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Michael J. Graetz and Ian Shapiro: Death by a Thousand Cuts

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A Political Mystery

At the heart of this story lies a mystery about politics and persuasion. For almost a century, the estate tax affected only the richest 1 or 2 percent of citizens, encouraged charity, and placed no burden on the vast majority of Americans. This tax was grounded on a core American value: that all people should have an equal opportunity to pursue their economic dreams. Yet it became so despised and generally unpopular that a wide majority of Congress voted to repeal it. How, in a democratic society, did this happen? And what does its demise signal about our future?

A law that constituted the blandest kind of common sense for most of the twentieth century was transformed, in the space of little more than a decade, into the supposed enemy of hardworking citizens all over this country. How did so many people who were unaffected by the estate tax—the most progressive part of the tax law—and who might ultimately see their own taxes increased to replace the revenues lost if the estate tax disappeared, come to oppose it? Who made this happen?

The answers to these questions reveal a great deal about how American politics actually works in the age of polls, sound bites, think tanks, highly organized membership organizations, and single-issue coalitions. The standard depiction of policy-making in Washington tends to focus on the incestuous relationship between the nation's lawmakers in Congress and the slick, well-heeled lobbyists who ply their trade between Capitol Hill and K Street by day and grease political wheels through campaign contributions and fundraising parties by night. The tale of the estate tax's demise—an epic whose final chapter has yet to be written—is different. It defies what we think of how big money influences politics. And the forces that killed this tax are now poised to take on much larger prey.

Contrary to conventional wisdom, inside-the-beltway machinations from Gucci Gulch did not send the estate tax to its grave. Rather, the move-

ment to kill the “death tax” (as its opponents very effectively renamed it) first started, and until the mid-1990s operated almost exclusively, outside the nation’s capital. The tax’s assailants ranged from farmers to florists, from cattle ranchers to newspaper owners, from the humblest of small businesses to some of the largest fortunes in the nation. For years Washington insiders viewed the movement to repeal the tax as a pipe dream. They tinkered at the tax’s edges, hoping to ease its burden here or there. But the outsiders never wavered in their quest to eliminate the tax entirely, picking up support in Congress slowly but steadily. The force that brought this change about drew its strength, if not from the grassroots, at least from the grass-tops of a large swath of American society.

To be sure, repeal would not have happened if this incredibly broad coalition of outsiders had not eventually come together under centralized leadership, deploying savvy Washington representatives and ideologically sympathetic insiders. By the late 1990s, this band of outsiders had united with Republican antitax philosophers, activists, and legislators, who regard all progressive taxation as morally obnoxious and economically destructive. Seeds of this movement date back to the late 1970s. It flowered a bit during Ronald Reagan’s presidency, but it did not gather genuine political strength until the Republican takeover of the House in 1994. Since then, eliminating all taxes on wealth or income from wealth has become a matter of Republican orthodoxy. Indeed, as stunning as the estate tax repeal was, it is a bellwether of a larger conflict—over the future of progressive taxation in America. Estate tax repeal is one important strand of a looming effort to strip from our nation’s tax system the very idea that those who have more should shoulder a larger share of the tax burden.

Many observers, who have become cynical about the role money now plays in our nation’s political process, will not be surprised that the interests of the wealthy triumphed here. But money did not lubricate this particular legislative change in the way that most people would expect. Tax policy has always been a prime area where moneyed interests attempt to work their wiles on willing politicians. Yet in the estate tax debate, the big money players who stood to gain the most from repeal—the multimillionaires and billionaires looking to escape future taxes—remained in the background, giving relatively small campaign contributions and refraining from direct lobbying. The large sums of money that facilitated repeal did not buy legislators’ votes. Money did play a crucial role, but a more indi-

rect one, a role that cannot be curtailed within the American constitutional system.

The political movement to repeal the estate tax achieved a great victory with the passage of George W. Bush's massive 2001 tax-cutting bill. That unprecedented piece of legislation began a decade-long phaseout of the estate tax, culminating in a repeal scheduled for 2010. But the entire 2001 tax law "sunsets"; the repeal disappears in 2010 unless subsequent legislation extends it or makes its changes permanent. Because a new law is needed, Democrats remain complacent. Having failed to learn any lesson from their trouncing in 2001, they are in danger of losing the larger war.

