrants "tended to obtain an above average share of jobs in a few professional specialties, including computer and math sciences and life/physical science occupations.).

403. President Clinton initially relegated environmental and labor standards to unenforceable side agreements to win Congressional approval of NAFTA, but later incorporated them into the treaty itself. Louis Uchitelle, *It's the Economy, Right? Guess Again*, N.Y. TIMES, July 4, 2005, at 3-1 ("President Bush has put limits on the enforcement of Nafta [sic] and of the treaties that his administration has negotiated."); see also Louis Uchitelle, *Challenging the Dogmas of Free Trade*, N.Y. TIMES, Feb. 9, 2002, at B7

(The Bush administration's goal is to 'take care of business first, second and last, and not do enough to make sure workers are getting their fair share,'[Rep. Adam] Smith [(D-Wash), co-chairman of House New Democrat Coalition] said. Rep. Ellen Tauscher (D-Calif.), another co-chairman, said 'the promise of trade liberalization has not lived up to the rhetoric, certainly not for American workers.' . . . Both . . . accused House Majority Leader Tom DeLay (R-Tex.) and Majority Whip Roy Blunt (R-Mo.) of supporting the weak labor and environmental provisions in CAFTA in an effort to build the case with business donors that they should abandon the Democratic Party altogether.);

Thomas B. Edsall, *'New Democrat' Bloc Opposes Trade Pact; Hi-Tech Industry's Support at Risk*, WASH. POST, May 21, 2005, at A4.

Furthermore, white collar jobs are beginning to be offshored or outsourced.⁴⁰⁴

Regardless of the explanation, the result is clear: decreasing returns on labor (except at top) and increasing returns on capital. Some conclude that the two are linked. Some studies indicate that rising income inequality

404. Lael Brainard, et al., *A Fairer Deal for America's Workers in a New Era of Offshoring* 2, (Sept. 14, 2005); EPI ISSUE GUIDE: OFFSHORING, available at <http://www.epi.org/issueguides/offshoring>; L. Josh Bivens, *Truth and Consequences of Offshoring* (EPI Briefing Paper #155 Aug. 2, 2005)

([A] number of studies have been released by various organizations touting large economic benefits that will accrue to the American economy through the offshoring of white-collar work. A closer examination of these studies, however, shows that the promised benefits of offshoring are far overstated, while the likely economic costs are not addressed at all. Further, even the potential benefits to the American economy from offshoring are likely to be concentrated in the incomes of a relatively select percentage of American households.);

Louis Uchitelle, *Maybe It's Time for Another New Deal*, N.Y. TIMES, Apr. 11, 2004, § 3, at 3 (noting public skepticism that just ending the Bush II tax cuts will result in job creation due to “[y]ears of layoffs, wage stagnation, outsourcing and now offshore contracting.”); David Nather, *GOP's Support for Bush Showing Signs of Strain*, 62 CONG. Q. WKLY. 412 (2004)

(A statement by one of his [Bush's] top economists—N. Gregory Mankiw, chairman of the White House Council of Economic Advisers—that praised outsourcing as a ‘new way to do international trade’ was slapped down in a rare rebellion by the House’s top Republican, Speaker J. Dennis Hastert of Illinois. Hastert said the statement ‘fails a basic test of real economics. An economy suffers when jobs disappear.’);

see also N. Gregory Mankiw, Chairman, Council of Econ. Advisers, White House Special Briefing (Feb. 7, 2004), in FED. NEWS SERV., at ¶¶ 21-23.

([O]utourcing is a growing phenomenon, but it's something that we should realize is probably a plus for the economy in the long run. . . . When we talk about outsourcing, outsourcing is just a new way of doing international trade. We're very used to goods being produced abroad and being shipped here on ships or planes. What we're not used to is services being produced abroad and being sent here over the Internet or telephone wires. But does it matter from an economic standpoint whether values of items produced abroad come on planes and ships or over fiberoptic cables? Well, no, the economics is basically the same. More things are tradeable than were tradeable in the past and that's a good thing. That doesn't mean there's not dislocations; trade always means there's dislocations. And we need to help workers find jobs and make sure to create jobs here. But we shouldn't sort of retreat from the basic principles of free trade. Outsourcing is sort of the latest manifestation of the gains from trade that economists have talked about at least since Adam Smith.);

