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THE FISCAL CRISIS IN THE UNITED STATES AND THE HISTORY OF TAX CONSENT: SUMMARY

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The contemporary fiscal crisis in the United States consists of two elements: huge budgetary deficits and a severe structural deficiency in key types of public investment and expenditure on social services. These problems have resulted mainly from a failure to raise tax revenues sufficiently, which was the consequence of a persistent and powerful pattern of tax resistance. This essay explores the history of this pattern.

The inflation which followed World War II interacted with the mass-based, and highly progressive, income tax (which had financed wartime mobilization) to create severe "bracket-creep" problems. In response, in 1945 and 1948 the federal government enacted major tax cuts The tax cutting continued until 1982, sometimes to address bracket-creep problems but more often to stimulate consumption and investment. For the latter two purposes the administration of President Dwight D. Eisenhower cut income taxes significantly in 1954, and the administration of Lyndon B. Johnson engineered an even more ambitious cut in 1964. For all three purposes the administration of Ronald Reagan championed the Economic Recovery Tax Act (ERTA) in 1981. The only tax increases during this period were modest, temporary measures for the Korean and Vietnam wars and increases in taxes earmarked for the very popular Social Security and Federal Highway programs

Much of this tax cutting took place during what public finance scholars have called the "era of easy finance"—a period, lasting until the 1970s, in which economic growth and inflation yielded substantial increases in income-tax revenues even without legislated tax increases. The revenue bonanza allowed a significant expansion of domestic programs, including the introduction of Medicare and the diverse programs of the "Great Society" of President Johnson. In addition, the federal government increased various implicit financial commitments. An important mechanism for doing so was the financial service corporation. "Fannie Mae" and "Freddie Mac," for example, subsidized the residential mortgage market and, reinforced by the federal highway system and tax subsidies to homeowners and community developers, helped create and tie together major new conurbations. However, by disguising the public subsidies, none of these kinds of measures relied on taxpayer consent. In sum, tax consciousness and consent eroded during this era of economic expansion and prosperity, automatic revenue increases, major tax cuts, painless expansion of public programs, and hidden subsidies. The stage was set for a subsequent loss of faith in government.

Beginning with the oil shock of the 1973, the "natural" fiscal slack largely disappeared for two decades. Long-term economic growth slowed, recessions interrupted economic recoveries, inflation accelerated, and the public increasingly lost confidence in government. While President Reagan and other Republican leaders continued to rail against government, bipartisan worries about mushrooming deficits, pressure from the banking community to reduce deficits, and popular support for the protection of national defense, Social Security and Medicare, all drove the federal government to adopt significant tax increases. What followed was perhaps the most significant string of peacetime tax increases in American history outside of the New Deal era. Three presidents, Reagan, George H.W. Bush, and Bill Clinton all played important roles in adopting the tax increases—Reagan in 1982, 1983, and 1984; George H.W. Bush in 1990; and Clinton in 1993. In addition, Reagan provided crucial leadership for the Tax Reform Act of 1986, which was the most significant base-broadening measure in the history of the U.S. income tax.

By the end of the Clinton administration in 2001, the series of tax increases reinforced by the tax revenues which a resumption of rapid economic expansion generated, the United States achieved significant deficit reduction. The tax increases did not reflect, however, any enthusiasm for increasing social spending or enhancing the social reach of the federal government. The three Presidents ended what had been a trend of rapid increases in spending on civilian programs during the period between 1955 and 1981. And, they actually cut, as a share of GDP, spending on infrastructure, education, job training, and development of alternative energy. Thus, these three presidents coped with the end of the "era of easy finance" not only by increasing taxes but also by reducing spending on significant social programs. Their central goals were fundamentally conservative: to expand or protect military spending; to fund entitlement commitments; and to reduce budget deficits. The lowest priority of all three Presidents was discretionary domestic spending. By stressing the goal of deficit reduction, the three Presidents had further undermined tax consent. They explained increases in Social Security taxes and gasoline taxes to the public but the Presidents did not link increases in income taxation with the need for domestic social spending.

During the first decade of the new century, the United States resumed the tax cutting which Reagan had begun in 1981. The electoral victory of George W. Bush, along with the onset of a recession in March 2001, created the political basis for an extended period of tax cutting which yielded across-the-board benefits but focused heavily on extending favors to the wealthiest Americans and to increasing returns on capital investment. The cuts contributed in a major way to the emergence of unsustainable levels of deficits and debt

This study suggests that solutions to the contemporary fiscal crisis will be difficult to attain in light of the historic weakness of tax consent. To develop the means of funding the domestic programs required for the economic and social health of the United States, political leaders will have to make arguments on behalf of both new tax revenue and expansion of domestic spending–something that no federal government in the United States has done since the 1930s In the process, the United States will need to embrace what might be described as fundamental tax reform. Advocates of fiscal reform will have to argue not only that new social programs will require significant new tax revenues—"the price of civilization"—but also that the increased taxes will be accompanied by substantial reforms which make tax systems much fairer, more efficient, and more transparent.