Conceived at a time of huge projected surpluses in the federal budget, the 2001 tax cuts are now caught in a kind of limbo: with the surpluses gone, replaced by deficits as far as the eye can see, final repeal of the estate tax is by no means certain. But Democrats underestimate the power of the forces working to eliminate progressive taxation in America. The coalitions and their leaders are working as hard as ever. Their agenda for progressive taxation in America is simple: death by a thousand cuts.

This is a story about how power in this country actually works today. The unexpected and often counterintuitive events that led to the 2001 repeal have important implications for lawmaking—not just lawmaking about taxes and the redistribution of wealth or income, but about the entire machinery of persuasion that goes into creating legislation in twenty-first-century American politics. The stakes in this battle could not be higher. At issue is what kind of government we shall have and who shall pay to finance it.

The law at the center of this tale is simple enough. When a person who is among the very wealthiest in this country dies, his or her estate has to pay a portion of the value of its assets to the United States government before the rest of the estate can be passed on to children or other heirs. But there are several important caveats. If the estate is passed to a spouse, there is no tax. If the person leaves the money to a charity or sets up a charitable foundation, as so many of America's wealthiest individuals have over the years, none of the money donated is taxed. Depending on where the person lives, state estate taxes may also apply, although, until the 2001 legislation, most of these payments could offset what the estate owed the federal government.

Until the passage of the 2001 tax bill, the tax affected only individuals

with assets of more than \$650,000, or married couples with assets of more than \$1.3 million—figures known as “the exemption.” That is to say, the first \$650,000 of any individual’s estate was “exempt” from the tax, and the exemption was scheduled to rise to \$1 million by 2002. Any amount above that would be taxed. In 1999, just 2.3 percent of all estates were taxed by the federal government; the other 97.7 percent of adults who died that year owed no estate tax. The average size of the estates taxed that year was \$2.5 million. The average estate tax paid was \$469,000, for an average tax rate of just under 19 percent. Combined, the taxes collected from these estates totaled \$24.4 billion. This amount would fund nearly one-half of the total spending in 2004 of the Departments of Homeland Security or Education and is more than twice the size of annual Pell grants, the federal government’s largest expenditure to help students attend college. Of the total revenue from the tax, more than half came from the richest 7 percent of taxable estates, those valued at \$5 million or more, the wealthiest 0.1 percent of our society. Nearly one-quarter of the total revenue—\$5.7 billion—came from the 550 estates with \$20 million or more of wealth. And nearly two-thirds of the wealth taxed by the estate tax is publically traded securities and other liquid assets, not family business or farms.

First adopted in the nineteenth century to fund various wartime government revenue shortfalls, the estate tax in its modern form has been on the books continuously since 1916. While the tax rate levied on large estates went up and down over the years, the tax itself was, until the movement we describe, generally considered an uncontroversial means of raising federal revenue from those most able to pay. Perhaps the most amazing accomplishment of the network of coalitions that worked to repeal this tax is the way in which it changed so many people’s opinions about who was affected by the tax and its fairness as a means of funding government. One poll showed 77 percent of the population believing that the estate tax affects all Americans. Many polls show that more than one-third of Americans believe that they themselves will have to pay the tax.

As effective as the repeal forces were, they benefited greatly from an inept and inattentive opposition. The more traditionally liberal forces, who thought they could defeat the repeal movement simply by pointing out the fact that only the richest 2 percent are taxed, utterly misread the political dynamic at work.

Why did appeals to economic self-interest fail? One reason is Americans' enduring belief in the personal attainability of great wealth—our enduring optimism. In the 2000 presidential race, speaking before rallies of middle-class citizens across the country, George W. Bush again and again received his most enthusiastic applause when he declared his intent to end the death tax. It was a political lesson that he and his advisors would not forget.