Stephen J. Norton, *For Democrats Blasting Bush on Jobs, Outsourcing Is in*, 62 CONG. Q. WKLY. 620 (2004).

contributed to rapid growth in the United States economy which benefited high income households the most.⁴⁰⁵

The Clinton 1993 tax increase on the rich was a significant factor in the ensuing twelve fat years in which the top one percent disproportionately benefited.⁴⁰⁶ Thus they did not merit a roll back of their 1993 tax increase. “During the Bush years, the tax rate on wages and on income from investments has declined, but the decline for investment income is roughly 4 percentage points while that for workers is 2 points, according to estimates by the Congressional Budget Office.”⁴⁰⁷

VI. STARVE THE BEAST

There is evidence that one of the purposes of the Bush II tax cuts was to restrain spending by taking money out of the government coffers⁴⁰⁸ (in

405. Gary Burtless, *Has Widening Inequality Promoted or Retarded US Growth?* 29 CANADIAN PUB. POL’Y S185, S189 Table 2, (Supp. 2003) (indicating that one-third of change in personal income inequality between 1979 and 1996 reflects increasing inequality of wage earnings, particularly among men; thirteen percent is attributable to a higher correlation between married couples’ earnings, viz., high earners are increasingly likely to be married to high earners; and twenty-one percent is attributable to fewer people living in married-couple households and more living in single parent households).

406. *See supra* note 395. President Clinton’s actions raising the maximum ordinary income rate to 39.6% in 1993 (retaining the OBRA 1990 phase-outs) played a positive, indirect role in the ensuing economic good times. President Clinton redistributed some of the revenue increases from the ordinary rate increases to the working poor (by increasing EITC benefits), and then under Congressional pressure devoted much of the remaining revenues to reducing otherwise increases in the deficit. 146 CONG. REC. S11362-63 (daily ed. Oct. 30, 2000) (statement of Sen. Gramm). These “deficit reduction” efforts led to Federal Reserve Chairman Alan Greenspan’s campaign of lowering interest rates as proponents of rate increases at the top hoped. Proponents of retaining a capital gains preference had denigrated any such interest rate cut as “mythical.”

407. Louis Uchitelle, *Bush Plans Could Raise U.S. Deficits*, N.Y. TIMES, Sept. 4, 2004, at A13.

408. Janet Hook, *Budget Plan Handcuffs Democrats*, L.A. TIMES, June 8, 2001, at A1; Gary S. Becker, *The Real Reason We Need A Tax Cut*, BUS. WK., Mar. 19, 2001, at 28 (“[T]he most important effect of a tax reduction is to curtail government spending, not to stimulate private spending. In his address to the House of Representatives, President Bush did claim that tax cuts help to keep a lid on government spending by reducing the fiscal surplus.”); Gebe Martinez, *The GOP’s Internal Divide*, 62 CONG. Q. WKLY. 166 (2004) (indicating that many liberals say the real GOP agenda is to cut taxes to point out to Congress through the increasing deficit that it must cut domestic spending—a view held by conservative Grover Norquist, president of Americans for Tax Reform and adviser to President Bush’s re-election team).

addition to re-energizing the GOP's tax cutting-base⁴⁰⁹). Considering these regressive Bush II 2001-2003 tax cuts, "[c]ombined with his stated desire to eliminate virtually all taxes on capital income and to privatize Medicare and Social Security, it's not much of an exaggeration to say that Bush would like to roll back the federal government to something resembling its pre-New Deal state."⁴¹⁰ George W. Bush's true reasons for the 2001 and 2003 tax cuts seem to have been to reward the rich and at the same time to starve the government of revenues, forcing it to downsize, i.e., reverse the New Deal and Great Society social welfare programs.⁴¹¹ "The key date

409. Edward Walsh, *Will the Tax Cut Benefit the GOP?; Potential Impact on 2002 Vote Debated, With 2 Sides Citing Course of Economy*, WASH. POST, June 10, 2001, at A5.

