Fordham Law Review

Volume 81 | Issue 5 Article 16

2013

Making Impossible Tax Reform Possible

Susannah Camic Tahk
University of Wisconsin Law School

ARTICLE

MAKING IMPOSSIBLE TAX REFORM POSSIBLE

*Susannah Camic Tahk**

The United States has long struggled to reform its federal income tax code. Despite enthusiastic and widespread bipartisan support for tax reform laws that would eliminate special-interest loopholes, the legislative process has been paralyzed when it comes to passing these laws. This Article proposes a solution to this seemingly intractable federal tax lawmaking paralysis. This paralysis arises because tax reform spreads its benefits among broad groups while concentrating its costs on narrow ones. Political science theory accurately predicts that laws with this cost-benefit allocation will fail. However, federal lawmakers can overcome tax lawmaking paralysis by distributing tax reform's costs and benefits differently. In particular, the federal government can do this by following the examples of states that have successfully escaped tax lawmaking paralysis by earmarking taxes for specific purposes. This Article examines the phenomenon of earmarking and examines several instances of earmarked state taxes. In so doing, this Article argues that earmarking tax revenues for particular purposes offers an opportunity for lawmakers to permanently reform the tax code at last.

TABLE OF CONTENTS

* Assistant Professor of Law, University of Wisconsin Law School. Thanks to Charles Camic, Andrew Coan, Lindsay Clayton, Howard Erlanger, Keith Findley, Cori Harvey, Alexandra Huneeus, Brian Jenn, Cecelia Klingele, Florence Roisman, Brad Snyder, William Whitford, Bree Grossi Wilde, Lua Yuille, and Eric Zolt for extremely helpful comments and discussions; to the Graduate School at the University of Wisconsin and the Arthur Andersen Summer Research Fellowship for funding; and to Monica Mark, Ning Leng, Laura Singleton, and Emma Shakeshaft for outstanding research assistance. All errors are my own.

INTRODUCTION

For decades, fervent calls for tax reform in the United States have crossed party lines. In his 2012 acceptance speech, President Barack Obama proclaimed that he was "looking forward to reaching out and working with leaders of both parties to meet the challenges we can only solve together. Reducing our deficit. Reforming our tax code."[1] Presidential candidate Governor Mitt Romney explained in a debate during the primary election that, as president, he would begin a process of "reshaping the entire tax code."[2]

Going back in time, two campaigns earlier, President George W. Bush told the Republican National Convention in 2004 that "[a]nother drag on our economy is the current tax code, which is a complicated mess, filled with special interest loopholes, saddling our people with more than 6 billion hours of paperwork and headache every year."[3] In 1985, President Ronald Reagan spoke to the nation, telling his listeners that he had "proposed a sweeping new reform that will . . . reduce the many special tax privileges."[4] President Jimmy Carter attempted similar reforms, telling the Democratic

1. *President Obama's Acceptance Speech (Full Transcript)*, WASH. POST (Nov. 7, 2012), http://articles.washingtonpost.com/2012-11-07/politics/35506456_1_applause-obama-sign-romney-sign/2.

2. Mitt Romney, *Republican Debate Transcript, Tampa, Florida, January 2012*, COUNCIL ON FOREIGN REL. (Jan. 23, 2012), http://www.cfr.org/us-election-2012/republican-debate-transcript-tampa-florida-january-2012/p27180.

3. *President Bush's Acceptance Speech to the Republican National Convention*, WASH. POST (Sept. 2, 2004), http://www.washingtonpost.com/wp-dyn/articles/A57466-2004Sep2.html.

4. Address to the Nation on Tax Reform, 1 PUB. PAPERS 705 (June 1, 1985).

National Convention in 1976 that "[i]t is time for a complete overhaul of our income tax system."[5]

Going still further back in time, in 1974, President Gerald Ford supported a "tax reform bill [that would raise revenue with] . . . a windfall tax, profits tax on oil producers, and by closing other loopholes."[6] Addressing Congress in 1961, President John F. Kennedy said that "[i]t will be a major aim of our tax reform program to . . . [broaden] . . . the tax base and [reconsider] . . . the rate structure. The result should be a tax system that is more equitable, more efficient and more conducive to economic growth."[7]

In their appeals for tax reform, these leaders from both sides of the aisle, including both candidates in the 2012 presidential election, all advocated "broadening the income tax base," which entails subjecting more income to tax by eliminating tax preferences.[8] These preferences usually take the form of exclusions, deductions, credits, and special rates, many of which are the hated tax "loopholes" so bemoaned in popular and academic commentary alike.

Broadening the income tax base allows lawmakers to lower baseline income tax rates for hundreds of millions of citizens without losing revenue. This is because a large tax base subject to a low rate can raise the same amount of revenue as a smaller tax base subject to a higher rate. If the tax code[9] gains exclusions, deductions, credits, and special rates, lawmakers must raise rates to maintain revenue levels. Conversely, cutting tax preferences allows lawmakers to lower tax rates. In this way, "tax reform"—broadening the tax base by excising loopholes—gives politicians a chance to offer widespread benefits for huge numbers of constituents. Lawmakers can accomplish tax reform incrementally, cutting one tax loophole at a time, or take a comprehensive approach, slashing large bundles of preferences at once.

As popular as this goal is across the political spectrum, it is nearly impossible to accomplish. "As appealing as the concept sound[s]," wrote journalists Jeffrey H. Birnbaum and Alan S. Murray in the 1980s, "few . . . thought it could be done."[10] Observers from popular-press and academic perspectives alike have used the word "impossible" to describe tax

5. President Jimmy Carter, "Our Nation's Past and Future": Address Accepting the Presidential Nomination at the Democratic Nat'l Convention in N.Y.C. (July 15, 1976), *available at* http://www.presidency.ucsb.edu/ws/index.php?pid=25953.

6. Address to a Joint Session of Congress on the Economy, 2 PUB. PAPERS 228 (Oct. 8, 1974).

7. Special Message to the Congress on Taxation, 1 PUB. PAPERS 290 (Apr. 20, 1961).

8. *See* C. Eugene Steuerle, *Tax Reform, Federal*, TAX POL'Y CENTER, http://www.taxpolicycenter.org/taxtopics/encyclopedia/Tax-Reform.cfm (last visited Mar. 19, 2013).

9. The phrase "tax code" refers to the Internal Revenue Code of 1986, as amended, found in Title 26 of the U.S. Code.

10. JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM 13 (1987).

reform.[11] As late as the summer of 2012, a popular *Washington Post* blogger titled a post, *Tax Reform Is Going To Be Really, Really Hard*.[12] Further, as hard as tax reform is to enact, it is even harder to maintain. Even the few tax reform packages that have become law have fallen apart within several years of passage.[13] No matter how many powerful figures from both sides of the aisle support tax reform, getting it done successfully remains elusive. I call this problem federal tax lawmaking "paralysis."

This Article proposes a partial solution to this seemingly intractable problem. Federal tax lawmaking paralysis arises because tax reform distributes its costs and benefits in ways that doom it to failure. In particular, as I will discuss, federal tax reform has highly concentrated costs and extremely diffuse benefits. Political science theory predicts that laws with concentrated costs and diffuse benefits will not succeed. Viewed from this perspective, tax reform's difficulties are not surprising. This perspective also reveals, however, that tax reformers can overcome federal tax lawmaking paralysis by distributing tax reform's costs and benefits differently.

How states have structured their tax laws makes evident how reformers might do this. In particular, many states earmark[14] specific taxes for specific programs that benefit concentrated groups. As a result, these concentrated groups work to protect those taxes. In this way, the cost-benefit allocation that paralyzes federal income tax lawmaking would not present a problem for earmarked taxes. In fact, examining specific earmarked taxes shows that many of them have attracted defenders who can guard against would-be preferences and loopholes. For this reason, earmarking tax revenues for particular purposes offers a path out of tax lawmaking paralysis and creates opportunities for genuine tax reform.

This Article proceeds in two parts. Part I explores federal tax lawmaking paralysis in detail and explain the ways in which it has come to pervade the U.S. income tax system. Part II demonstrates how the earmarking mechanism can allow tax lawmakers to escape this paralysis. Part II.A describes how states have employed the earmarking device. Part II.B explains how this device addresses the tax lawmaking paralysis problem. Part II.C discusses how to address the risks of earmarking. Part II.D

---

11. *See id.*; David R. Beam, Timothy J. Conlan & Margaret J. Wrightson, *Solving the Riddle of Tax Reform: Party Competition and the Politics of Ideas*, 105 POL. SCI. Q. 193, 194 (1990).

12. Ezra Klein, *Tax Reform Is Going To Be Really, Really Hard*, WONKBLOG (Aug. 10, 2012, 9:05 AM), http://www.washingtonpost.com/blogs/ezra-klein/wp/2012/08/10/tax-reform-is-going-to-be-really-really-hard/.

13. *See* ERIC M. PATASHNIK, REFORMS AT RISK: WHAT HAPPENS *AFTER* MAJOR POLICY CHANGES ARE ENACTED 35–55 (2008); Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261 (2002); Michael J. Graetz, *Reflections on the Tax Legislative Process: Prelude to Reform*, 58 VA. L. REV. 1389 (1972).

14. "Earmarking" a tax's revenues means designating a tax's revenues for a particular purpose. The term "earmark" also refers to an unpopular form of federal special interest spending. *See generally* Rebecca M. Kysar, *Listening to Congress: Earmark Rules and Statutory Interpretation*, 94 CORNELL L. REV. 519 (2009).

discusses several situations in which the earmarking has effectively overcome tax lawmaking paralysis. These situations include four case studies that I have developed using archival material on state tax laws. These case studies show how state-level earmarked taxes have in fact successfully evaded the cost-benefit allocation that gives rise to tax lawmaking paralysis.

I. FEDERAL TAX LAWMAKING IS PARALYZED

Ezra Klein, a prominent economic commentator, recently made the following observation about tax reform:

> As polarized as Washington is over tax and budget issues, a base-broadening, rate-lowering tax-code overhaul has become the one policy every wonk in town can agree on. It formed the core of the Simpson-Bowles deficit-reduction plan,[15] as well as the Domenici-Rivlin proposal.[16] It was the cornerstone of the supercommittee's failed negotiations.[17] It has been talked up by Sen. Max Baucus, the top Senate Democrat on tax issues, and by Rep. Dave Camp, the Republican who heads the tax-writing House Ways and Means Committee. Romney, President Barack Obama and House Budget Committee Chairman Paul Ryan have all endorsed the idea.[18]

Yet, Klein went on to note that each of these Washington movers and shakers has been paralyzed in his efforts to reform the tax code.[19] Why does the tax system face this paralysis? The following section will first describe the paralysis problem and then turn to explain why this problem persists.

A. Federal Tax Lawmaking Paralysis Throughout Recent U.S. History

Tax reformers in the United States have not failed for lack of trying. Yet their endeavors make for a near-tragic narrative. As Birnbaum and Murray wrote in 1987, "[t]he [then-]seventy-three-year history of the income tax had been a story of steady erosion in the tax base, with more and more loopholes being added and few being taken away."[20] Perhaps the most

---

15. This is the report issued from President Obama's bipartisan National Commission on Fiscal Responsibility and Reform, or, in popular parlance, "deficit reduction commission," convened on November 10, 2010. *See Co-Chairs' Proposal*, FISCALCOMMISSON.GOV, http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/CoChair_Draft.pdf (last visited Mar. 19, 2013).

16. This debt reduction report came out of the Bipartisan Policy Center, founded in 2007 by Republican senators Bob Dole and Howard Baker and Democratic senators Tom Daschle and George Mitchell. *See About the Bipartisan Policy Center*, BIPARTISAN POL'Y CENTER, http://bipartisanpolicy.org/about (last visited Mar. 19, 2013).

17. The Budget Control Act of 2011 created this bipartisan Joint Select Committee on Deficit Reduction. For a description of this "supercommittee" and its members, see Chris Good, *Meet the Super Committee*, ATLANTIC (Aug. 11, 2011, 7:00 PM), http://www.theatlantic.com/politics/archive/2011/08/meet-the-super-committee/243495/.

18. Klein, *supra* note 12.

19. *Id.*

20. BIRNBAUM & MURRAY, *supra* note 10, at 13.

remarkable part is the reformers' unwillingness to abandon their cause in the face of seemingly insurmountable obstacles.

The first president to undertake serious tax reform efforts was President John F. Kennedy.[21] For the highest tax policymaking position in his administration, President Kennedy selected Stanley Surrey, a Harvard law professor and dedicated opponent of tax loopholes and, in fact, of most uses of the tax code for nonrevenue-raising purposes.[22] Interest groups strongly opposed the appointment, unleashing a "storm of protest."[23] Senator Harry Byrd, chair of the Senate Finance Committee (the Senate committee responsible for tax legislation), let Surrey know that loophole-closing reform legislation would certainly die before the committee due to interest group opposition.[24] As a result, in the early part of President Kennedy's administration, his "reform efforts wilted."[25] He tried again in 1963, proposing many of Surrey's loophole closers, but the Congressional tax-writing committees killed all of these proposals.[26]

The next serious tax reform efforts emerged in the late 1960s. In 1967, the Treasury Department began working on a major tax reform package. The Treasury released it in 1969, timed to coincide with a speech from Treasury Secretary Joseph Barr "warning of a 'tax revolt' based on the inequities in the tax code, particularly the 'loopholes' that permitted the very rich to avoid taxation."[27] Perhaps as a result, in 1969, Congress finally passed a piece of tax reform legislation, the Tax Reform Act of 1969.[28] Although this law successfully excised a number of tax loopholes, "the reform victory was short-lived."[29] In the years that immediately followed, "subsequent legislation reopened most of the closed loopholes."[30] Tax reform's prospects worsened in 1974 when Representative Wilbur D. Mills, the powerful chair of the House's tax-writing committee—the House Ways and Means Committee—resigned from the House after a sex scandal.[31] Mills had been a committed advocate of tax reform and had worked hard to "constrain the growth of the tax-break system."[32] After his resignation, however, the tax legislative process and its rules became increasingly receptive to interest group participation.[33] According to political scientist Eric Patashnik, "[t]he immediate winners from these changes were lobbyists, who found it easier to obtain special tax benefits for their

21. *See* JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 155–56 (1985).
22. BIRNBAUM & MURRAY, *supra* note 10, at 14.
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. WITTE, *supra* note 21, at 166.
28. Pub. L. No. 91-172, 83 Stat. 487.
29. PATASHNIK, *supra* note 13, at 37.
30. BIRNBAUM & MURRAY, *supra* note 10, at 14.
31. PATASHNIK, *supra* note 13, at 37.
32. *Id.*
33. *Id.*

clients."[34] In this period, new special preferences flooded the tax code. Even the so-called Tax Reform Act of 1976 added a variety of loopholes and made the tax code "more, not less, complex."[35]

This deluge prompted then-presidential candidate Jimmy Carter to propose, as a key plank of his 1976 campaign platform, "comprehensive, total tax reform" that would "eliminate hundreds of tax breaks and greatly reduce the tax rate."[36] Proposing tax reform in 1978, President Carter told Congress that "[f]undamental reform of our tax laws is essential and should begin right now. . . . constitut[ing] a major step towards sustaining our economic recovery and making our tax system fairer and simpler."[37] President Carter's proposal "followed very closely the classic formulation for tax reform" and "advocated broadening the tax base by eliminating or tightening tax reduction provisions; [to] . . . simplify the tax system" and lower rates.[38] Although most tax policy experts applauded President Carter's plan and found his case for reform "extremely powerful, most knowledgeable observers believed the prospects for its adoption were exceedingly dim."[39] Perhaps unsurprisingly, Congress gutted President Carter's reform plans and passed a bill that was "a complete renunciation of the Carter tax proposals and any notion of tax reform."[40] Instead, the would-be tax reform package, enacted in 1978, "expand[ed] many existing tax breaks and add[ed] numerous new provisions targeted to help farmers, teachers, native Alaskans, railroads, record manufacturers, the Gallo winery of California, and two Arkansas chicken farmers."[41] The period that followed "signaled a new era in tax policy, the triumph of a broad coalition of business lobbyists who came together under the rubric of 'capital formation,'" and stuffed the tax code full of new loopholes and industry-specific—and, in some cases, company-specific—preferences.[42] Congress passed several tax bills during this period, but none envisioned major base-broadening reform.[43]

Then, the Tax Reform Act of 1986[44] (1986 Act) arrived. In 1986, the stars aligned to create what multiple observers have called a political or legislative "miracle."[45] Political entrepreneurs from both sides of the aisle,

---

34. *Id.*

35. WITTE, *supra* note 21, at 196.

36. BIRNBAUM & MURRAY, *supra* note 10, at 15.

37. Economic Report and Tax and Budget Messages: Remarks at the Signing Ceremony, 1 PUB. PAPERS 123 (Jan. 20, 1978).

38. WITTE, *supra* note 21, at 205.

39. PATASHNIK, *supra* note 13, at 38.

40. WITTE, *supra* note 21, at 213.

41. BIRNBAUM & MURRAY, *supra* note 10, at 16.

42. *Id.*

43. *E.g.*, Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified in scattered sections of 26 and 42 U.S.C.); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified in scattered sections of 26 U.S.C).