It would be wrong, however, to think that the president, the coalitions, and business groups merely hoodwinked people into mistaking the interests of the super-rich for their own. They also managed to win in the court of public opinion, by making a philosophical argument over the very legitimacy of taxing large accumulations of wealth. The death tax was brought to its knees by a decade-long assault on its political support, its philosophical underpinnings, indeed, its moral character. The philosophical argument about fairness and justice that was marshaled on behalf of repeal animates the entire story this book tells, and its origins run at least as far back as the founding of the country.

Is inheritance a natural right or a social privilege? That is a long-standing question. Is the wealth that is accumulated during a lifetime, either through work or investment, the sovereign possession of its current owner to dispose of entirely as he or she chooses? Or does society have some claim on it from having provided the markets, the rules of law, the security, and the enforcement that allowed the wealth to grow and develop? If inheritance is a natural right, government has no business taxing it. Such a levy would represent what repeals forces call "double taxation," because the money is taxed once when it is earned and again when it is passed on to the next generation.

But if inheritance is a privilege in a society that has helped the wealth come into being, then the government can legitimately tax it as it has throughout most of our history. Indeed the failure to tax large inheritances of wealth threatens the fundamental American value that everyone deserves an equal opportunity to succeed—an equal shot at the American Dream.

This argument, while in principle applicable to any and all inheritance, has in practice focused only on the legitimacy of taxing large fortunes. No one, not even the most ardent advocate for the estate tax, believes that middle-class Americans should have to pay the government any portion of

whatever savings or assets they have managed to accumulate when they die. The question is and always has been how to treat the wealthy and the super-wealthy.

When he endorsed the idea of a tax on inheritance back in 1906, Theodore Roosevelt said that its “primary objective should be to put a constantly increasing burden on the inheritance of those swollen fortunes, which it is certainly of no benefit to this country to perpetuate.” Andrew Carnegie agreed, believing unfettered inheritance of huge fortunes makes people idle and profligate. In the early part of the twentieth century, when the nation’s images of wealth came from Rockefellers and railroad barons, the general public also tended to agree. They didn’t like the idea of an economic aristocracy perpetuating itself generation after generation in a country founded on the idea of equal opportunity for all.

Today, the images—if not the realities—of wealth have changed. Despite the well-publicized greed of the Dennis Kozlowskis, Martha Stewarts, and Kenneth Lays, our most famous rich citizen is a computer entrepreneur who started his business in a garage and became a billionaire. If Bill Gates can do it, so can you—at least that is how the thinking goes. And if you start the business, work the long hours, earn the money, and pay income tax on it, why should the government get anything when you die, no matter how rich you become?

Moreover, we have become a nation of capitalists and wanna-be capitalists. Although the financial assets of most are quite small, more than half of all Americans—70 percent of those who vote—now have some stock market investments through their retirement plans. When Ronald Reagan became president, the number of investors was closer to 20 percent. And if, as George W. Bush has suggested, a portion of Social Security taxes is allowed to be invested rather than paid over to the government, the number of people with some stake in the stock market will grow dramatically. Protecting one’s wealth is no longer a concern of only the upper crust.

Taking advantage of this changed view of wealth, and sometimes manipulating it, repeal forces effectively turned their cause into a moral crusade. Once the issue became one of abstract fairness to all rather than the best policy for treating giant accumulations of wealth in a democratic society, the philosophical argument had been won. Opponents of repeal were then on the defensive—never a good place to be in politics.

Within the larger mystery—how this change in the climate of opinion

and political fortunes occurred so quickly and unexpectedly—lie two further mysteries. How did the coalitions for repeal stick together even after they were offered compromises that most observers would have expected to splinter them? And why was the opposition to the repeal incredibly paltry, late, and disorganized? Why were the Democrats and other groups who opposed repeal unable to stop the repeal juggernaut? Why was there no modern Teddy Roosevelt to warn the public of the dangers of rewarding dynastic wealth in America? What does the opposition's failure here tell us about their ability to thwart the coming attacks on progressive taxation in this country?