410. Jonathan Chait, *Mad About You*, NEW REPUBLIC, Sept. 29, 2003, at 20. Janet Hook, *The Nation; Senate GOP Supports a Temporary End to Taxes on Dividends; Party Divisions Remain, with Bill's Author Admitting He Doesn't Have Votes for Approval*, L.A. TIMES, May 7, 2003, pt. 1, at 22

(“The truth of the matter is that this has nothing to do with the growth of the economy.” said Rep. Charles B. Rangel . . . ‘But it has everything to do with getting rid of the resources that support the programs that a lot of people believe should be supported by this Congress.’);

David Firestone & Richard W. Stevenson, *House Republicans Retreat from Ending Dividend Tax*, N.Y. TIMES, May 2, 2003, at A26 (indicating that the Senate majority leader preferred even a temporary repeal of the dividend tax to the House approach, in the hopes that the repeal would later be made permanent).

411. Adriel Bettelheim, *Going Beyond Social Security*, 63 CONG. Q. WKLY. 1556 (2005) (reporting that the savings incentives being considered by Ways & Means Chair Bill Thomas, according to many Democrats, constitute “a convenient rationale for shrinking Social Security. ‘The real goal here is to set in motion changes that will eventually completely replace Social Security,’ said Sander M. Levin of Michigan, the ranking Democrat on the Ways and Means Social Security Subcommittee.”); Robert Scheer; Commentary, *Social Security Ain't Broke, so Bush Is Obsessed With Fixing It; He Hates Government Programs No Matter How Much Good They Do*, L.A. TIMES, Mar. 8, 2005, at B11 (“The country is being led by a group of ideologues who fanatically reject the notion that government has a role to play in ameliorating the harshest aspects of capitalism.”); Adam Posen, *The Economics of a Second Term*, FIN. TIMES, Nov. 9, 2004, at 19

(These ‘permanent’ tax cuts will provide no short-term stimulus but will convince high-income voters that any shift away from Republican majorities will come at their expense. The cuts are also part of the multi-pronged ‘starve the beast’ strategy to limit any future non-defence government programmes that might aid the Democrats or their voters.);

Craig Gordon, *Analysis: Budget Tabulations Are a Numbers Game*, NEWSDAY, Feb. 8, 2005, at A6

(Bush hopes to appeal to the ‘starve the beast’ contingent—those who want to cut federal taxes so much that there is little left over for what they see as big-government social spending programs. Bush wants to make his tax cut proposals permanent, at a 10-year cost of \$1.1 trillion.);

probably will be 2027, when payroll taxes and interest income paid to the Social Security trust funds are expected to no longer cover program costs. That means the Treasury Department will be required, in essence, to start repaying the \$7.5 trillion or so it will have borrowed to help finance the rest of the government since Social Security was overhauled in 1983. And unless something is done, the trust funds will be empty by 2042, according to the latest estimate.”⁴¹²

As long as foreigners continue to invest so heavily in Treasury securities, the deficit will not have such a corrosive effect on the economy by driving up interest rates.⁴¹³ At the end of 2004, international investors

Martin Sullivan, *Economic Analysis: Getting Serious About Starving The Beast*, 107 TAX NOTES 822, 822 (2005) (indicating that “starve the beast” is now the explicit rationale for tax cuts: deficits will force government to shrink); Warren Rojas, *News Analysis: Norquist Sees Antitax Crusade As Cornerstone Of GOP Domination*, 102 TAX NOTES 307 (2004); Jay Soled, *Refinancing America: The Republican Antitax Agenda*, 101 TAX NOTES 1235 (2003); see also Editorial, *Mr. Bush's Budget Strategy*, N.Y. TIMES, Feb. 28, 2001, at A18 (reporting that polls indicate public recognition that Bush's tax cut was weighted toward the rich and jeopardizes paying down the debt, fending off deficits, and financing education, retirement and health). Professor Shaviro shows that, in fact, government has grown under Bush II. See Shaviro, *supra* note 183.