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

45. BIRNBAUM & MURRAY, *supra* note 10, at 285; Michael J. Graetz, *The Truth About Tax Reform*, 40 U. FLA. L. REV. 617, 619 (1988).

including President Ronald Reagan, Treasury Secretary Donald Regan, White House Chief of Staff James Baker, Senator Bob Packwood, Senator Bill Bradley, Representative Jack Kemp, and Representative Dan Rostenkowski, "employed virtually every strategy in the book"[46] to pass a meaningful tax reform bill that was, in President Reagan's words, "a triumph for the American people and the American system."[47] To pass the 1986 Act, Congress and the Reagan Administration exerted massive effort in the face of major interest group resistance to excise from the tax code hundreds of loopholes and special-interest tax preferences and to use the resulting increase in revenue to cut tax rates substantially across the board.[48] Celebrating the legislative achievement in the 1986 Act's signing statement, President Reagan cited a *Washington Post* headline: "*The Impossible Became the Inevitable.*"[49]

The 1986 Act was a remarkable piece of legislation indeed, distinguished by the "sheer *number* of credits and deductions scrapped,"[50] including high-revenue items such as tax preference for capital gains, large breaks for the oil and gas industries, deductions for state and local sales taxes and interest, favorable rules for business entertainment, and a number of provisions that had previously allowed tax shelter activity.[51] All of this loophole-closing allowed Congress to replace the preexisting multilevel rate structure, which had a top marginal rate of 50 percent, with a simple rate schedule with just two rates: 15 percent and 28 percent.[52] As a result, the 1986 Act gave four out of five individual taxpayers tax cuts.[53] In the wake of the 1986 Act, commentators from the popular and academic presses alike rushed to study this "legislative miracle."[54] Scholars of tax policy and of politics wanted to understand how a few political entrepreneurs had overcome such substantial interest group resistance to remove so many preferences and loopholes at once.

---

46. *See* R. DOUGLAS ARNOLD, THE LOGIC OF CONGRESSIONAL ACTION 213 (1990); David E. Rosenbaum, *A Tax Bill for the Textbooks*, N.Y. TIMES, Oct. 23, 1996, at D16.

47. *Negotiators Formally OK New Tax Bill*, HOUS. CHRON., Aug. 17, 1986, § 1, at 1.

48. *See generally* BIRNBAUM & MURRAY, *supra* note 10; Beam, Conlan & Wrightson, *supra* note 11; Rosenbaum, *supra* note 46 (discussing the difficulties of passing the 1986 Act).

49. Remarks on Signing the Tax Reform Act of 1986, 2 PUB. PAPERS 1414 (Oct. 22, 1986).

50. PATASHNIK, *supra* note 13, at 43.

51. Pub. L. No. 99-514, tits. I.D–I.E, III, IV.B, § 411–413, 100 Stat. 2085, 2113–21, 2216–21, 2225–27 (codified as amended in scattered sections of 26 U.S.C.).

52. PATASHNIK, *supra* note 13, at 40.

53. *Id.*

54. *See* BIRNBAUM & MURRAY, *supra* note 10, at 285; TIMOTHY J. CONLAN, MARGARET T. WRIGHTSON & DAVID R. BEAM, TAXING CHOICES: THE POLITICS OF TAX REFORM (1990); Beam, Conlan & Wrightson, *supra* note 11, at 202; Dennis Coyle & Aaron Wildavsky, *Requisites of Radical Reform: Income Maintenance Versus Tax Preferences*, 7 J. POL'Y ANALYSIS & MGMT. 1, 11–17 (1987); James M. Verdier, *The President, Congress, and Tax Reform: Patterns over Three Decades*, ANNALS AM. ACAD. POL. & SOC. SCI. 114, 121–23 (1988).

To this day, observers from a variety of political perspectives recognize the 1986 Act as a major legislative accomplishment. For instance, Robert McIntyre, head of the left-leaning Citizens for Tax Justice recently said that, with the 1986 Act,

> Congress approved and the president signed what many called the most monumental tax reform bill in American history. Six million low-income families were taken off the income tax rolls, and taxes were reduced for 80 percent of middle-income Americans. And the well-off freeloaders, both corporate and individual, were told to start paying again.[55]

President Reagan's chief economic adviser, Harvard economist Martin Feldstein, also recently applauded, "The Tax Reform Act of 1986 was a powerful, positive force for the American economy."[56] He continued, heralding that "[e]qually important, as we look back on it after 25 years, we . . . see that it taught us . . . that politicians with very different political philosophies on the right and on the left could agree on a major program of tax rate reductions and tax reform."[57]

Since 1986, however, the miracle of the 1986 Act has almost entirely fallen apart. No sooner had the bill passed than members of Congress and their constituencies hurried to refill the tax code with loopholes and preferences. Consequently, tax rates again started to rise. Between 1986 and 2010, the number of tax preferences, many of which are quite narrowly targeted, has rapidly increased, along with the share of GDP that those preferences represent.[58] Tax historian Joseph Thorndike summarized the reigning scholarly consensus when he recently wrote of the 1986 Act that

> the law's achievements began to erode almost immediately. In the early 1990s, persistent deficit worries prompted lawmakers to raise rates, especially on high-income taxpayers. These same fiscal pressures prompted a surge of tax expenditures, as lawmakers cast about for ways to spend money without looking like they were doing it. Ultimately, the high-minded ideals of traditional tax reform proved no match for the resurgent political traditions of American democracy. The anomaly of [the] 1986 [Act]—like an episode of sunspots—was over.[59]

New York University tax scholar Daniel Shaviro echoed this view when, upon the twenty-fifth anniversary of the 1986 Act, he observed how "the grand bargain of base broadening for rate reduction," has, in the years since 1986, "slowly unraveled."[60] On the same anniversary, Michael Graetz of Yale and Columbia similarly pointed out that "[t]he 1986 tax reform gave

---

55. Robert S. McIntyre, *Remembering the 1986 Tax Reform Act*, 133 TAX NOTES 351, 356 (2011).

56. Martin Feldstein, *The Tax Reform Act of 1986: Comments on the 25th Anniversary*, 133 TAX NOTES 343, 343 (2011).

57. *Id.*

58. SUZANNE METTLER, THE SUBMERGED STATE: HOW INVISIBLE GOVERNMENT POLICIES UNDERMINE AMERICAN DEMOCRACY 20 (2011).

59. Joseph J. Thorndike, *1986? Who Cares?*, 133 TAX NOTES 349, 349 (2011).

60. Daniel N. Shaviro, *1986-Style Tax Reform: A Good Idea Whose Time Has Passed*, 131 TAX NOTES 817, 818 (2011).

our income tax a good cleansing, but its ink had hardly dried before Congress started adding new tax breaks and raising rates."[61] In *The Washington Post*, journalist Jeffrey Birnbaum, chronicler of the 1986 Act's passage, recently wrote an article entitled *Historic Tax Code Changes Eroded Since 1986*.[62] In it, he bemoaned that,

> while vestiges of the historic measure remain, the tax code has been allowed to revert in many ways to its pre-1986 form and politicians of both parties are eager to push it back further. It has been repopulated with dozens of targeted tax breaks and its rates have not only gone up, but the number of brackets have multiplied.[63]

He quoted former Assistant Secretary of the Treasury for Tax Policy Mark Weinberger explaining what has gone wrong: "Unfortunately, as tax bills wind through Congress, special interests get to them."[64] Along similar lines, former Assistant Secretary of the Treasury and IRS Commissioner Fred T. Goldberg Jr. recently testified before Congress:

> The [Tax Reform] Act [of 1986] did indeed broaden the base and lower rates, and was an improvement over prior law in important respects. But whatever those gains may have been, they were transitory at best. The tax system today is grotesquely complicated. It is perceived as unfair from every point on the political spectrum—from the most liberal Democrat to the most conservative Republican. It has caused gross distortions in the allocation of resources, and has played a significant role in eroding our competitive position in a global economy.[65]

Patashnik, in his study of how legislatures succeed or fail at maintaining reforms over long periods of time, makes a case study of the 1986 Act, using it as a classic example of an unsustainable reform. He writes, "A key test of the durability of a reform is whether subsequent politicians who were not official parties to the bargain feel constrained by it."[66] This test is one that the 1986 Act emphatically failed. Following President Reagan, President George H.W. Bush called for reinstating the preferential rate on capital gains and blessed a series of additional tax preferences, most notably for oil exploration and small business, "signaling to lobbyists that his Administration was in the tax-break business."[67] Between 1987 and 1998, eight in ten members of Congress sponsored or cosponsored legislation to provide special treatment for particular industries, amounting to more than 700 tax bills introduced in the House of Representatives or the Senate

61. Michael J. Graetz, *Tax Reform 1986: A Silver Anniversary, Not A Jubilee*, 133 TAX NOTES 313, 321 (2011).
62. Jeffery H. Birnbaum, *Historic Tax Changes Eroded in Years Since 1986*, WASH. POST, June 7, 2004, at A1.
63. *Id.*
64. *Id.*
65. *How Did We Get Here? Changes in the Law and Tax Environment Since the Tax Reform Act of 1986: Hearing Before the Sen. Comm. on Fin.,* 112th Cong. 40 (2011) (statement of Fred. T. Goldberg Jr., Former Asst. Sec'y, Treasury for Tax Policy).
66. PATASHNIK, *supra* note 13, at 43.
67. *Id.*

during this period.[68] Almost all of these bills proposed new preferences rather than cutting old ones.[69] This trend continued into the next decade, with the American Jobs Creation Act of 2004[70] creating particular provisions, among many others, for "tackle box makers, Native Alaskan whaling captains, restaurant owners, Hollywood producers, makers of bows and arrows, NASCAR track owners, and importers of Chinese ceiling fans."[71]

According to Patashnik's analysis, this reversal occurred because the 1986 Act, the one truly meaningful tax reform bill ever to pass Congress, failed to alter the "political dynamic" of tax lawmaking.[72] He cites prominent economist Milton Friedman, who predicted soon after the 1986 Act's passage that "[n]othing has changed to prevent the process that produced our present tax system from starting over. As lobbyists get back into action, and as members of Congress try to raise campaign funds, old loopholes will be reintroduced and new ones invented."[73] He points out that, following the 1986 Act, most of the interest groups that had opposed the legislation were still powerful and had plenty of time and resources left to devote to expressing their opposition and attempting to reverse what Congress had done in 1986.[74] Even interest groups that had supported the 1986 reform started to hack away at it as soon as they needed a tax preference.[75] One prominent lobbyist described the common post-1986 attitude among interest groups as follows: "If you can have your cake and eat it, too, and have no change in the [lowered] rates and get goodies . . . well, why not?"[76]

Further, the members of Congress who depended on tax-related campaign donations continued to do so. Seats on the tax-writing committees remained reliable sources of campaign funds.[77] When Congress was writing the 1986 Act, members of the House Ways and Means Committee, which handles tax legislation, received on average a 24 percent increase in contributions during the 1985–86 cycle.[78] Rather than decline in the face of a newly reformed tax code with fewer loopholes, that figure only continued to increase after that cycle.[79]

In 2005, tax reform supporter President George W. Bush appointed a prominent bipartisan commission on tax reform. The commission strongly supported classic rate-lowering, base-broadening reform in the style of the

68. *Id.* at 44.
69. *Id.*
70. Pub. L. 108-357, 118 Stat. 1418 (codified in scattered sections of 26 U.S.C.).
71. PATASHNIK, *supra* note 13, at 44 (internal quotation marks omitted).
72. *Id.* at 50.
73. *Id.* at 54.
74. *See id.* at 51.
75. *See id.*
76. *Id.*
77. *Id.*
78. *Id.* at 51–52.
79. *Id.* at 52.

1986 Act. Explaining reasons for that recommendation, the members of the commission wrote:

> Since the 1986 tax reform bill passed, there have been nearly 15,000 changes to the tax code—equal to more than two changes a day. Each one of these changes had a sponsor, and each had a rationale to defend it. Each one was passed by Congress and signed into law. . . . In retrospect, it is clear that frequent changes to the tax code, no matter how well-intentioned, ultimately undermine the integrity of the code in real and significant ways.[80]

The commission went on to advocate a detailed series of reforms, including eliminating such large preferences as the ones for home mortgage interest and employer-provided health insurance.[81] The affected interest groups, including realtors and life insurance firms, jumped into action to oppose the proposal, however, and none of the commission's proposals became law. Similarly, despite the fact that President Obama has made tax reform a plank of both his 2008 and 2012 presidential campaigns and has proposed major loophole-closing reforms in each of his budgets since winning office, his tax reform plans have also gone nowhere.[82]

Perhaps in part because the income tax has been so difficult to reform, it remains unpopular with Americans, and most favor cutting it. For example, a recent poll asked respondents, "It is now agreed that, because the United States is in a recession and at war, the federal government will be in a deficit for the next few years. Given this, please tell me whether you would favor or oppose . . . providing tax cuts for middle- and low-income individuals."[83] In response, 80 percent of survey participants favored tax cuts, with another 4 percent answering "not sure" or "it depends."[84] Without the deficit prompt, the number of respondents favoring cuts rises to 87 percent.[85]

80. PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR & PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM vi (2005), *available at* http://permanent.access.gpo.gov/lps64969/TaxReformwholedoc.pdf.

81. *See generally id.*

82. For a summary of President Obama's proposed loophole-closing reforms, none of which have become law, see OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2013, at 196–212 (2012); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2012, at 198–212 (2011); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2011, at 170–192 (2010); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2010, at 265–276 (2009).