By the time the 2001 tax bill was being negotiated in Congress, Democrats and other repeal opponents were willing to raise the estate tax exemption well above \$650,000 to \$3 million, \$4 million, or even \$5 million. At this level the tax would have applied to only a miniscule slice of Americans, about the top one-quarter of one percent, but it would have still generated significant revenue. The vast majority of the small businesses that comprised the National Federation of Independent Businesses (NFIB), one of the most important and effective advocates for repeal, would have faced no tax liability whatsoever. Nor would most of the members of the other trade associations that had banded together to seek elimination of the tax. The number of farmers still subject to the levy would have been tiny. The choice became stark: an immediate, substantial increase in the estate tax exemption offered by the Democrats, or the Bush plan—a slowly phased-in repeal, with outright elimination postponed until the year 2010.

But by the time these reform proposals appeared as realistic legislative alternatives, the movement to repeal the death tax had already been absorbed into a larger Republican antitax crusade, an effort to reduce the size and functions of American government. The leaders of this wing of the Republican Party regard the tax issue, not the wedge issues of social policy, as the linchpin to a long-term Republican majority. One of its most effective and outspoken leaders, Grover Norquist, insists that taxation is “the central vote-driving issue.” “You win this issue,” he says, “you win—over time—all issues.” The antitax forces and their strategists have no intention of stopping with the estate tax. How they won this campaign tells us much about what may lie ahead in the most contentious upcoming battles over tax policy.

The antitax zealots bided their time during the 1990s, winning votes and support wherever they could, patiently awaiting their next opportunity. By 2001, estate tax repeal provided just such a chance. The repeal coalitions had built up broad-based support among the voters and won over a majority of Congress by the late 1990s. When the 2000 presidential election brought us George W. Bush—a president who was willing to support repeal and who also subscribes to the more fundamental antitax philosophy—the stage was set. Not only did the conservative antitax zealots embrace estate tax repeal, an issue they had come to late, but they also fused the death tax coalition, which had been a single-issue movement, with their broader attack on taxation as we know it.

Once we understand the place of the estate tax in the long-term war against progressive taxation, it becomes easier to see why even a long-delayed and uncertain repeal became preferable to a certain and substantial reform. Accepting reform would have meant conceding the justice of the estate tax. But the antitax movement has built up a powerful philosophical attack on the very concept of progressive taxation that underpins the estate tax. And by 2001 their attacks on progressivity had fundamentally changed the nature of tax politics in America, reviving a debate that had seemingly been settled in the first decades of the twentieth century. The antitax fighters wanted to get repeal on the books, no matter what the form. They were willing to gamble that they would be able to take the next step and make repeal permanent. The story of how and why this occurred, based on extensive conversations with the players and powerbrokers on both sides, un-masks the hidden dynamics of lawmaking.

The opposition's mysterious weakness is another aspect of our story, and in unraveling it we see a mirror image of the repeal movement's "perfect storm," with its motivated activists, grassroots organization, articulate spokespeople, and eventual presidential backing. Opponents of repeal, such as they were, were completely outmaneuvered. They never saw repeal coming until it was well on its way down the tracks. They consistently underestimated the diverse array of forces—including minorities, gays, and environmentalists, as well as farmers and small businesses—that would press for repeal. When they offered any responses at all, they answered moral attacks with numerical and tactical replies. "But you don't pay the estate tax!" was their battle cry. An opposing philosophical case was never made. Those who wanted to retain the tax mainly played catch-up and

closed stable doors. If the stories of the organized coalitions and their drive for repeal constitute a textbook for effective political action, the disarray of the opposition is a cautionary tale about relying on stale assumptions and diffuse preferences in a battle against intense and organized opponents.

Well beyond the particulars of the estate tax, the American public stands to learn a great deal from understanding what happened in this endeavor. Regardless of ideological or political commitments, whatever one's stand on this tax or any other, the public needs to know how power and politics actually operate in Washington today. And, whatever the final outcome, one thing is certain: this contest has radically altered the political landscape. The broader antitax force is marching forward in Washington and in the great heartland. The fundamental principle of progressive taxation is under attack. The movement to repeal the estate tax has been the vanguard in this crusade. How this occurred is, in the end, a peculiarly American story peopled by buccaneering newspapermen, political climbers, crusaders and ideologues, farmers and entertainers, beer distributors and billionaires. This is a story about the carnival of politics in the United States in the twenty-first century, and how it is shaping the world in which we all live.