412. Andrew Taylor, *Next Presidency: A Future of Shortfalls*, 62 CONG. Q. WKLY. 2230 (2004).

413. *Id.* (indicating that foreign investment avoids competition between Wall Street and the Treasury for investment dollars running up interest rates); see Michael R. Crittenden, *30-Year Bonds: An “Old” Solution for the New Deficit*, 63 CONG. Q. WKLY. 1425 (2005) (indicating that foreign central banks are some of largest buyers of Treasury instruments); Andrew Taylor, *With Half-Trillion in Red Ink, U.S. Inc. Looks Bad on Paper*, 62 CONG. Q. WKLY. 132 (2004) (reporting that former Treasury Secretary Rubin argued that large deficits could bring on a cavalcade of other economic problems, including lower stock prices and a sharp decline in the value of the dollar. [He] warned that financial markets and foreign investors will lose confidence in the ability of the U.S. political system to control the deficit and will demand higher interest rates to protect against the risk of inflation.);

John Cranford, *Political Economy: The Long and Short of It*, 63 CONG. Q. WKLY. 2018 (2005) (indicating that Greenspan concluded that the disconnect between federal reserve rates and interest rates was

the result of an excess of global savings combined with a dearth of global investment. In short, foreign savers are looking for a place to park their money—other than putting it into businesses at home—and Treasury securities and U.S. mortgages are perfect spots, with reasonable yields and almost absolute security. If Greenspan's right, that spells trouble because one thing the Fed cannot change is the savings rate in China or Japan or Europe. Nor can it induce investment in those countries, either. Heck, the Fed can't even do much about U.S. savings and investment rates.).

As of June 2003, foreign and international investors owned 20.3% of public debt (but the Federal Reserve and government accounts held 52.6%); Daniel J. Parks, *How Much Debt Is*

held more than \$5.7 trillion in U.S. stocks, corporate bonds and Treasury securities, while U.S. investors held about \$2.5 trillion in foreign securities, leaving America in debt to the rest of the world in the amount of roughly \$3.1 trillion.⁴¹⁴ At this date, the Treasury had more than \$3.9 trillion in outstanding tradable long-term notes and bonds and short-term bills with forty-nine percent held in accounts owned by foreigners, approximately \$1.2 trillion (or sixty percent of foreign holdings) was held by foreign central banks to maintain stable currency reserves.⁴¹⁵ “International investors increased . . . Treasury holdings by \$436 billion [in 2004] while the total marketable debt sold by the U.S. government grew by \$369 billion.”⁴¹⁶ Japanese investors held about thirty-seven percent of all foreign held marketable Treasury securities; China, ten percent; British investors, almost nine percent; and investors in the Caribbean, South Korea, Taiwan, Germany and the oil-exporting countries of OPEC, more than fifteen percent.⁴¹⁷ The Treasury asked a formal advisory committee of bond market traders for its opinion as to the risk of such foreign holdings. “The answer: There are plenty of U.S. investors ready to step into the market if foreigners flee.”⁴¹⁸ Then, however, the stage would be set for a drive up of

Too Much?, 62 CONG. Q. WKLY. 141 (2004); John Cranford, *The Deficit's Hard Truths*, CONG. Q. WKLY. 2554 (2005)

([T]he federal government now imports almost every dollar that it borrows on Wall Street to pay its daily bills. That makes the country even more reliant on foreign capital than it is on foreign oil—and, in theory at least, that money could dry up quickly if foreign investors suddenly decided to invest elsewhere. Since George W. Bush became president, the budget surplus has disappeared, and four years of deficits—including a record \$412.1 billion in fiscal 2004—have required the government to borrow \$1.1 trillion in financial markets. In that same period, overseas investors have lent the federal government a bit more than \$1 trillion. . . . Japan is by far the largest investor in Treasury securities, and China is a fast-rising No. 2. If those two countries, plus investors in Britain and elsewhere, decide to stop lending to the Treasury, Americans will have to pick up the slack. That would drive up Treasury's interest rates—less demand requires a bigger incentive to buy—but also interest rates in general, since U.S.-backed Treasury notes provide the safest investment and thus form a benchmark for all private borrowing. The upshot would limit the amount that Americans could invest in their own businesses and families.).

414. John Cranford, *Political Economy: Ownership Societies*, 63 CONG. Q. WKLY. 606 (2005).

415. *Id.*

416. *Id.*

417. *Id.*

418. *Id.*

interest rates as Treasury and Wall Street compete for the same interest dollars.⁴¹⁹

Several commentators show that, historically, income tax cuts have proven ineffective in restraining spending.⁴²⁰ While this appears to be the case short-term, long-term is another story (holding all else even) and having the Bush II tax cuts a permanent fixture.⁴²¹ The Government Accountability Office has concluded that “[a]bsent policy changes on the

419. Gale & Samara, *supra* note 173, at 158 (“Under the conventional view of fiscal policy, increased public debt and deficits raise the overall supply of debt relative to demand, and thus reduce the price—that is, raise the interest of yield—on such debt.”); Crawford, *supra* note 287; CONG. BUDGET OFFICE, THE ECONOMIC AND BUDGET OUTLOOK: FISCAL YEARS 1988-1992 Part I, 97-102 (Jan. 1987), available at <http://www.cbo.gov/ftpdocs/61xx/doc6196/doc01b-Entire.pdf>. See *supra* note 411.