83. *NBC News/Wall Street Journal Poll, Feb. 2009*, ROPER CENTER, http://tinyurl.com/buhrg5t (last visited Mar. 19, 2013).

84. *Id.*

85. *Gallup/USA Today Poll, Jan. 2008*, ROPER CENTER, http://tinyurl.com/apvydym (last visited Mar. 19, 2013).

As for the basis of this attitude, tax scholars have linked the income tax's unpopularity to the fact that taxpayers do not understand what the tax's revenues fund. Professor Graetz writes:

> Recently retired congressman Beryl Anthony of Arkansas clearly linked anti-government sentiment and tax resistance: "The voters clearly believe government is not giving anywhere close to a dollar's worth of value for a dollar's worth of taxes." The singer and songwriter Richie Havens captured this sentiment more graphically when he said, "We should pay for what we get, not for what we don't get. What we don't get is just about everything."[86]

B. Understanding Federal Tax Lawmaking Paralysis

In light of the subsequent history of the 1986 Act, the federal tax system presently appears completely paralyzed when it comes to reform. Observers agree that passing the 1986 Act was a political miracle, the likes of which have never otherwise happened in the income tax's ninety-nine year history.[87] But even that miracle did nothing to overcome this paralysis in any sustained manner. Reform happened, fell apart, and seems unlikely to happen again any time soon. While politicians continue to promise tax reform, its prospects seem very dim.

While the tax literature to date devotes substantial time to studying the details of different federal tax reform packages,[88] it offers no theoretical framework for understanding *why* federal tax reform lawmaking is paralyzed. For this reason, the tax literature has no solution to tax lawmaking paralysis. The existing scholarship has a great deal to say about the costs and benefits of different reform proposals that have, or perhaps should have, been tried.[89] Existing scholarship also has a great deal to say about what tax reform should look like going forward, should it pass.[90] Different scholars have different lists, all long, of the loopholes that most

86. MICHAEL J. GRAETZ, THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE 6 (1999).

87. *See* BIRNBAUM & MURRAY, *supra* note 10, at 285; CONLAN, WRIGHTSON & BEAM, *supra* note 54, at 1.

88. *See generally, e.g.*, GRAETZ, *supra* note 86, Reuven S. Avi-Yonah, *The Report of the President's Advisory Panel on Federal Tax Reform: A Critical Assessment and a Proposal*, 59 SMU L. REV. 551 (2006); Joseph Bankman & David A. Weisbach, *The Superiority of an Ideal Consumption Tax over an Ideal Income Tax*, 58 STAN. L. REV. 1413 (2006); Michael J. Graetz, *Taxes That Work: A Simple American Plan*, 58 FLA. L. REV. 1043 (2006); Daniel N. Shaviro, *Replacing the Income Tax with a Progressive Consumption Tax*, 103 TAX NOTES 91 (2004); Linda Sugin, *Tax Expenditures, Reform and Distributive Justice*, 3 COLUM. J. TAX L. 1 (2011).

89. *See generally, e.g.*, David L. Cameron, *Research Tax Credit: Statutory Construction, Regulatory Interpretation and Policy Incoherence*, 9 COMPUTER L. REV. & TECH. J. 63 (2004); Fred T. Goldberg Jr. & Susannah Camic, *Tax Credits for Health Insurance*, 37 J.L. MED. & ETHICS 73 (2009); Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347 (2000); Katherine Pratt, *The Debt-Equity Distinction in a Second-Best World*, 53 VAND. L. REV. 1055 (2000).

90. *See* sources cited *supra* note 89.

need closing, of preferences that have most clearly ceased to serve their original purposes, and of breaks whose costs to federal revenue have most substantially outpaced their social benefits.[91] Nevertheless, no tax scholarship proposes a way to overcome this paralysis and to enable some of these reforms to become law.

Understanding this paralysis and what might overcome it requires instead a broader look at how interest groups function more generally. What factors particular to federal tax law paralyze its developmental apparatus? Interest group theory from political science provides an answer to this question. Theories of regulation, particularly those following Harvard political scientist James Q. Wilson's famous work on the subject, have argued that how a law distributes its *costs* and *benefits* determines how easy that law is to pass and to sustain.[92] Significantly, tax scholars have yet to consider using this cost-benefit framework in the context of tax lawmaking. Yet this framework can explain federal tax lawmaking paralysis and, more importantly, suggests a previously neglected path out of that paralysis.

According to Wilson's framework, laws have either *concentrated* costs or *diffuse* costs.[93] Laws also have either *concentrated* benefits or *diffuse* benefits.[94] Laws with concentrated costs or benefits focus their costs or benefits on a particular, narrow group, such that every member of the group receives a substantial cost or benefit. In contrast, laws with diffuse costs or benefits spread those costs or benefits over a broad group so that every member of this large set receives a small cost or benefit. This cost-benefit feature of laws is, according to this argument, very important to legal development.[95] The following diagram demonstrates the four types of possible laws under this cost-benefit framework.

91. *See* sources cited *supra* note 89.

92. James Q. Wilson, *The Politics of Regulation*, *in* THE POLITICS OF REGULATION (James Q. Wilson ed., 1980). For later development of this theory, see, for example, Michael D. Reagan, *The Politics of Regulatory Reform*, 36. W. POL. Q. 149 (1983); Elaine B. Sharp, *The Dynamics of Issue Expansion: Cases from Disability Rights and Fetal Research Controversy*, 56 J. POL. 919 (1994); Charles R. Shipan, *Regulatory Regimes, Agency Actions, and the Conditional Nature of Congressional Influence*, 98 AM. POL. SCI. REV. 467 (2004); Bruce A. Williams & Albert R. Matheny, *Testing Theories of Social Regulation: Hazardous Waste Regulation in the American States*, 46 J. POL. 428 (1984); B. Dan Wood & Richard W. Waterman, *The Dynamics of Political Control of the Bureaucracy*, 85 AM. POL. SCI. REV. 801 (1991); B. Dan Wood, *Does Politics Make a Difference at the EEOC?* 34 AM. J. POL. SCI. 503 (1990).

93. *See* Wilson, *supra* note 92, at 367.

94. One can debate whether a handful of laws fall in a gray area but, as a general matter, this is how laws distribute costs and benefits.

95. Wilson, *supra* note 92, at 367–70.

Table 1: Cost-Benefit Framework

	Costs		
Benefits		Diffuse costs	Concentrated costs
	Diffuse benefits	**Quadrant 1** Diffuse costs, diffuse benefits (“majoritarian politics”)	**Quadrant 3** Concentrated costs, diffuse benefits (“entrepreneurial politics”)
	Concentrated benefits	**Quadrant 2** Diffuse costs, concentrated benefits (“client politics”)	**Quadrant 4** Concentrated costs, concentrated benefits (“interest group politics”)

To understand this framework, let’s begin with Quadrant 2 in the table. A law from Quadrant 2 has diffuse costs and concentrated benefits and, according to the theory, will likely be easy to enact and to expand. The costs of laws of this type are too widely shared to provide any group a strong enough incentive to organize against them.[96] The benefits are concentrated in groups that work hard to organize and advocate for these laws.[97] Wilson calls the politics of Quadrant 2 “client politics.”[98] In this quadrant,

> [s]ome small, easily organized group will benefit and thus has a powerful incentive to organize and lobby; the costs of the benefit are distributed at a low per capita rate over a large number of people, and hence they have little incentive to organize in opposition—if, indeed, they even hear of the policy.[99]

Examples of Quadrant 2 client politics from the nontax areas of public policy include “less conspicuous regulatory programs, such as state laws that license (and protect) occupations” or “where the government is supplying a cash subsidy to an industry or occupation.”[100]

Conversely, this theory holds that laws that have diffuse benefits and concentrated costs (i.e., Quadrant 3 laws) get nowhere.[101] In these cases, the particular groups that stand to bear the concentrated costs work hard to

96. *Id.* at 369.
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.* at 370.

resist these laws. However, no group has a sufficient incentive to fight *for* these laws. As the author of a subsequent study about this typology explains, "the powerful group that would have costs imposed on it [by a Quadrant 3 law] will organize in opposition while diffuse unorganized beneficiaries have no incentive to push for the policy at issue."[102]

Wilson calls Quadrant 3 politics "entrepreneurial politics" because powerful political entrepreneurs must mobilize if a Quadrant 3 policy is ever to pass.[103] Wilson explains the difficulty of policymaking in Quadrant 3: "Since the incentive to organize is strong for opponents of the policy but weak for the beneficiaries, and since the political system provides many points at which opposition can be registered, it may seem astonishing that regulatory legislation of this sort is ever passed."[104] An exception, he points out, is consumer-safety regulation of the type that Ralph Nader, "a skilled entrepreneur who can mobilize latent public sentiment," was instrumental in passing.[105]

Lawmaking in the other two quadrants is neither as easy as that in client politics (Quadrant 2) or as difficult as that in entrepreneurial politics (Quadrant 3). Quadrant 1 is home to the "majoritarian politics" of laws whose costs and benefits are both widely distributed.[106] Here, "[a]ll or most of society expects to gain; all or most of society expects to pay."[107] For this reason, "[i]nterest groups have little incentive to form around such issues because no small, definable segment of society (an industry, an occupation, a locality) can expect to capture a disproportionate share of the benefits or avoid a disproportionate share of the burdens."[108] Quadrant 1 laws sometimes pass and sometimes do not, depending on whether the proposals make it onto the political agenda at all, whether lawmakers agree that the law is a legitimate government action, and whether sufficient numbers of involved parties agree with the proposed law ideologically.[109] According to Wilson, examples include maintaining a large standing army in the years following World War II, the Sherman Antitrust Act,[110] and the Federal Trade Commission Act.[111] In all of these cases, "[n]o single industry was to be regulated; the nature and scope of the proposed regulations were left vague; any given firm could imagine ways in which these laws might help them."[112] None of these laws inspired "determined industry opposition," but, to pass, each required mass public support.[113]

102. Sharp, *supra* note 92, at 921–22.
103. Wilson, *supra* note 92, at 370.
104. *Id.*
105. *Id.*
106. *Id.* at 367.
107. *Id.*
108. *Id.*
109. *Id.*
110. 15 U.S.C. §§ 1–7 (2006).
111. *Id.* §§ 41–58; Wilson, *supra* note 92, at 367.
112. Wilson, *supra* note 92, at 367–68.
113. *Id.* at 368.

Quadrant 4 laws, which give rise to "interest group politics," also have mixed success in terms of passage. Here, "[a] subsidy or regulation will often benefit a relatively small group at the expense of another comparable small group."[114] With regard to Quadrant 4 laws, "[e]ach side has a strong incentive to organize and exercise political influence."[115] Mass opinion rarely plays a major role because "[t]he public does not believe it will be much affected one way or another; though it may sympathize more with one side than the other, its voice is likely to be heard in only weak or general terms."[116] In "[m]ost examples of interest-group politics," neither interest group is the total victor and instead, there is "something in the final legislation to please each affected party."[117] Labor laws, including landmarks such as the Wagner Act[118] and Taft-Hartley Act,[119] often fall into this category.[120]

Extending Wilson's framework to the study of tax legislation offers a fruitful way to understand tax lawmaking paralysis. Wilson's analysis suggests that governmental units are likely to become paralyzed when trying to enact Quadrant 3 laws (i.e., laws with diffuse benefits and concentrated costs). Throughout its recent history, federal tax reform legislation is indeed of this very type. Reforming the federal tax code by closing loopholes has very diffuse benefits and very concentrated costs—a classic Quadrant 3 scenario. When tax lawmakers opt to close a loophole or a series of loopholes, the benefits from doing so are quite diffuse. Closing loopholes allows the federal government either to lower tax rates across the board or, in the alternative, to grow its fund of general revenue and to distribute this increased revenue across multiple federal programs. Accordingly, when lawmakers seek to reform the tax code, potential beneficiaries fall into two amorphous groups: (i) all individuals who pay federal taxes and (ii) individuals who may happen to benefit in unspecified ways from the growth of general government revenues. In the 1986 Act, where loophole closing allowed for massive rate lowering, the former group—taxpayers en masse—constituted the beneficiaries. The costs of tax reform tend to be concentrated, however, landing almost exclusively on those groups that have heretofore gained from the particular preferences to be pruned from the tax code.[121] For example, if a tax reform bill along the lines of the 1986 Act were to reverse the tax consequences of the American Jobs Creation Act of 2004, the reform bill's costs would be concentrated among "tackle box makers, Native American whaling captains, restaurant owners, Hollywood producers, makers of bows and arrows, NASCAR track

114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. 29 U.S.C. §§ 151–169 (2006).
119. *Id.* §§ 141–197.
120. Wilson, *supra* note 92, at 368.
121. CONLAN, WRIGHTSON & BEAM, *supra* note 54, at 193 (observing this cost-benefit distribution in passing, but not exploring its consequences).

owners, and importers of Chinese ceiling fans."[122] At the same time, the bill's beneficiaries would be the diffuse millions of taxpayers whose tax rates might fall a little.

Quadrant 3 lawmaking is difficult. Laws from this quadrant rarely pass and only do so with disproportionate amounts of effort or in very particular circumstances.[123] Take the example of the tax preference that NASCAR track owners received in 2004 in the form of a preferred depreciation schedule for NASCAR tracks.[124] Whichever member of Congress inserted that preferred depreciation schedule for NASCAR tracks into the 2004 Act would likely not have even known that NASCAR owners needed a new depreciation schedule unless a representative of that group came forward to flag the issue. If, after 2004, a member of Congress attempted to excise this established preference, that same interest group would spring into action. The group would work with the members of Congress who have NASCAR tracks in their districts to preserve the preference. A NASCAR facility in a district presumably brings with it substantial economic stimulus and plenty of jobs. To keep a track in his or her district, a member of Congress would likely be willing to work to maintain the special treatment. In fact, the member of Congress could probably find other members who needed to preserve similar preferences for their own constituents, and the members could agree to watch out for each others' provisions.

At the same time, however, no interest group represents the hundreds of millions of Americans who either lost a bit of government revenue due to the favorable depreciation schedule or whose taxes had to go up to make up for the lost revenue. No interest group staffer will make the rounds of congressional offices pleading with members to remove the favorable NASCAR depreciation schedule. Removing the schedule is a classic Quadrant 3 project.

On occasion, tax reform may also fall within Quadrant 1 as a diffuse-costs, diffuse-benefits law. Take efforts to reform the federal alternative minimum tax (AMT) as an example. Most scholars, commentators, and taxpayers agree that the federal AMT has spiraled out of control, both in terms of complexity and in terms of the number of affected taxpayers.[125] Initially designed to make sure that very high-income taxpayers paid a minimum amount of tax regardless of available deductions or credits, the AMT now hits many middle-income taxpayers and has become

---

122. PATASHNIK, *supra* note 13, at 44; *see* American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 102, 211, 332, 333, 335, 704, 713, 118 Stat. 1418, 1424, 1429, 1477, 1478, 1548, 1561 (codified as amended in scattered sections of 26 U.S.C.).

123. Wilson, *supra* note 92, at 370.

124. American Jobs Creation Act of 2004 § 704.

125. *See generally* LEONARD E. BURMAN, JULIANNA KOCH, GREG LEISERSON & JEFFREY ROHALY, TAX POLICY CTR., THE INDIVIDUAL ALTERNATIVE MINIMUM TAX (AMT): 12 FACTS AND PROJECTIONS (2008), *available at* http://www.taxpolicycenter.org/UploadedPDF/411707_12AMTFacts.pdf.

extraordinarily complicated.[126] Members of Congress and presidential candidates from both sides of the aisle have repeatedly called for eliminating or at least substantially reforming the AMT.[127] Aside from annual temporary tinkering, however, the tax remains in place and only grows larger and more burdensome with every year.[128]

Failure to pass lasting AMT reform is not, however, a Quadrant 3 problem. No concentrated interest group is currently benefitting from the AMT, so no one has a particular incentive to protect it. But while the AMT hits hundreds of thousands of middle-income Americans a year, its costs are diffuse enough such that no one has sufficient incentive to push Congress toward resolving the issue.

Understanding tax reform proposals as Quadrant 3 laws (or, less often, Quadrant 1 laws) makes federal tax lawmaking paralysis easier to grasp. As the federal tax lawmaking process currently works, no party to this process has sufficient incentive to attempt to remove any one of the loopholes and preferences currently pervading the tax code.[129] The benefits of pruning each are simply too diffuse. As a result, the provisions, with their highly concentrated advantages, stay in the tax code indefinitely. Members of Congress move along to other bills that incite less opposition or provide concrete benefits to another target constituency. Reform efforts remain paralyzed.

---

126. *Id.* at 2; *see also* LEONARD E. BURMAN, WILLIAM G. GALE & JEFFREY ROHALY, TAX POLICY CTR., THE EXPANDING REACH OF THE ALTERNATIVE MINIMUM TAX 7–8, 10–11 (2005), *available at* http://www.urban.org/uploadedPDF/411194_expanding_reach_AMT.pdf.

127. *See, e.g.*, Walter Hamilton, *Obama Aims To Abolish a Detested Tax*, L.A. TIMES, Feb. 15, 2012, at B1; Aviva Aron-Dine, *Alternative Approaches to AMT Reform: Criteria for Evaluation and Preliminary Assessments*, CENTER ON BUDGET & POL'Y PRIORITIES, 1 (Apr. 30, 2007), http://www.cbpp.org/files/4-2-07tax.pdf; Jim Meyers & Kathleen Walter, *Hatch: Middle Class Faces "Stealth Tax" Without AMT Reform*, NEWSMAX (Nov. 28, 2012 3:39 PM), http://www.newsmax.com/US/hatch-alternative-minimum-tax/2012/11/28/id/465738.

128. BURMAN ET AL., *supra* note 125, at 2.

129. Interest groups may have an incentive to remove other groups' tax favors when a group is proposing a new preference. As tax scholar Elizabeth Garrett documents in her outstanding article on this topic, the congressional tax-writing committees have to comply with certain offset requirements. As a result, in many cases, when a group wants a new preference that will cost the government revenue, the revenue needs to come from a reduction elsewhere. For this reason, interest groups often peruse lists of tax provisions, looking for some that Congress might prune. But this practice does not do enough to end tax lawmaking paralysis. No interest group proposing a new preference has any particular attachment to any specific cut. As a result, if an interest group suggests paying for that new preference by slicing some other group's item and the attacked group fights back, the group seeking the preference has an incentive to move on and proffer another way to pay for it that inspires less resistance. These interest group battles occasionally cull the herd of preferences, but the offset rules more often just make it somewhat more difficult to enact new preferences and less often result in minor cuts and additional complexity within the existing set. For a discussion of these issues, see Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501 (1998).

II. EARMARKING FEDERAL TAX REVENUES TO OVERCOME PARALYSIS

Given this federal paralysis problem, the question becomes, what tax lawmaking alternatives are out there? What devices might serve as potential vaccines against this paralysis that prevents tax lawmakers from enacting widely supported tax reform bills that would provide benefits to hundreds of millions of Americans?

The key is to find a way to move tax reform into one of the quadrants where paralysis is less likely to occur. At first, this task may seem difficult, given that tax reform seems like a classic diffuse-benefits situation, usually a politically doomed Quadrant 3 law. Contemporary state-level tax lawmaking, however, provides a striking alternative to the federal approach. In particular, all fifty states earmark tax revenues for specific purposes. With the notable exception of Social Security and Medicare, the federal government has not had very much experience with earmarked taxes. The revenue that the federal income tax collects goes into general revenues and is not earmarked for any specific purpose.

When a governmental unit "earmarks" a tax, the governmental unit "set[s] aside [the revenue] for a specific purpose or recipient."[130] In contrast, nonearmarked taxes go into general revenues, a large pool of money that the government later distributes for most of its spending programs. While states vary in their earmarking practices, in 2005, states were deriving on average 24 percent of their revenues from earmarked taxes.[131]

Earmarking tax revenues for particular purposes, or taxing with purpose, has the potential to move tax reform legislation into one of the quadrants—often Quadrant 4, but sometimes Quadrant 2—that does not suffer from paralysis problems. In this part, I explain why this is the case.

A. How Earmarking Works

States earmark tax revenues for a wide range of purposes. In this section, I briefly describe the common types of earmarked taxes and discuss how states precommit earmarked revenues.

Great variety exists among earmarked taxes at the state level. For instance, highways receive motor fuel taxes in forty-five states.[132] States also fund highways through motor vehicle registrations (eight states) and general sales taxes (seven states).[133] Forty-six states earmark taxes for local governments, most commonly transportation taxes.[134] Thirty-five states earmark taxes for both K–12 and higher education.[135] Earmarked state

130. BLACK'S LAW DICTIONARY 584 (9th ed. 2009). Again, I do not use this term to refer to the practice of Congressional special-interest spending.
131. ARTURO PÉREZ, EARMARKING STATE TAXES 5 (2008).
132. *Id.* at 3.
133. *Id.*
134. *Id.*
135. *Id.*

taxes dedicate revenues to health and social services in almost as many (thirty-four) states.[136] Most programs for health services receive funds from tobacco taxes (twenty-three states) and alcoholic beverage taxes (thirteen states).[137] Taxes earmarked for environmental causes receive precommitted tax revenue in thirty states.[138]

To review the state taxes most frequently earmarked, the motor fuel tax mentioned above is the most popular, and is earmarked in all but one state.[139] Twelve states earmark their motor vehicle registration fees.[140] Also commonly earmarked are taxes on general sales (thirty-five states), tobacco (twenty-six states), alcoholic beverages (twenty-three states), and insurance and severance (twenty-six states each).[141] Twenty states earmark some of their income tax.[142]

Within this variety, earmarked state taxes fall, broadly speaking, into four descriptive categories. The first kind of earmarked taxes are penalties, which tax private activities that the state lawmakers view as disproportionately costly to the general public.[143] These include taxes on cigarettes, alcohol, and gambling. Sometimes, states use these taxes to force smokers, drinkers, and gamblers to finance, for example, antismoking, antidrinking, and antigambling efforts, or otherwise to pick up the public costs of these activities.

States also earmark penalty taxes for purposes that have nothing to do with the penalized activity. A few examples of such penalty taxes include Alaska's cigarette tax, earmarked for the rehabilitation, construction, repair, and associated insurance costs of state school facilities and for tobacco use "education and cessation" (64.1 percent of the revenue collected through this tax);[144] Tennessee's mixed-drink tax, earmarked for public schools (45.4%) and for cities and counties (45.4%);[145] and Idaho's liquor tax, earmarked for cities and counties (48.8%), community colleges (0.9%), welfare programs (1.9%), alcohol treatment (3.6%), public schools (3.6%),

136. *Id.*
137. *Id.*
138. *Id.*
139. *Id.* at 4.
140. *Id.*
141. *Id.*
142. *Id.*
143. *See, e.g.*, LA. CONST. art. VII, § 27; ALA. CODE §§ 28-3-53.2, -74, -184, -200 to -205, 28-7-16 (LexisNexis 2003); CAL. REV. & TAX. CODE §§ 30001–30481 (West 2004); COLO. REV. STAT. ANN. §§ 12-47.1-701, 24-22-117, 39-22-623 (West 2012); LA. REV. STAT. ANN. §§ 27:91–:93, :270, :311–:312, :392–:393, 47:711–:727, :771–:788, :801–:815, :820.1–:820.4, :1681–:1691, 51:781–:800 (2009); MICH. COMP. LAWS ANN. §§ 205.421, 431.301–.336, 436.2201–.2207 (West 2001); MINN. STAT. ANN. § 240.15, 297F.10 (West 2010); S.D. CODIFIED LAWS §§ 35-5-22, 42-7A-63 (2002); TEX. TAX CODE ANN. § 183.021 (West 2012).
144. ALASKA STAT. ANN. § 43.50.140 (West 2012); PÉREZ, *supra* note 131, app. D.
145. TENN. CODE ANN. §§ 49-3-357, 57-3-302 to -306 (2012); PÉREZ, *supra* note 131, app. D.

court services (5.4%), and the state Department of Water Resources (21.3%).[146]

The second type of earmarked taxes functions as service charges, which tax users of specific state services or resources.[147] These include taxes on emergency services and very common taxes on the use of state natural resources. States often channel these taxes to pay for providing the service in question or renewing the affected resource, although states sometimes do earmark these taxes for unrelated purposes. One example is Oklahoma's severance tax both on gas, earmarked for school districts (8.2%) and roads (8.2%); and on oil, earmarked for school districts (14.9%), roads (7.4%), education and student aid (66.9%), and water resources (3.7%), as well as for a county fund for road and bridge upkeep (3.7%).[148] Another is Colorado's minerals taxes, earmarked for public facilities in areas affected by minerals mining (50%), development and conservation of water resources (25.4%), geological surveys (1.4%), site cleanup (0.6%), mining reclamation (1.8%), a water lawsuit settlement (10.8%), and a low-income energy assistance program (5.3%).[149]

The third subgroup of earmarked taxes consists of redistributive taxes.[150] These taxes include income and corporate taxes as well as inheritance and estate taxes. Examples include Maryland's corporate income tax, earmarked for public transportation (24%),[151] and Illinois's estate and generation-skipping transfer tax, earmarked for counties (6%).[152]

Fourth, some earmarked taxes are blanket taxes, imposed on almost every citizen or visitor to a state regardless of his or her behavior, use of service, or ability to pay.[153] These blanket taxes include the most prevalent

146. IDAHO CODE ANN. §§ 23-217, -404, -17, 63-10, -25 (2012); PÉREZ, *supra* note 131, app. D.

147. *See, e.g.*, WIS. CONST. art. VIII, § 10; ALASKA STAT. §§ 16.51.120, 43.55.211, 43.75.130, 43.76.025, .150, 43.77.060 (2012); ARIZ. REV. STAT. ANN. §§ 5-321, -323, 28-5801, -5808, -6001, -6008, -8335, -8345, 42-5202, -5304, -5205, -14255, 49-1031, -1036 (2011); KAN. STAT. ANN. § 79-4227 (1997); MISS. CODE ANN. §§ 27-25-1 to -27, 27-25-501 to -525, 27-25-701 to -723 (West 2012); NEB. REV. STAT. § 57-705 (2010); OHIO REV. CODE ANN. §§ 4501, 4503-4, 5727, 5749 (LexisNexis 2012); OR. REV. STAT. ANN. §§ 321.015, .017, .152,. 324.340 (West 2012); W. VA. CODE ANN. §§ 11-13A-12b, -20a, 31-15A-16 (LexisNexis 2008); WIS. STAT. ANN. §§ 70.37–.3965, .41–.42, .421, 76.01–.28, 168.12, 289.645 (West 2010).

148. OKLA. STAT. tit. 68, § 1001–1024 (2012); PÉREZ, *supra* note 131, app. D.

149. COLO. REV. STAT. § 39-29-109 (2012); PÉREZ, *supra* note 131, app. D.

150. *See, e.g.*, HAW. REV. STAT. § 235-1 to 235-69, -92 to -113, 237-1 to -49 (West 2012); IND. CODE ANN. § 6-3-7-3 (2007); MO. ANN. STAT. §§ 148.010–.230, .540–.541, .610–.710, 178.896 (West 2006); OKLA. STAT. ANN. tit. 68, §§ 2351–2385.31 (West 2012); S.C. CODE ANN. §§ 8-21-790, 12-16-510 (2000); S.D. CODIFIED LAWS §§ 10-41-67, 10-43-76, -77 (2012); TENN. CODE ANN. §§ 9-9-103, 67-9-101 to -103 (West 2012).

151. MD. CODE ANN. TAX-GEN. §§ 2-613 to -615 (LexisNexis 2010); PÉREZ, *supra* note 131, app. D.

152. 35 ILL. COMP. STAT. ANN. 405/1–/18 (West 2012); PÉREZ, *supra* note 131, app. D.

153. *See, e.g.*, ALA. CONST. art. XIV, § 260; ALA. CODE §§ 16-16-11, 28-3-281, 38-4-12, 40-8-3, 40-17-146, -223, 40-21-51, -87, -100 to -107, -23-2, -35, -77, -85 to -88, -100 to -108 (2012); ALASKA STAT. ANN. § 43.40.010 (West 2012); ARIZ. REV. STAT. ANN. §§ 20-224, 28-5720, -5852, 42-5008, -5010, -5029 (2002); ARK. CODE ANN. §§ 6-5-301 to 302, 19-6-

of all earmarked taxes: taxes on motor vehicles and fuel. Another popular blanket tax is levied on tourists to a state, often specifically on the use of hotel rooms. Another extremely common type of earmarked blanket tax is the sales and use tax. The proceeds of these blanket taxes go for countless different purposes, many of which have nothing to do with the taxed activity. Examples include Idaho's sales tax, earmarked for cities and counties (11.5%), a multistate tax commission (0.1%), state building maintenance (0.5%), water pollution control (0.4%), a county circuit breaker (1.3%), and property tax relief (1.5%);[154] and Missouri's sales tax, earmarked for school districts (24.6%), soil and water conservation (1.2%), state parks (1.2%), conservation of natural resources, (3.1%) and state highways (8.2%).[155]

All of these earmarked taxes share one key feature: they precommit tax revenues to particular purposes before the government collects the tax.[156] Upon paying the tax, taxpayers know where the revenue is going. States have only rarely attempted to dip into earmarked taxes for nondesignated purposes. Perhaps this is because tax earmarks often give legal recourse to intended beneficiaries if lawmakers tamper with the promised revenue pool.

For instance, *Wisconsin Medical Society, Inc. v. Morgan*[157] considers a tax that the state of Wisconsin imposes on health care providers earmarked for a medical liability "trust fund." If a health care provider has to pay a medical liability claim in excess of the provider's statutorily mandated liability insurance, the fund will make up the difference.[158] Putting money into a fund called a trust fund is quite common among earmarked taxes. In 2007, this particular fund had excess money, however, and the state of Wisconsin diverted the money to a different medical fund.[159] But health care providers who paid the tax sued, claiming that the state could not use these tax revenues for anything other than their designated purpose. The Wisconsin Supreme Court ruled in favor of the medical providers. The court held that the medical providers had a property interest in the trust fund that "a future legislature is not free to confiscate."[160]

301(3)–(4), 301(40), 301(182), 24-11-301, -809, 26-52-316, 26-55-205, -1002 to -1005, -1201, 26-56-201 to -202, -301, -502, 26-57-604, -610, 26-62-201, 27-70-104, 27-72-305, 27-206-07 (West 2003); MD. CODE ANN., TAX-GEN. §§ 2-1001 to 2-1104 (LexisNexis 2012); MONT. CODE ANN. §§ 15-65-121, 15-70-204 (2011); N.C. GEN. STAT. ANN. §§ 105-164.1 to .44D, 105-228.28 to .36, 105-449.37 to .139, 105-187.1 to .10 (2011); S.C. CODE ANN. §§ 12-28-2720, -2750, 12-28-2910, 12-36-2620 to -2630, -2640; WASH. REV. CODE ANN. §§ 70.149, 82.04, 82.36, 82.38 (West 2008).