420. Gale & Samara, *supra* note 173, at 165

(It is not difficult to see why tax cuts may prove ineffective in restraining spending. About 70 percent of spending in 2000 was for social security, medicare, medicaid, defense, and net interest (CBO, 2001a). A significant reduction in spending would require substantial cuts in these programs or massive cuts in others, both of which seem difficult politically. As a result, tax cuts represent a fiscal gamble: if the cuts do not effectively restrain spending, the government could find itself in a difficult fiscal position, as it did after 1981.).

This was another “Riverboat Gamble” that Congress lost.

421. Matthew Miller, Opinion, *A Democratic counter to the “7.2,”* SAN DIEGO UNION-TRIB., Nov. 6, 2003, at B15

(The real problem is that Bush has used the legitimate need for short-run stimulus to enact long-term tax cuts aimed mostly at the best-off. This strategy is a nefarious twofer because it’s also designed to create long-term deficits that conservative ideologues can use to ‘starve the beast’ of government. Bush’s perverse harnessing of short-run need to sell long-run insanity is what Democrats need to make the public understand. . . . Democrats are in a tizzy over news that the economy grew 7.2 percent in the last quarter, the fastest such growth since 1984.);

Mitchell Rofsky, Opinion, *The Liberal Legacy (and the Myth of Conservative Primacy)*, BOSTON GLOBE, Feb. 22, 2004, at D1

(Bush’s tax cuts may well be part of a long-term strategy to ‘starve the beast’ and force huge cuts in social programs. But if the Republicans really believed that their free-market ideology was popular, wouldn’t they openly propose getting rid of all regulatory and social programs and reducing government spending by 50 or 75 percent? . . . For all the damage conservatives can do to the federal budget with tax cuts, or to environmental and corporate regulations with lax or subversive administration, the truth is they can’t swing America back to even the conservatism of the 1970s, much less earlier. It’s frequently said that the political spectrum has moved to the right, but it would be more legitimate to assert that it has shifted left. Not only have conservatives accepted an earlier liberal policy agenda, but what once may have been seen as anti-establishment cultural extremes have become societal norms.).

spending and/or revenue sides of the budget, a growing imbalance between federal spending and tax revenues will mean escalating and ultimately unsustainable federal deficits and debt. For example, . . . if discretionary spending grows at the same rate as the economy and all expiring tax provisions are extended, federal revenues could be adequate to cover little more than interest on the federal debt by 2040.”⁴²² In that event, the Government would be truly starved.

Consider this from the perspective of a not atypical GOP voter—say, a young married woman with three small children living in Ohio. She voted for Bush because he promised to vigorously defend her family against terrorists and because he shares her values. But she has material interests too. She would like to raise her kids full time, but the money isn’t there. Her husband is working long hours, but it’s not nearly enough, and the tax cuts barely made a dent in their debts. At some point, she has to wonder, what has President Bush done for me lately?

Precious little is the right answer, and GOP politicians would do well to take note. Liberals like Thomas Frank, author of “What’s the Matter With Kansas,” have long argued that populist conservatism is nothing more than a con. Conservatives sell values to the working class, but they deliver economic ruin. It’s a view that is overheated, under-informed and more than a little condescending. Unfortunately, it contains a grain of truth.

This wasn’t always the case. In 1980, the federal tax burden was a serious problem, and slashing taxes for the middle class was genuinely populist because it was genuinely popular. But after President Reagan closed countless loopholes and lowered rates, and President Clinton shifted the tax burden onto those most able to pay, the most pressing problems faced by working families weren’t too-high taxes; rather it was the rising costs of healthcare and of raising children.

Somehow, K Street conservatives—the revolving-door clique of high-powered lobbyists, congressional staffers, administration officials and think-tank true believers that defines the Republican agenda—never got the memo. Slashing taxes and “starving the beast” of government remained the order of the day.⁴²³

422. UNDERSTANDING THE TAX REFORM DEBATE, *supra* note 6, at 17.

423. Reihan Salam Commentary; *The Crisis of ‘Sam’s Club’ Republicans*, L.A. Times, Jan. 11. 2005, at B13.

VII. CONCLUSION

Karl Marx quipped about Louis Napoléon:⁴²⁴ “history repeats itself, but the first time was tragedy, and the second time was farce.”⁴²⁵ Farce describes the first phase of the capital gains story (1921-1986) both as to progressivity and, in the case of the Reagan 1981 tax cuts, as to “trickle down” economics (the political philosophy that lower taxes at the top resulted in economic benefits for taxpayers of lesser incomes as well). For pre-tax income at the bottom decreased adjusted for inflation while effective tax rates increased, and pre-tax income at the top exploded while effective rates decreased. Similarly, the supply side argument that tax cuts would pay for themselves was disproved as to the Reagan tax cuts when the deficit exploded. Exactly the same results are occurring under the Bush II tax cuts (particularly as they are fully phased in and if made permanent). Given that this record was pointed out to the Republican majority in Congress, the Bush II tax cuts go beyond a farce. Income redistribution from middle and lower income taxpayers to higher income taxpayers⁴²⁶ through raiding Social Security, lowering effective rates at the top and increasing effective rates at the bottom, and cutting funding of programs aimed at the bottom make the Bush II tax cuts a tragedy.

Tax policies should ameliorate by restoring progressivity. Whether the resulting increases in revenue should be used on education, health care, or

424. Following the abdication and flight of King Louis Phillippe in the French Revolution, Louis Napoléon Bonaparte, nephew and heir to the throne of Napoléon I, was elected President of France in December 1848 on a platform of strong government, social consolidation and national greatness. Louis Napoléon twice withdrew earlier in 1848 from the political arena and returned several times from exile in England, which had been the result of two prior abortive coup attempts. In 1851, he overthrew the Second Republic and seized dictatorial powers as Napoléon III. All this appears the source of Marx’s quip. Under Napoléon III, France scored several military victories in Europe and abroad, becoming again the largest military power in Europe. But Napoléon III’s blunders in Mexico, not supporting Austria in its war with Prussia, and starting and then losing the Franco-Pussian War in 1870, resulted in his being deposed (after capture by the Prussians) and being exiled again to England. Now that was a farce.

425. Keith R. Fisher, *The Higher Calling: Regulation of Lawyers Post-ENRON*, 37 U. MICH. J. L. REF. 1017 (2004) (citing Karl Marx, *The Eighteenth Brumaire of Louis Bonaparte*, in *KARL MARX & FREDERICK ENGELS, SELECTED WORKS* 97 (Progress Publishers reprint 1968) (1852)).

426. 147 CONG. REC. H2212 (daily ed. May 16, 2001) (statement of Rep. Matsui) (indicating that sixty percent of the projected surplus was from Social Security taxes; thus, the income tax cut skewed to the top constitutes “redistributing this tax cut in a way that takes from the average taxpayer or the average worker and gives to the super-rich.”).

for paying down the deficit (or some combination) is the more difficult question. I believe that the bottom line is that the tax system should not make the gap between the after tax income of the top and the rest of Americans greater than the pre-tax gap, as it has under President George W. Bush's 2001 and 2003 tax cuts.

Ideally the tax cuts should be reversed now. Given the narrowness of the victory of the Clinton 1993 tax increases at the top when the Democrats had majority control of both Houses, this is unlikely. Even if the GOP lost control of Congress in the upcoming mid-term elections, a reversal is unlikely under President George W. Bush since he surely would veto any reversal of his tax cuts and opponents of the cuts would not likely be able to override any such veto.