154. IDAHO CODE ANN. § 63-3601 to -3641 (2007); PÉREZ, *supra* note 131, app. D.

155. PÉREZ, *supra* note 131, app. D.

156. For more on how earmarked taxes precommit revenues and for a deeper look at the topics discussed in the next few paragraphs, see my initial exploration of earmarking in Susannah Camic, *Earmarking: The Potential Benefits*, 4 PITT. TAX REV. 55 (2006).

157. 787 N.W.2d 22 (Wis. 2010).

158. *Id.* at 27.

159. *Id.* at 30.

160. *Id.* at 46.

Along the same lines, the New Hampshire Supreme Court reached a similar result, based on a contract claim, in *Tuttle v. New Hampshire Medical Malpractice Joint Underwriting Ass'n*.[161] That case also concerned a tax on medical providers earmarked for a governmental fund to cover medical liabilities in excess of the providers' insurance.[162] Here, New Hampshire diverted excess money from that fund to pay for services for medically underserved populations.[163] The taxpaying medical providers sued, arguing that the state had violated the contract it had with them. The court held that New Hampshire had in fact violated the fund beneficiaries' contractual rights by using the earmarked funds for a purpose other than the one intended.[164]

Two things are notable about these cases. First, of course, these cases demonstrate that beneficiaries of earmarked tax revenues have legal recourse if states ever attempt to take away the earmarked funds. Second, the cases point to the key role that beneficiary interest groups play in the politics of earmarked taxes. In both *Wisconsin Medical Society* and *Tuttle*, interest groups—the Wisconsin Medical Society, the New Hampshire Medical Society, and the American Medical Association—took active parts. As soon as the states attempted to divert the earmarked revenues away from these interest groups, their members sprung into action and got the money returned. These interest groups filed suit, submitted amicus briefs, and coordinated the multiple plaintiffs. In both cases, the interest groups exerted these efforts even though the trust funds in question were running surpluses. In neither case did the trust fund actually deny a medical provider's claim. Using even excess funds for the nonearmarked purpose was sufficient to spur the interest groups to action. These cases point to a crucial feature of earmarked taxes: their beneficiaries protect them. This feature allows earmarking to address tax lawmaking paralysis, which I discuss in the next section.

B. How Earmarking Overcomes Tax Lawmaking Paralysis

Part I of this Article described a seemingly intractable problem. Federal tax lawmaking efforts become paralyzed because proposed tax reforms have concentrated costs and diffuse benefits. Laws with diffuse benefits are extraordinarily difficult to pass and to sustain. Of these frequently stalled diffuse-benefits laws, the ones that also have concentrated costs have even more trouble. As a result, reform bills that close loopholes and eliminate narrowly targeted preferences, while helping hundreds of millions of Americans, cannot move out of Congress. On the rare occasion that such a bill makes it through and becomes law, its accomplishments unravel almost immediately after.

161. 992 A.2d 624, 636–38 (N.H. 2010).
162. *Id.* at 630.
163. *Id.* at 633.
164. *Id.* at 641.

Unlike federal tax reforms with their diffuse benefits, however, earmarked taxes often have concentrated benefits. For this reason, many of the earmarked state taxes fall into the two concentrated-benefits quadrants—Quadrants 2 and 4. While certain earmarked taxes fall into each quadrant of the cost-benefit matrix, a substantial number belong in the ones with concentrated benefits. For example, state alcohol taxes earmarked for programs at the county level concentrate benefits in the residents of that county. State taxes that are earmarked for education concentrate benefits in part in students represented by educational advocacy groups and in teachers' unions. State taxes earmarked for replenishing natural resources benefit the groups that use and enjoy those resources. As a result, these earmarked taxes and the programs they fund have identifiable constituencies to support them.

Very often, in fact, earmarked state taxes fall into the most politically advantageous concentrated benefit/diffuse cost quadrant—Quadrant 2. Many of these state taxes fall on extremely broad-based groups (people who buy things, people who earn income, people who use the roads, etc.), while benefits accrue to relatively narrower groups. Among the many examples are blanket taxes like Kansas's motor vehicle tax, earmarked for the construction of buildings at public universities (39.5%) and mental institutions (18.6%),[165] and income taxes like Michigan's, earmarked for K–12 public education (32.5%).[166]

States also have a number of Quadrant 4 tax laws, which have concentrated costs and concentrated benefits. These laws include, among many others, user fees like Mississippi's oil (33.1%) and gas (22.6%) severance taxes, earmarked for the source counties of the oil and gas.[167] These Quadrant 4 laws also include a number of penalty taxes such as Washington's beer and wine tax, earmarked for cities (28.3%), counties (7.1%) Washington State University's research on wine and grapes (0.2%), state Wine Commission operations (0.2%), border cities and counties (0.2%), state health care programs (12.8%), and drug enforcement and education (13.3%).[168]

The table below shows the cost-benefit framework described in Part II with some examples of earmarked state taxes that fit into each quadrant.

165. KAN. STAT. ANN. § 79-5109 (West 2012); PÉREZ, *supra* note 131, app. D.

166. MICH. COMP. LAWS ANN. § 206.51 (West 2012); PÉREZ, *supra* note 131, app. D.

167. MISS. CODE ANN. § 27-25-501 to -525, -701 to -723 (West 2012); PÉREZ, *supra* note 131, app. D.

168. WASH. REV. CODE § 66.24.210, .290 (2012); PÉREZ, *supra* note 131, app D.

Table 2: Cost-Benefit Framework with Earmarked Tax Examples

	Costs		
Benefits		Diffuse costs	Concentrated costs
	Diffuse benefits	(1) Diffuse costs, diffuse benefits *Nebraska's sales tax earmarked for state, city, and county roads and streets* *Hawaii's gross income tax earmarked for debt service*	(3) Concentrated costs, diffuse benefits *Alaska's corporate income tax on oil and gas companies earmarked for a constitutionally established budget reserve fund* *Indiana's gambling tax earmarked for capital projects*
	Concentrated benefits	(2) Diffuse costs, concentrated benefits *North Dakota's property tax earmarked for the University of North Dakota Medical Center* *California's sales tax earmarked for health and social services, particularly mental health services*	(4) Concentrated costs, concentrated benefits *Minnesota's tax on mining operations earmarked for the University of Minnesota* *Texas's tax on attorneys earmarked for public schools*

The earmarked taxes in the concentrated-benefits quadrants, Quadrants 2 and 4, offer a particularly clear path *out* of tax lawmaking paralysis at the federal level—where, once again, they have yet to be substantially tried. Rather than impose a cost on a politically powerful or popular constituency to provide a benefit spread across an entire population, these taxes do the reverse. They spread a cost across an entire population, in many cases to benefit a concentrated group. As a result, these laws would be much less likely to give rise to tax lawmaking paralysis. As an initial matter, this cost-benefit theory suggests that these state earmarked tax bases are less likely to erode than the federal income tax base. If an interest group proposes an exception from a tax with concentrated benefits, that exception will hurt one or more specific interest groups. That exception would be a Quadrant 4 law giving rise to interest group politics. A suggested exception in many earmarked taxes would pit two concentrated groups against each other.[169] Depending on the circumstances, the beneficiary group might be able to stop the exception altogether. If the exception passed, it would likely do less damage to the tax base than it would have had the beneficiary group not been there to fight against it.[170]

Then, assuming that a special preference does manage to embed itself in an earmarked tax with concentrated beneficiaries, a reform bill that removed the preference would not be a paralyzed Quadrant 3 law. Again, it would be a Quadrant 4 law, pitting two interest groups against each other. Extending this model to the federal level, a member of Congress who would propose to close a loophole in a tax benefiting a particular group will likely hear from members of that group, who will provide a crucial counterweight to the interest group advocating to keep the loophole open.

To take an example, recall the preferential depreciation schedule that Congress gave to NASCAR track owners in 2004.[171] Removing that special treatment would be a classic doomed Quadrant 3 law. Any lawmaker attempting to eliminate the preference would face a serious paralysis problem. As things now stand, subjecting NASCAR tracks to the same depreciation schedule as other similar assets would impose substantial costs on a concentrated group, NASCAR track owners, while producing a very small benefit for a large but diffuse group, the millions of U.S. citizens who would either face higher taxes or lower government revenues due to elimination of the loophole.

In contrast, imagine that Congress had followed the example of several states and earmarked the income tax with the NASCAR loophole for a particular purpose, such as federal funding for public schools. Under this scenario, if a member of Congress attempted to eliminate the NASCAR preference, that proposal would be one that would also raise revenue for the public schools. As a result, education interest groups like public school teachers' unions and advocacy groups for public education would know that a pending bill would benefit them (just as they know when a legislature is considering an education subsidy). These interest groups would then support the bill and lend assistance to federal legislators trying to eliminate the NASCAR loophole.

169. *See* Wilson, *supra* note 92, at 368.

170. *Id.* Quadrant 4 politics are, in Wilson's theory, compromise politics. If one group manages to pass an exception to a tax benefitting another group, that likely represents a compromise between the two groups. The group that allows the exception may not agree to the compromise unless the exception is not that big.

171. *See supra* note 124 and accompanying text.

In fact, some of the education groups might take the initiative and approach members of Congress to suggest slicing this preference. A member of Congress who had a particularly powerful teachers' union in his district might hear from a representative from the union demanding that the favorable treatment be excised. The member might know that the union lends its money and volunteer assistance only to candidates who are responsive to the union and successfully help it accomplish its goals. For this reason, the member would have a strong incentive to try to cut out this preference. The member could then ally himself with other members with strong teachers' union support to propose legislation to that effect and to see it through the legislative process. Of course, some other members of Congress with NASCAR tracks in their districts would still have incentives to preserve the favorable treatment. In any case, whether to keep the loophole around would no longer be a fight between NASCAR-district members and no defined constituency at all. Instead, the debate would be between NASCAR-district members and teachers' union–district members. This balanced interest group competition would prevent paralysis. This example demonstrates why federal tax reformers who are currently encountering paralysis may want to consider some of the concentrated-benefits templates that states have used in their earmarked taxes. With earmarking, Congress can move tax reforms out of the politically doomed Quadrant 3 into the more politically promising concentrated-benefit/concentrated-cost Quadrant 4, earmarking a tax to benefit a concentrated group and, in so doing, giving the tax built-in interest group protection.

C. How To Address Earmarking's Risks

Despite the potential advantages to earmarking identified so far, increasing the use of earmarking might initially appear to present certain risks. In view of these risks, although the members of Congress may find earmarking a useful device for overcoming tax lawmaking paralysis, they may not want to switch to funding government programs entirely out of earmarked tax revenues. Setting certain limits on the extent to which Congress earmarks revenues may, therefore, be appropriate. As mentioned above, even the state governments, which rely more heavily on earmarking than does the federal government, earmark on average only 24 percent of tax revenues.[172] The following section considers three of the possible risks of earmarking, which Congress should weigh along with the potential benefits of earmarking discussed above, when deciding whether to earmark a particular revenue stream.

First, the specific manner in which earmarking configures statutory costs and benefits may threaten the tax system's progressivity. As the cost-benefit matrix presented above shows, laws with concentrated benefits and diffuse costs are easiest to pass. But individual taxes of this kind are not

172. PÉREZ, *supra* note 131, at 5.

necessarily progressive. The current federal income tax is progressive, designed so that it "takes a larger percentage of income from high-income groups than from low-income groups" and "is based on the concept of ability to pay."[173] In contrast, state sales and excise taxes are regressive, designed so that "everyone, regardless of income level, pays the same fixed amount . . . [which] . . . causes lower-income people to pay a greater proportion of their income than higher-income groups pay."[174] Undeniably, many earmarked taxes fall into this regressive category.

Although this fact is an important one, not every earmarked tax poses this risk or poses it to a significant degree. Some earmarked state tax laws are actually quite progressive in a broader, more substantive sense of that word. They tax groups that are relatively well-off (high earners in some cases, but even people who use roads or who buy things) to help groups that are not well-off (poor children, indigent sick people). Thinking in terms of these examples, one can imagine federal earmarked taxes that are progressive in this same way. For instance, the federal government could impose a small rate increase on the top 25 percent of corporations by earnings to fund health care programs for those factory workers who the North American Free Trade Agreement has displaced. In that case, the overall structure of the tax would be progressive in its design and effect. The program would tax a very sizeable but well-off group of taxpayers to help a group that is smaller and more concentrated but poorer. For this reason, despite the possible risk to progressivity, earmarking also creates opportunities to redistribute income in a way that is, broadly speaking, quite progressive.

A second risk that earmarking could pose is restrictions on legislative flexibility. When a legislature earmarks tax revenues for a particular purpose, those revenues are not then available for future use in the general-revenues pool. Scholarship on the theory of democracy has rightly identified problems with measures that reduce future legislative flexibility. Political theorist Stephen Holmes, for example, has lamented the fact that political leaders precommit their successors to certain policies in efforts to "remove certain decisions from the democratic process, that is, to tie the community's hands."[175] Against this practice, Holmes appeals to the founding fathers, citing not only Thomas Paine's belief that "[e]very age and generation must be as free to act for itself, in all cases, as the ages and generations which preceded it,"[176] but also Thomas Jefferson's famous statement that "the earth belongs in usufruct to the living."[177] Beyond such theoretical considerations regarding earmarking, assigning tax revenues to a

173. *Theme 3: Fairness of Taxes, Lesson 3: Progressive Taxes*, IRS, http://apps.irs.gov/app/understandingTaxes/teacher/whys_thm03_les03.jsp (last visited Mar. 19, 2013).

174. *Theme 3: Fairness of Taxes, Lesson 2: Regressive Taxes*, IRS, http://apps.irs.gov/app/understandingTaxes/teacher/whys_thm03_les02.jsp (last visited Mar. 19, 2013).

175. Stephen Holmes, *Precommitment and the Paradox of Democracy*, *in* CONSTITUTIONALISM AND DEMOCRACY 195, 196 (Jon Elster & Rune Slagstad eds., 1993) (emphasis omitted).

176. *Id.* at 200.

177. Letter from Thomas Jefferson to James Madison (Sept. 6, 1789).

specific programmatic destination at the time of collection does—as a practical matter—reduce a legislature's ability to repurpose those funds in accord with ever-shifting spending priorities.