The second best alternative is for these cuts to expire pursuant to their various sunsets. A better alternative would be to narrow the gap between the pre-Bush II tax cuts maximum individual capital gains (20%) and ordinary income tax rates (approximately 42% taking account of the PEP and Pease phase-outs). Given that at the top, on average, amounts of capital gains and ordinary income reported are roughly equal, raising the capital gains rate eight percentage points back to 28% (which may be the revenue maximizing rate anyway⁴²⁷ and lowering the ordinary income rate by eight percentage points to 34 or say 35% and eliminating the phase-outs looks about right. As many have suggested, the estate tax rates should be lowered somewhat, and the exemption raised between \$5 million to \$10 million or so.⁴²⁸ The ideal alternative would be to repeal the corporate income tax, individual capital gains tax at least for stock, and the estate tax, while at the same time taxing the owners annually on the entity's profits—in the case of public corporations, through the easier to administer proxy of mark-to-market (difference between traded value on (a) first of tax year or when acquired if later and (b) last of tax year or when disposed of if earlier

427. STAFF OF THE JOINT COMM. ON TAXATION, NO. JCS-12-90, EXPLANATION OF METHODOLOGY USED TO ESTIMATE PROPOSALS AFFECTING THE TAXATION OF INCOME FROM CAPITAL GAINS (1990) (estimating a revenue maximizing over the long-term capital gains tax rate of 28.5%).

428. Jeffrey H. Birnbaum & Jonathan Weisman, *The 1% Split Over Estate Taxes; The Few at the Top of the Heap Disagree on How to Keep the Most*, WASH. POST, Aug. 12, 2005, at D1 (reporting that small businesses favor \$10 million floor and rate equal to capital gains rate; the very wealthy oppose anything other than total repeal); Dustin Stamper, *Frist Still Promising Estate Tax Repeal Vote; Grassley Outlines Compromise*, 2005 TAX NOTES TODAY 169-2 (2005); Dustin Stamper, *Thomas's Tax Agenda Includes Estate Tax Compromise*, 2005 TAX NOTES TODAY 86-2 (2005).

is taxed as ordinary gain or loss), and in the case of private firms as if they were partners taxed directly on the entity's earnings or loss.⁴²⁹

If, however, President George W. Bush is able to make these cuts permanent and the Treasury is unable to pay its debts to Social Security—the principal of which consists of wages upon which, in many cases, income taxes were paid but the wages were not received by the workers—then I sincerely advocate that the Treasury default on *all* of its obligations. In that case, by analogy to the priority in bankruptcy for unpaid wages,⁴³⁰ I think the Social Security trust funds should have a priority, and if necessary Government buildings, etc., should be transferred to the funds. When I propounded this notion to my father, a retired ironworker, he pointed out that many pension funds hold Government securities. Since employer contributions to qualified retirement plans are conceptualized as deferred wages earned by participants and not employer gratuities,⁴³¹ Treasury securities held by qualified retirement plans should also have a priority.

Of course, our foreign lenders would not lend us any more (recycled U.S. dollars from our imbalance of payments paying for imports from them), so it is likely that we would not import as much from them. Then we would have to manufacture here again and run our economy on consumer spending by better paid workers. While I would hope workers would earn a greater portion of national income, I would expect that the owners of capital would do less well.

429. Professor Dodge has written an excellent exposition of such dual-track integration and I earlier sketched this proposal. Joseph M. Dodge, *A Combined Mark-to-Market and Pass-Through Corporate-Shareholder Integration Proposal*, 50 TAX L. REV. 265, 266-67 (1995) (providing a rigorous and elegant application of these ideas). I fully agree with this two tier model. John W. Lee, *President Clinton's Capital Gains Proposals*, 59 TAX NOTES 1399, 1414, 1418 (1993) (indicating that (a) the critical difference between public and closely held corporations is the separation of ownership and control and (b) at the current graduated inside corporate rates where most owners materially participate violate horizontal and vertical equity).

430. 11 U.S.C. § 507(a)(3) (2005) (providing priority for unsecured claims, but only to the extent of \$10,000 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for—(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual . . .).

Obviously, I would not limit the priority to \$10,000 per Social Security beneficiary.

431. John W. Lee, *ERISA's "Bad Boy": Forfeiture for Cause in Retirement Plans*, 9 LOY. U. OF CHI. L. J. 137, 146-47 (1977); *Ashenbaugh v. Crucible, Inc.*, 1975 Salaried Retirement Plan, 854 F.2d 1516, 1537 (3d Cir. 1988), *cert. denied*, 490 U.S. 1105 (1988) (“[T]he legislative history of ERISA leaves no doubt that Congress considered pensions to be the deferred wages of employees.”).