These problems show only one side of the picture, however, because earmarking need not entirely bind future congressional hands. This is true for two basic reasons. One: an earmarked tax does not necessarily extend indefinitely in time. In fact, many states earmark tax revenues for explicitly limited periods of time. For instance, many states earmark revenues to service particular debts; and as soon as the state pays off the debt, the earmarked tax then expires. In these cases, legislatures are restricting their options only for the stipulated period of time while they accomplish specific purposes. Two: legislatures always remain free to revise statutes. For this reason, insofar as the members of a legislature later change their minds about the destination for certain earmarked tax revenues, nothing prevents those legislators from rewriting the tax statute either to modify the percentage of the tax allocated for the designated purpose or to eliminate the earmarking feature altogether.

A third risk is that the costs of earmarking will fall on disempowered groups. As described in detail above, earmarked taxes have the advantage of giving the organized beneficiaries of a revenue stream a voice in the legislative decisions that pertain to that stream. This being the case, interest groups that gain from a particular tax can work to protect that tax. By the same token, the political dynamics of earmarking afford no clear role for groups that are politically disempowered. For this reason, organized interest groups may be able to reap the benefits of earmarked taxes while politically unorganized constituencies fail to do so.

Nevertheless, this third risk is by no means unique to earmarked taxes. Groups that lack influence in the political process have equivalent difficulties in obtaining benefits out of the general-revenue pool. In fact, in the latter case, even if a disempowered group does manage in some year to snag a few dollars from the general-revenue pool, the group may have trouble holding on to its gains in the competition for those funds in subsequent years. In other words, there is no compelling reason to believe that the political dynamics of earmarking handicap powerless groups any more than do the political dynamics of the existing tax lawmaking process.

D. Earmarking in Practice: Nonparalyzed Lawmaking

Part II.B outlined in broad, theoretical terms the way in which earmarking taxes for particular purposes addresses tax lawmaking paralysis. That section argued, based on interest group theory, that earmarked taxes offer a promising path out of the paralysis that has plagued federal tax reform efforts. To assess how well that interest group theory describes actual tax lawmaking, the following sections discuss three situations in which governments have in fact earmarked revenues, placing the taxes in Quadrants 2 or 4. In each of these situations, interest group dynamics have played out in ways that point to earmarking's potential effectiveness against tax lawmaking paralysis.

1. Social Security

The federal government has little experience with earmarked taxes. Most of the federal government's earmarked taxes are relatively small, both in revenue terms and in terms of the number of affected individuals.[178] The

178. *See, e.g.*, Harbor Maintenance Trust Fund, 26 U.S.C. § 9505 (2006) (tax on commercial cargo upon loading or unloading to ships earmarked for harbor maintenance); BUREAU OF TRANSP. STATISTICS, U.S. DEP'T OF TRANSP., GOVERNMENT TRANSPORTATION FINANCIAL STATISTICS 34 (2001), *available at* http://www.rita.dot.gov/bts/sites/rita.dot.gov.bts/files/publications/government_transportation_financial_statistics/2001/pdf/entire.pdf (tax on airline tickets and aviation fuels earmarked for capital and other expenditures of the FAA); FED. GAS TAX: HOUSEHOLD EXPENDITURES FROM 1965 TO 1995, TRANSTATS 1–4 (1997), *available at* http://www.rita.dot.gov/bts/sites/rita.dot.gov.bts/files/publications/transportation_statistics_newsletter/issue_02/pdf/entire.pdf (motor fuels excise tax earmarked for highway construction and maintenance); OFFICE OF RESEARCH, EVALUATION & STATISTICS, SOC. SEC. ADMIN., SOCIAL SECURITY PROGRAMS IN THE UNITED STATES 78 (1997), *available at* http://www.ssa.gov/policy/docs/progdesc/sspus/railroad.pdf (payroll tax earmarked for old-age income support and equivalent program for railroad workers); OFFICE OF UNEMPLOYMENT INS., U.S. DEP'T OF LABOR, UNEMPLOYMENT COMPENSATION: FEDERAL-STATE PARTNERSHIP 6 (2011), *available at* http://ows.doleta.gov/unemploy/pdf/partnership.pdf (payroll tax earmarked for unemployment compensation); U.S. FISH & WILDLIFE SERV., CELEBRATING THE WILDLIFE & SPORT FISH RESTORATION PROGRAM 4, 7 (2004), *available at* http://digitalmedia.fws.gov/cdm/singleitem/collection/document/id/1307 (tax on sport fishing equipment earmarked for management, conservation, and restoration of fishery resources); U.S. FISH & WILDLIFE SERV., FEDERAL AID IN WILDLIFE RESTORATION 560 (2005), *available at* http://www.fws.gov/budget/2007/FY%202007%20GB/23.00%20federal%20aid%20in%20wR.pdf (tax on sporting arms and ammunition earmarked for federal aid to wildlife restoration); Dennis M. Brown, *The Nation's Inland Waterway System and Rural America*, 16 RURAL AM. 11, 13 (2002), *available at* http://ntl.bts.gov/lib/12000/12300/12317/ra164c.pdf (tax on diesel fuel used in travel on commercial inland waterways, earmarked for construction and rehabilitation projects on those waterways); Robert L. Bamberger, *The Abandoned Mine Land Fund: Grants Distribution & Issues*, NAT'L LIBR. ENV'T (Mar. 26, 1997), http://digital.library.unt.edu/ark:/67531/metacrs398/m1/1/high_res_d/97-401_1997Mar26.html (tax on domestically mined coal earmarked for abandoned mine reclamation); *How is Medicare Funded?*, MEDICARE.GOV, http://www.medicare.gov/about-us/how-medicare-is-funded/medicare-funding.html (last visited Mar. 19, 2013) (payroll tax earmarked for old-age medical assistance); *Leaking Underground Storage (LUST) Trust Fund*, U.S. ENVT'L PROT. AGENCY, http://www.epa.gov/swerust1/ltffacts.htm (last visited Mar. 19, 2013) (fuel excise tax earmarked for cleanup of sites with leaking underground tanks); *National Vaccine Injury Compensation Program*, HEALTH RES. & SERV. ADMIN., U.S. DEP'T HEALTH & HUM. SERVS., http://www.hrsa.gov/vaccinecompensation/ (last visited Mar. 19, 2013) (excise tax on vaccine purchase earmarked for compensating victims of vaccine injury); Office of the Asst. Sec'y for Policy, *Health Benefits, Retirement Standards, and Workers' Compensation: Black Lung Compensation*, U.S. DEP'T OF LABOR (Sept. 2005), http://www.dol.gov/asp/programs/guide/blklung.htm (tax on domestically mined coal earmarked to compensate former mine workers who suffer from black lung disease); *Recreational Trails Program*, FED. HIGHWAY ADMIN., http://www.fhwa.dot.gov/environment/recreational_trails/funding/ (last visited Mar. 19, 2013) (tax on nonhighway recreational fuel use earmarked for development and maintenance of recreational trails); *Superfund: Twenty Years of Protecting Human Health and the Environment*, U.S. ENVT'L. PROT. AGENCY (2000), http://www.epa.gov/superfund/30years/ (tax on hazardous materials (oil and chemicals) earmarked for an environmental cleanup fund called Superfund); U.S. Dep't of Transp., *Fact Sheet: Recreational Boating Safety*

federal government does, however, fund one of its largest programs through an earmarked tax: Social Security. Social Security is a Quadrant 2 law. It imposes costs on a large and diffuse group, American employees and employers, to fund a program for a narrower and more concentrated group, older Americans. Social Security's Quadrant 2 cost-benefit distribution is among the factors that have prevented it from having a paralysis problem.

The federal income tax and the Social Security payroll tax have very different histories. As described in the earlier parts of this Article, for decades, the federal income tax base has continued to shrink as special preferences erode it and efforts to reverse the trend become paralyzed.[179] In contrast, an advisor to former Speaker of the House Tip O'Neill famously called Social Security the "third rail" of American politics, explaining that no politician can undermine Social Security without facing political death.[180] This was President Franklin D. Roosevelt's intent when he insisted on funding the program with an earmarked payroll tax.[181] In her seminal book on the history of Social Security, policy scholar Martha Derthick explained that, at the program's inception, lawmakers proposed to fund it like any other federal program, out of general revenues.[182] The federal Committee on Economic Security, which initially drafted the plans for Social Security, proposed to support it with a limited-rate earmarked tax in the program's early years but, once the needs of senior citizens exceeded the revenues from that fixed-rate tax, to start turning to general revenues.[183] President Roosevelt, in a manner described as "uncompromising," opposed this idea.[184] Roosevelt believed that only an earmarked tax could protect his program from attack by future generations. He told an observer:

> [T]hose taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions . . . . *With those taxes in there, no damn politician can ever scrap my social security program*.[185]

Interest groups became immediately attached to the payroll tax. The American Federation of Labor supported the tax from the beginning, telling workers that, if the program was "financed with general revenues, they

---

Program, TEA-21 (Sept. 21, 1998), http://www.fhwa.dot.gov/tea21/factsheets/rbs.htm (motorboat tax earmarked for boat safety); U.S. Dep't of Transp., *Fact Sheet: Trust Funds and Taxes*, TEA-21 (Sept. 14, 1998), http://www.fhwa.dot.gov/tea21/factsheets/htf.htm (motorboat gas excise tax earmarked for conservation of aquatic resources). For an excellent discussion of earmarking at the federal level, see ERIC M. PATASHNIK, PUTTING TRUST IN THE US BUDGET: FEDERAL TRUST FUNDS AND THE POLITICS OF COMMITMENT (2000).

179. *See supra* Part I.A.

180. Lawrence O'Donnell, Jr., *Inconspicuous Valor*, NEW YORK (Apr. 24, 2000), http://nymag.com/nymetro/news/politics/columns/nationalinterest/2851/.

181. MARTHA DERTHICK, POLICYMAKING FOR SOCIAL SECURITY 229 (1979).

182. *Id.*

183. *Id.*

184. *Id.*

185. ARTHUR M. SCHLESINGER JR., THE AGE OF ROOSEVELT: THE COMING OF THE NEW DEAL 308–09 (1959) (emphasis added).

would 'irresistibly be pulled down to relief standards.'"[186] An issue of one of the federation's bulletins urged workers to accept the new tax, saying that

> [W]hen the money goes directly out of our pay, . . . people realize that it is our insurance and we can have a strong voice in advising on the way the insurance system works. The more social security protection we try to build up, the harder it will be for us to get it and to see that it works properly unless right in the books it shows that we are paying our share.[187]

As the program expanded substantially over the rest of the century and into the twenty-first, affected interest groups continued to protect the payroll tax, preserving the program's "fundamental popularity."[188] Interest groups, particularly organized labor, senior citizens' groups, and the legendarily competent Social Security Administration continued to advocate hard for increases in Social Security taxes so that, by the late 1970s, "[p]otential opponents of expansion were so conditioned to expect defeat that they anticipated expansion and, in anticipating it, made concessions to it."[189]

The Social Security payroll tax has continued to grow and no countervailing interest group has made any serious effort to undermine it. Whereas the income tax base, as discussed, has hundreds of exceptions and special favors, the Social Security wage base has almost none. Taxpayers pay income tax based on their "taxable income," a figure that is generally much smaller than their total earnings because it reflects so many carveouts.[190] Taxpayers pay Social Security tax on the Social Security wage base, which essentially equals their total wage amount up to a certain figure without any carveouts.[191] Politicians who have suggested cuts to Social Security have had no success thus far. In fact, these lawmakers face their own version of a Quadrant 3 paralysis problem. Lawmakers who want to prune Social Security presumably do so in the hopes of reducing the burden on the large and diffuse group of working Americans who pay Social Security taxes. Reducing Social Security taxes threatens to impose costs on a relatively narrower and politically well-represented group: the elderly.[192] This doomed Quadrant 3 plan never progresses.

---

186. DERTHICK, *supra* note 181, at 230.

187. *Id.* at 230–31 (internal quotation marks omitted).

188. *Id.* at 377.

189. *Id.* at 407.

190. *See* I.R.C. § 63 (2006).

191. *See* 42 U.S.C. § 409 (2012); *see also* IRS, DEP'T OF THE TREASURY, (CIRCULAR E) EMPLOYER'S TAX GUIDE 14–17 (2013), *available at* http://www.irs.gov/pub/irs-pdf/p15.pdf.

192. In 2012, vice presidential candidate Representative Paul Ryan proposed a potential decrease in Social Security benefits that would not affect anyone over the age of fifty-five. *See* HOUSE BUDGET COMM., THE PATH TO PROSPERITY: A BLUEPRINT FOR AMERICAN RENEWAL 52 (2012), *available at* http://budget.house.gov/uploadedfiles/pathtoprosperity2013.pdf. In so doing, he attempted to turn cutting Social Security—usually a doomed diffuse-benefits, concentrated-costs Quadrant 3 proposal—into a more politically promising diffuse-benefits, diffuse-costs Quadrant 1 proposal. Had Ryan won the vice presidency, he

Derthick explains, "politicians . . . in their candid moments acknowledge that the social security benefits incorporated in law are sacrosanct. Reduction is simply unthinkable, no matter what the method of financing or the inflationary effects might be."[193] President Roosevelt understood how earmarking afforded Social Security this degree of protection and reduced its vulnerability to the political dynamics that have entrenched loopholes in the federal tax code. With hindsight, Derthick agrees with Roosevelt's initial prediction, writing that, "[h]ad social security been . . . financed by general revenues, the preceding history would be very different."[194]

2. Municipal Bonds

The history of Social Security offers a key example of how earmarking has prevented lawmaking paralysis in the one area where the federal government has experimented with an earmarked tax. Given the federal government's limited experience with earmarked taxes, a detailed understanding of how they work and how they might address paralysis requires examining lower levels of government. As discussed in Parts II.A–B, the states have relied heavily on earmarked taxes. Yet there is little scholarship on the subject; only a few scholars in political science have studied the mechanism in one particular related form: local-level municipal bonds. In the next section of this Article, I offer several case studies that make a first effort at studying the dynamics of these earmarked state taxes. Before turning to the state-level case studies, this Article considers municipal bonds and the ways in which the municipal bond literature further highlights the earmarking mechanism's potential to undo tax lawmaking paralysis.

Municipal bonds present an unexpected dynamic that resembles the one seen in the context of Social Security lawmaking. Despite the conventional wisdom that voters rarely elect to increase their own taxes and the oft-repeated understanding that a candidate cannot win public office with a promise to raise taxes, voters have never balked at increases in their Social Security taxes, as discussed in the previous section. Similarly, in the context of municipal bond issues, voters regularly vote to increase their own taxes in certain and concrete ways. One other feature unites Social Security and municipal bonds: both involve earmarked taxes.

Local governments rely heavily on municipal bond issues to raise money for particular capital projects. This became especially true in the 1980s and 1990s after the Reagan Administration cut federal spending for local endeavors and began a trend of routing more funds through state capitols rather than channeling them directly to local municipalities.[195] Bond issues

may have had more success with it than past lawmakers who have hoped to reduce or rein in Social Security.

193. DERTHICK, *supra* note 181, at 414–15.

194. *Id.* at 420.

195. *See* Susan A. MacManus, *Financing Federal, State, and Local Governments in the 1990s*, 509 ANNALS AM. ACAD. POL. & SOC. SCI. 22, 23 (1990).

often require voters to approve a tax increase dedicated for a particular purpose, typically a specific project.[196] Municipal bond issues frequently succeed. In fact, in the context of commonly requested bond issues for education, one study showed that only a quarter of school districts have ever had a bond issue rejected.[197]

Bond issues are generally Quadrant 2 policies with diffuse costs and concentrated benefits. When bond issues pass, all property taxpayers' taxes go up a small amount to finance a project that will help a small, concentrated group, such as a defined group of schools. Affected interest groups usually lobby on behalf of the bond issue, making the case about the benefits of the particular project at hand. Scholars have found that these interest groups play a key role in bond issues, often distributing information about the proposal.[198] Studies have shown that voters are more likely to vote for a bond issue if they know more about the planned use of the funds, especially the ways in which the funds might benefit their community. Interest groups can disseminate this information effectively.

A seminal study showed that bond issues were more likely to pass when local leaders recruited neighborhood associations to work on behalf of the bonds by touting the benefits that the bonds would have for the individual neighborhoods.[199] This study concerned a bond referendum in St. Louis that sought to impose "nearly a dollar per hundred incremental increase in property taxes; an amount of eye popping proportions to many voters."[200] While bond referenda are often successful, at the time of this study, St. Louis had been having trouble passing them due to demographic shifts that turned the city's population into one that generally opposed taxes.[201] In the referendum considered in the study, St. Louis officials worked to energize interest groups around the issue by emphasizing the ways in which the proposal concentrated benefits in particular neighborhoods. The recruited neighborhood associations assisted with "a carefully orchestrated newspaper and direct-mail campaign for the entire 'package' [of proposed bonds that] stressed specific neighborhood benefits."[202] In this direct-mail campaign, voters received information on street, sidewalk, park, and other improvements designed for their immediate vicinity should the bond package succeed.[203]

This strategy of spurring interest group activity and highlighting the concentrated benefits of the proposal proved largely successful. While only

196. Kent L. Tedin, Richard E. Matland & Gregory R. Weiher, *Age, Race, Self-Interest and Financing Public Schools Through Referenda*, 63 J. POL. 270, 270 (2001).

197. *See, e.g.*, *id.*

198. *See, e.g.*, Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 30 FORDHAM URB. L.J. 639, 658–64 (2012).

199. J. Clark Archer & David R. Reynolds, *Locational Logrolling and Citizen Support of Municipal Bond Proposals: The Example of St. Louis*, 27 PUB. CHOICE 21, 25 (1976).

200. *Id.* at 27.

201. *Id.* at 25.

202. *Id.*

203. *Id.*

one of the proposed bond issues got the two-thirds vote necessary for passage, eight of the ten bonds in the package received majority approval, an uptick from previous campaigns that had less heavily emphasized the concentrated benefits of the proposals and featured less interest group activity.[204] Perhaps even more remarkably, this study demonstrated that, when tax increases are earmarked for concrete benefits for particular segments of a voting population, a majority of even a generally antitax voting population may be willing to increase its own taxes to pay for those benefits.

Similarly, a more recent study examined another city that had historical trouble with bond issues: Jackson, Mississippi.[205] In this study, Jackson's school superintendent was aware that earlier bond referenda had provided little information about the actual destination of the funds.[206] The superintendent worked to provide voters with additional information about the planned uses of the bond money, as had been done in St. Louis. He and other school administrators "put together a bond issue that was actually a set of ten 'mini' bond issues, a checklist of different items that voters could choose to individually support or reject."[207] With the new mini bond issue approach, voters could "cast separate votes to air condition and renovate the schools, replace portable classrooms, purchase new library books, construct new science labs, purchase new computer equipment, and build new athletic facilities."[208] "With this novel approach to the ballot, a list of projects spread throughout the city, and a clear presentation of the needs of the school district," the superintendent "sought to build a coalition of supporters, and he lined up support from civic leaders, *The (Jackson) Clarion-Ledger*, the business community, and even administrators from some of Jackson's private academies."[209] The only opposition to the bond

---

204. *Id.* at 27.

205. James M. Glaser, *White Voters, Black Schools: Structuring Racial Choices with a Checklist Ballot*, 46 AM. J. POL. SCI. 35 (2002).

206. *Id.* at 37.

207. *Id.*

208. *Id.*

209. *Id.* Many earmarked taxes first become law through referenda, and the information-providing role that interest groups can play becomes particularly important in the context of referenda. Political science scholarship has noted that referenda often lack the partisan cues usually present on ballots. For that reason, endorsements and other elite cues can help voters figure out how to vote in the absence of the usual partisan information. *See* Susan Banducci, *Searching for Ideological Consistency in Direct Legislation Voting*, *in* CITIZENS AS LEGISLATORS 132 (Shaun Bowler, Todd Donovan & Caroline J. Tolbert eds., 1998); Jeffrey Karp, *The Influence of Elite Endorsements in Initiative Campaigns*, *in* CITIZENS AS LEGISLATORS, *supra*, at 151; David McCuan, Shaun Bowler, Todd Donovan & Ken Fernandez, *California's Political Warriors: Campaign Professionals and the Initiative Process*, *in* CITIZENS AS LEGISLATORS, *supra*, at 76. *See generally* Shaun Bowler & Todd Donovan, *Information and Opinion Change on Ballot Propositions*, 16 POL. BEHAV. 411 (1994); Regina P. Branton, *Examining Individual-Level Voting Behavior on State Ballot Propositions*, 56 POL. RES. Q. 367 (2003); Elisabeth R. Gerber & Arthur Lupia, *Campaign Competition and Policy Responsiveness in Direct Legislation Elections*, 17 POL. BEHAV. 287 (1995); Mark R. Joslyn & Donald P. Haider-Markel, *Guns in the Ballot Box: Information, Groups, and Opinion in Ballot Initiative Campaigns*, 28 AM. POL. Q. 355 (2000); Arthur

was some "disorganized" griping from a white supremacist group.[210] This novel approach led to one of the first bond issue victories in recent Jackson history, with over half the requested funding approved.[211]

Like the St. Louis case, this bond issue demonstrated how earmarked taxes can harness the power of interest group dynamics in concentrated-benefit, diffuse-cost scenarios. The bonds in question imposed small costs on most of the Jackson community and produced substantial benefits for the beneficiaries of the proposed education projects. When the superintendent provided information to the community about the concentrated benefits available from the earmarked bond revenues, he was able to mobilize interest groups in support of the bonds. With no effective opposition, this strategy convinced over 60 percent of a traditionally antitax electorate to vote to raise their own taxes to generate revenue for school infrastructure.[212]

As in the case of Social Security, the experiences of earmarked taxes in the bond context differs markedly from the dynamics of federal income tax lawmaking. Part I.A discussed how deeply unpopular the income tax has become among taxpayers who believe they are getting nothing in return for the taxes they pay. In contrast, the earmarked taxes studied in the context of bond issues generally inspire the opposite sentiment. When informed about the concrete benefits of the earmarked taxes, voters agree to raise them, even imposing burdens that the voters themselves know they will bear. Raising revenue through bond issues is not paralyzed. Federal income tax lawmaking is.

3. Earmarked State Taxes: Case Studies

The previous two sections have drawn on the experience gleaned from the federal government's primary venture with earmarked taxes and from local bond issues. Legal scholars and social scientists have studied these two situations in some detail, and their research suggests that earmarking offers an opportunity to subvert tax lawmaking paralysis.

No scholarship to date has examined, however, the governmental site in which the most, and most diverse, earmarking occurs: state tax laws. As described in detail in Part II.A–B, states earmark on average 24 percent of their revenues for particular purposes and do so in a variety of ways.[213] The following sections take a closer look at several earmarked state taxes and their interest group dynamics in an effort to assess their potential for addressing tax lawmaking paralysis.

Lupia, *Busy Voters, Agenda Control, and the Power of Information*, 86 AM. POL. SCI. REV. 390 (1992); Arthur Lupia, *Shortcuts versus Encyclopedias: Information and Voting Behavior in California Insurance Reform Elections*, 88 AM. POL. SCI. REV. 63 (1994).

210. Glaser, *supra* note 205, at 37.

211. *See id.*

212. *See id.*

213. *See* PÉREZ, *supra* note 131, at 3.

To develop these case studies, I compiled a list of the many taxes with clearly concentrated benefits from the several hundred earmarked state taxes. From that list, I randomly selected four earmarked state taxes. Then, I conducted archival research about the four taxes. Using legislative history, earlier versions of statutes, reports from legislative committees, historical tax-rate data, floor debates from state legislatures, back issues of newspapers, and publications from various interest groups, I assembled the four case studies that I describe here.

a. Colorado's Tobacco Tax Earmarked for Public Health

In November 2004, Colorado voters overwhelmingly approved a constitutional amendment that would increase state cigarette and tobacco taxes (Amendment 35) and earmark the funds for public health, specifically, health care for underserved individuals.[214] A 1992 Colorado constitutional amendment known as the Taxpayer Bill of Rights (TABOR) requires that a majority of voters approve all tax increases in a statewide election.[215] As a result, tax increases such as this one require not just legislative approval but a referendum. In this case, faced with such a referendum, 61 percent of Coloradans voted for both the tax increase and to earmark the new revenues for particular purposes relating to public health.[216] These purposes included expanding coverage and increasing eligibility in Medicaid and Colorado's Child Health Plan (46 percent of revenue), funding comprehensive primary care through community health centers that primarily serve the uninsured and indigent (19%), supporting programs focusing on tobacco education, prevention, and cessation (16%), and paying for programs focusing on prevention, early detection, and treatment of cancer and cardiovascular and pulmonary diseases (16%).[217]

A coalition of organizations called Citizens for a Healthier Colorado sponsored the referendum.[218] The member groups included a number of potential tax beneficiaries, among them, a children's advocacy group called the Colorado Children's Campaign, the American Cancer Society, the American Heart Association, the American Lung Association, an antismoking group called the Colorado Tobacco Education and Prevention Alliance, the Colorado Hospital Association, two health-advocacy nonprofits called the Colorado Consumer Health Initiative and the Colorado Prevention Center, a community health center organization called the Colorado Community Health Initiative, and the National Jewish Children's

---

214. COLO. CONST. art. X, § 21.

215. *See id.* § 20(4).

216. *See Amendment 35/Tobacco Tax Funding at CDPHE*, COLO., http://www.colorado.gov/cs/Satellite/CDPHE-PSD/CBON/1251618137524 (last visited Mar. 19, 2013).

217. COLO. CONST. art. X, § 21(5)(a)–(d).

218. CTRS. FOR DISEASE CONTROL, SUSTAINING STATE FUNDING FOR TOBACCO CONTROL: A STORY FROM COLORADO 1 (2011) [hereinafter A STORY FROM COLORADO], *available at* http://www.cdc.gov/tobacco/tobacco_control_programs/program_development/sustainingstates/pdfs/colorado.pdf.

Hospital.[219] The chairs of Citizens for a Healthier Colorado were chairs of a children's advocacy group and the president emeritus of Colorado State University.[220] The group raised $2.1 million to campaign for the earmarked tax, which the coalition did through extensive advertising on television and radio and through direct mail.[221] This campaign's most common refrains included the presence of a "health care crisis . . . in Colorado," the fact that the earmarked funds would address pervasive "health issues such as cancer and heart and lung diseases," and the comprehensiveness of a program that "would address not only tobacco prevention and control but also the prevention, early detection, and treatment of cancer and heart and lung disease."[222] Observers largely attribute the tax's passage to the efforts of this group.[223] Neither the tobacco industry nor any other interest group appears to have actively opposed this Quadrant 2 amendment. Furthermore, in the years since this earmarked tax increase passed, no group has made any substantial effort to challenge or cut away at the tax, which has continued to provide a steady source of funds for its designated purposes.

Nor is the Colorado experience unusual in these respects. Indeed, the commonwealth of Virginia has had a similar history of an active public health coalition lending support and protection to a cigarette tax increase earmarked for a health care trust fund.[224] Notably, states that have tried funding similar health initiatives out of general revenues have had less success.[225] This may be because, as I have argued, the states fail to identify concentrated constituencies to support the tax. For example, although Nebraska's legislature approved a $7 million appropriation from general revenues for this purpose in 2000, the legislature cut that figure down to $405,000 three years later, citing budget concerns.[226]

---

219. COLO. SCH. OF PUB. HEALTH, AMENDMENT 35 SYMPOSIUM: GETTING A GOOD HEALTHY RESTART TO FUNDING (2012), *available at* http://publichealthpractice.org/sites/default/files/forum/16394/a35-symposium-presentations.pdf.

220. A STORY FROM COLORADO, *supra* note 218, at 2.

221. *Id.*

222. *Id.*

223. *Id.* at 1–2.

224. *See* CTRS. FOR DISEASE CONTROL, SUSTAINING STATE FUNDING FOR TOBACCO CONTROL: SNAPSHOT FROM VIRGINIA (2009), *available at* http://www.cdc.gov/tobacco/tobacco_control_programs/program_development/sustainingstates/pdfs/virginia.pdf.

225. *See* CTRS. FOR DISEASE CONTROL, SUSTAINING STATE FUNDING FOR TOBACCO CONTROL: SNAPSHOT FROM NEBRASKA (2009) [hereinafter SNAPSHOT FROM NEBRASKA], *available at* http://www.cdc.gov/tobacco/tobacco_control_programs/program_development/sustainingstates/pdfs/nebraska.pdf; CTRS. FOR DISEASE CONTROL, SUSTAINING STATE FUNDING FOR TOBACCO CONTROL: A STORY FROM NEW YORK (2009), *available at* http://www.cdc.gov/tobacco/tobacco_control_programs/program_development/sustainingstates/pdfs/newyork.pdf.

226. SNAPSHOT FROM NEBRASKA, *supra* note 225, at 1.

b. Missouri's Sales and Use Tax Earmarked for Conservation

In 1984, Missouri voters approved a constitutional amendment that would earmark a portion of the state's sales and use tax for soil and water conservation and for the acquisition, development, maintenance, and operation of state parks and historic sites.[227] To get on the ballot in Missouri required a petition drive from the measure's advocates. An active coalition of Missouri and national organizations supported this earmarked tax, including the Missouri Conservation Commission, the Citizens Committee for Soil, Water and State Parks, the Missouri Department of Natural Resources, the Coalition for the Environment, the Missouri Farm Bureau, the Conservation Federation of Missouri, the Missouri Parks Association, the Sierra Club, the Soil Conservation Society, the Audubon Society, and several individual farms. Their combined campaign in favor of the tax highlighted Missouri's high rate of soil erosion, farmers' inability to pay for necessary soil protection, and state residents' frequent use of the state parks. The amendment faced only a small degree of resistance, mostly from St. Louis–area groups that believed that the amendment unfairly helped rural residents while doing nothing for urban areas.

Since its electoral victory in 1984, voters have steadily renewed the tax.[228] The initial amendment required state residents to vote to renew the tax periodically after its passage.[229] As a result, the tax had to appear on the ballot again in 1988, 1996, and 2006.[230] Each time, a coalition of supporters again had to sponsor a petition drive to get the measure on the ballot and, each time, this happened without problems. The earmarked tax passed each time with overwhelming margins of support.[231] At no time since 1984 has anyone seriously attempted to reduce or otherwise undermine the tax, and it has been a reliable source of funds for its intended purpose throughout its twenty-eight years.

c. Utah's Income Taxes Earmarked for Education

Utah earmarks its entire personal and corporate income taxes, which have been in place since 1931 and 1948 respectively, for K–12 and higher education. This arrangement has given rise to a community of interest groups that mobilize in support of the earmarked tax, the vast majority of these groups consisting of those that work on public education issues. The groups that have been most vocal about the tax in its recent history have included Utah Voices for Children, the Utah School Board Association, the Utah School Superintendent Association, the Utah Education Association,

---

227. MO. CONST. art. IV, § 47(a)–(c).

228. *Parks, Soils and Water Sales Tax*, MO. STATE PARKS, http://mostateparks.com/page/55069/parks-soils-and-water-sales-tax (last visited Mar. 19. 2013).

229. MO. CONST. art. IV, § 47(c).

230. *See Parks, Soils and Water Sales Tax*, *supra* note 228.

231. *See id.*

the Davis Education Association, and the Utah Association of Public Charter Schools.

In the recent histories of these two earmarked taxes, the taxes have been relatively stable, although they do have some "subtractions" and credits. Subtractions against state income taxes in Utah are available for, among several other items, interest on government bonds[232] and income from Native American reservations.[233] Taxpayers may then take credits against tax liability for agricultural fuel,[234] stay-at-home parents,[235] solar projects,[236] special needs adoptions,[237] and taxes paid to another state,[238] among others. Although interest groups may have supported the tax laws actively, these exceptions suggest that they have not been entirely successful in protecting it from encroachment by other interest groups seeking preferences.

On the other hand, the interest groups involved seem to have been successful at keeping the income tax a steady source of revenue for public schools throughout its history. Utah's corporate tax rate has been steady since 1984, and several credits are currently available with regard to this tax.[239] Until 2008, the income tax had a reasonably constant rate structure. Over the past twenty years, the income tax had also been reasonably free of any new special preferences.[240]

Facing a large budget surplus in 2008, Utah cut those rates to a flat 5 percent. The advocacy groups campaigned heavily against reducing the tax rate.[241] In this instance, however, these interest groups lost the battle to another coalition of Utah groups that advocated for the rate reduction, including the Utah Taxpayers Association and a group of business leaders known as the Employers' Education Coalition.[242] The pro-cut groups also had the support of many Utah politicians, including then-Governor Jon Huntsman. Despite the efforts of the education groups, Utah's political bodies were able to amass sufficient political will to cut the tax in the face of education-group opposition. Perhaps due to this opposition or

232. UTAH CODE ANN. § 59-10-114(2) (LexisNexis 2012).
233. *Id.* § 59-10-114(2)(b).
234. *Id.* § 59-13-202.
235. *Id.* § 59-10-1005.
236. *Id.* § 59-10-1024.
237. *Id.* § 59-10-1104.
238. *Id.* § 59-10-1003.
239. *Id.* §§ 59-1-401 to -403, 59-7-101 to -805; *State Corporate Income Tax Rates, 2000–2012*, TAX FOUND., http://taxfoundation.org/article/state-corporate-income-tax-rates-2000-2012 (last visited Mar. 19, 2012).
240. The small handful of carveouts pertained to disabled individuals, adopted children, American Indian tribes, and people of Japanese ancestry who had been interned during World War II.
241. Bob Bernick Jr., *Coalition Seeks To Dump Flat-Tax System*, DESERET NEWS (Sept. 19, 2008, 12:22 AM MDT), http://www.deseretnews.com/article/700259889/Coalition-seeks-to-dump-flat-tax-system.html?pg=all.
242. Howard Stephenson, *Claims of 2008 Income Tax Hike Inaccurate*, UTAH TAXPAYERS ASS'N (Apr. 14, 2008), http://www.utahtaxpayers.org/?p=215.

subsequent budget conditions, Utah's income tax has remained stable since the rate cut of 2008, without further rate reductions or new carveouts.

d. Oklahoma's Income Tax Earmarked for Teachers' Pensions

Since 2003, Oklahoma has earmarked an increasing percentage of its individual and corporate income taxes for the Oklahoma Teachers' Retirement System. It was at that point that beneficiary interest groups became involved in income tax politics in Oklahoma, and, in particular, a number of education and retirement-related advocacy organizations started to work on income tax issues. They have stayed involved through the present time.

After the Oklahoma legislature partially earmarked the income tax for education, the income tax rate fell somewhat, but the income tax base has not eroded in any significant way. In 2004, the legislature cut income tax rates.[243] The same year, the criteria to obtain a credit for sales tax paid became more stringent.[244] In addition, Oklahoma residents approved a referendum to increase the tax exemption for retirement benefits, to eliminate personal and corporate income taxes on capital gains from the sale of Oklahoma-based property, and to tighten eligibility criteria further for the sales tax credit.[245] In 2005, the legislature cut the top marginal personal income tax rate and increased the standard deduction and the amount of retirement benefits excludible from taxable income.[246] The legislature also enacted some simplifying reforms.[247] The legislature did the same thing again in 2006 with regard to the rate, the standard deduction, and the exclusion for retirement benefits.[248]

In 2007, the legislature slightly lowered the rate again and inserted a state program modeled on the federal child-care credit.[249] In 2008, the only legislative change to the income tax introduced a new voluntary compliance initiative[250] and in 2009, the only change added an exclusion for income from the U.S. Armed Forces.[251] The year 2010 brought a reform-oriented package that put a two-year moratorium on credits against personal income tax liability.[252] In 2011, the legislature exempted an aerospace credit from the full credit moratorium[253] and added a credit for contributions to a scholarship-granting organization.[254] These small exceptions suggest that

243. *Compare* H.B. 2660, 49th Leg., 2d Sess. (Okla. 2004), *with* OKLA. STAT. tit. 68, § 2355 (2003).
244. H.B. 3152, 46th Leg., 2d Sess. (Okla. 1998).
245. H.B. 2660.
246. H.B. 1547, 50th Leg., 1st Sess. (Okla. 2005).
247. *Id.*
248. H.B. 1172, 50th Leg., 2d Sess. (Okla. 2006).
249. S.B. 861, 51st Leg., 1st Sess. (Okla. 2007).
250. S.B. 2034, 51st Leg., 2d Sess. (Okla. 2008).
251. S.B. 881, 52d Leg., 1st Sess. (Okla. 2009).
252. S.B. 1267, 52d Leg., 2d Sess. (Okla. 2010).
253. H.B. 1008, 53d Leg., 1st Sess. (Okla. 2011).
254. S.B. 969, 53d Leg., 1st Sess. (Okla. 2011).

the interest groups had a reasonable degree of success in protecting their revenue source.

In 2011, the tax's beneficiaries faced their first major challenge in protecting the tax. Oklahoma's conservative new governor, Mary Fallin, proposed a plan to phase out the state income tax slowly. Polls showed that most state residents supported this plan, as did majorities in the state senate and assembly. In addition, Governor Fallin's plan had support from a number of out-of-state antitax advocacy groups.

The plan failed, however, despite this widespread support, and despite the fact that Governor Fallin's party controlled both the Oklahoma House of Representatives and Senate.[255] Bemoaning this fact, a *Wall Street Journal* editorial in the spring of 2012 wrote, "A cavalcade of lobbyists, including local Chambers of Commerce, teachers unions and welfare groups are fighting the tax cut."[256] The article complained that "Republicans in the Oklahoma Senate are . . . letting the special-interest pressure get to them."[257] Governor Fallin similarly attributed the plan's failure to intense special-interest group activity.[258] In an editorial, the *Daily Oklahoman* also pointed out the power of interest groups in defeating the cut, explaining, "[a]verage Oklahomans weren't clamoring for a tax cut. Unlike in Kansas, neither was the business lobby. Tax consumers such as the public education establishment would like taxes raised, not lowered."[259] The interest group clamor featured voices from a number of groups, including the Oklahoma Pension Oversight Commission, Oklahoma's American Association of Retired Persons, the Oklahoma Education Association, a liberal advocacy group called the Oklahoma Policy Institution and a Tulsa antipoverty group called the Community Action Project. As observers noted, these groups played a critical role in this battle over the income tax. Their opposition, the commentary suggests, may have been the major obstacle in the way of Oklahoma's would-be eliminators of the income tax.

4. Lessons from Case Studies

The four brief case studies of earmarked taxes and their development demonstrate the political dynamics of earmarking. Notably, in all four of the case studies described here, each tax has beneficiary interest groups that are actively involved in advocating for the tax and in protecting its revenues. Colorado's tax on cigarette companies earmarked for public health is a Quadrant 4 tax with concentrated costs and concentrated

255. *2011 Current Partisan Composition Map*, NAT'L CONF. ST. LEGISLATURES, http://www.ncsl.org/legislatures-elections/legisdata/2011-current-partisan-composition-map.aspx (last visited Mar. 19, 2013).

256. Editorial, *Oklahoma Reform Showdown*, WALL ST. J., May 16, 2012, at A14.

257. *Id.*

258. Tim Talley, *Fallin Says Lobbyists Doomed Tax Cut*, TULSA WORLD (June 2, 2012, 10:27 AM), http://www.tulsaworld.com/news/article.aspx?subjectid=298&articleid=20120602_298_0_OKLAHO524725.

259. Editorial, *Tax Cut Wound Up Not Happening*, DAILY OKLAHOMAN, May 29, 2012, at 8A.

benefits. Efforts to prevent or remove special exceptions from this tax would fall into Quadrant 4, pitting concentrated loophole-seekers against concentrated beneficiaries. Missouri's sales and use tax earmarked for natural resources is a Quadrant 2 tax with diffuse costs and concentrated benefits. Similarly, stopping any narrowly tailored preferences from rooting themselves in this tax would be a Quadrant 4 endeavor. Utah's income tax earmarked for public education is a Quadrant 2 tax with diffuse costs and concentrated benefits. Again, reforms here would belong in Quadrant 4. Oklahoma's income tax earmarked for public health is similarly a Quadrant 2 tax with diffuse costs and concentrated benefits. As with the first three taxes, trying to keep these laws free of targeted favors would give rise to Quadrant 4 politics.

The concentrated beneficiaries of each of these taxes all play key roles in the tax lawmaking process surrounding their taxes. In Colorado, a coalition of public health groups that stand to benefit directly from the cigarette tax revenues, including hospitals, community health centers, and children's health groups were the impetus behind getting the referendum on this tax onto the ballot. This group also spent millions of dollars on passing the referendum and was extremely successful. Perhaps aware of the interest group momentum behind the tax, the tobacco industry, which would bear its concentrated costs, seems to have steered largely clear of the referendum debate. Since the tax passed, the legislature has made no effort to cut it. Again, perhaps legislators realize the strength of support this tax has and understand that chipping away at the tax would only awaken the ire of these interest groups. At the same time, given the absence of tobacco-industry activity surrounding this tax, reducing the tax would not provide a benefit to any engaged constituency. As a result, this earmarked tax remains a steady source of revenue for its beneficiaries.

In Missouri, the sales and use tax earmarked for conservation has a similar, actively involved protective constituency. The tax specifically benefits natural resources and farmers, and both environmental groups and farm groups have worked hard to develop and maintain this tax. Referenda both created and renewed this tax, and, in both cases, the interest groups had to mount a concerted campaign to get the issue on the ballot. They had to work to advocate for it and succeeded both times. In each case, the tax passed by an overwhelming margin. Given the diffuse costs of a sales and use tax, Wilson's theory might predict that these groups would face no opposition and have as easy a fight as they could expect over a referendum that would raise all voters' taxes. The story of this tax largely bears out that expectation. Only a handful of interest groups spoke out against this tax. The groups in question were urban groups representing the St. Louis metropolitan area. They objected not so much to the tax, but to its focus on rural areas. From the tone of their materials, these groups seemed more interested in finding ways to funnel taxpayer funds to St. Louis than in making sure money stayed away from rural groups. Perhaps because of this focus or because the number of opposed interest groups was reasonably small, the pro-tax environmental and farm groups appeared to have carried the day entirely in Missouri, protecting these tax revenues steadily for nearly thirty years.

In Utah, the concentrated beneficiaries of the income tax are education groups, many of which have been actively involved in trying to protect and grow income tax revenues. While a number of education groups are vocal participants in tax debates, these groups have not had the success of some other concentrated beneficiaries of earmarked taxes. The income tax in Utah does have a few credits and deductions—clearly not the thousands found in the federal code—and has faced across-the-board cuts in the past several years. The debate over these cuts has made evident how engaged education groups are in Utah's income tax debates. A number of advocates for public education, children, and teachers fought hard against those cuts but, in the face of substantial, unified political will to lower the rates, the interest groups lost the battle. At times, their opponents have presumably included interest groups hoping to carve special preferences into the tax code but, in this most recent fight, the income tax's supporters went up against a coordinated political effort on the part of state Republicans facing a large budget surplus. Their defeat in 2008 notwithstanding, Utah's education-oriented interests remain a key part of that state's tax debates and continue to oppose cuts in the income tax, including those that would create loopholes.

Oklahoma's income tax, earmarked in part for teachers' pensions, has inspired a broad coalition of supporters, including education advocacy groups, teachers' unions, organizations of retired persons, and nonprofits focused on children's issues. These groups are also extremely engaged in Oklahoma tax lawmaking. Perhaps because the number of groups is so large and includes members as powerful as the American Association of Retired Persons and Oklahoma's largest teachers' union, the tax's protectors have had a fair amount of success. Since the income tax was first earmarked for teachers' pensions, the legislature has carved out almost no special preferences. The legislature declared in 2009 a temporary moratorium on a huge bundle of the targeted items that had entered the code before the earmarking. In 2011, when the income tax faced a serious threat from a Republican governor whose party controlled both houses of the state legislature, the protector groups banded together and executed an effective campaign that observers credit with preserving the state income tax.

In all of these cases, the earmarked tax beneficiaries played extremely active roles in bolstering their taxes. This dynamic stands in sharp contrast to federal income tax lawmaking, where the diffuse beneficiaries of the federal income tax and of federal income tax reform are not substantially engaged in tax policymaking. Unlike in federal income tax politics, in all of these states, preventing the tax base from eroding is not a doomed Quadrant 3 endeavor but is instead a politically advantaged Quadrant 2 or 4 project. The paralysis present at the federal level is largely absent at the state level, pointing to the opportunity that tax earmarking has to help overcome federal tax lawmaking paralysis.

CONCLUSION

This Article has explored the problem of federal tax lawmaking paralysis in detail. Tax lawmaking paralysis has plagued the federal government for decades. Presidents since Kennedy have attempted to reform the tax code by ridding it of special preferences for particular interest groups. Nevertheless, reform efforts have seemed impossible to pass and to sustain. Even the most successful reform effort, the 1986 Act, collapsed almost entirely in the years after its passage.

This Article applied a cost-benefit framework to understand why tax reform faces such overwhelming paralysis at the federal level. In particular, this Article argued that loophole-closing tax reform proposals that might benefit many citizens struggle, politically speaking, in comparison with tax laws that help small, tightly concentrated groups. Tax laws that impose costs on a diffuse citizenry tend to have an easier time passing and remaining on the books than laws that impose costs on small, tightly concentrated groups.

This Article then proposed a solution to this paralysis problem that lawmakers from both sides of the aisle have been unable to shake. In particular, this Article argued that earmarking taxes for particular purposes offers an opportunity to overcome tax lawmaking paralysis. Using evidence from the federal government's primary experience with earmarking, from earmarking efforts at the local level, and from four state-level case studies developed from archival research, this Article demonstrated how taxing with purpose gives rise to political dynamics that can free federal tax policymakers from their paralysis problem.