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Shakedown at Gucci Gulch: A Tale of Death, Money & Taxes

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I. Introduction: The Traditional View of Politics

Ever since Mancur Olson's classic text, *The Logic of Collective Action*, was published in 1965[1]—if not before—the dominant view of legislative action in the United States has given pride of place to "special interest groups."[2] In the now standard view of politics, these small groups with high stakes arise independently, motivated by common interests and able to solve the "free rider" problem of collective action on account of their small size. The "special interests," as they are known for short, then descend on Washington and other bastions of power, in the form of cor-

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[1] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups*, Cambridge: Harvard University Press, 1965, Grossman and Helpman, Baron review.

porate lobbyists, and seek the non-market returns contemporary politics so amply provide.

This special interest conception of politics pervades the academy, the press, and even politicians' own self-awareness of politics, such as it is. In the 2000 presidential elections, for example, attacks on the power of special interest groups formed the basis of campaigns by Senator John McCain, on the right, and Ralph Nader, on the left. More recently, Arnold Schwarzenegger rose to populist power as the governor of California, America's most populous state, promising to terminate special interest politics. The 2004 presidential campaign promises more of the same old, same old: politicians on all sides lamenting the power that special interests wield on the other side, whatever it is. While no candidate has yet been successful in actually mitigating the power and influence of special interests.no one really ever has been—the various campaigns give voice, as Ross Perot had years earlier, to the wide-spread perception that special interests, through their campaign contributions and other efforts, dictate and corrupt public policy.

Both tracking and shaping popular political perceptions, an extensive literature in economics and political science analyzes public policy from the perspective of special interest groups.[3] The analysis often begins by noting the conditions under which

[2] Literature on "special interests"; note that used to be called pressure groups.

[3] References.

an interest group can be politically effective. Here Olson, nearly four decades ago, seminally identified two crucial barriers to the formation of a political interest group. One is a coordination problem. The benefits from political action may give each group member reason to participate in the group effort once the group is formed, but the formation costs—including identifying the group members, organizing the group, and agreeing on a political strategy—are high. While the actual cost of the political campaign—how much it takes, in campaign contributions or whatever, to get something done—may be largely independent of the group size, the coordination costs are not; these increase, sometimes exponentially, with the number of members in the group. The second, and related, problem involves free-riding.[4] Political action yields a public (or at least a group) good: a bill or policy that affects the entire population whether or not a particular individual participated in the lobbying effort. Beneficiaries benefit even if they do not bear any of the burdens. A political action group will have trouble keeping its members from defecting, as each has an incentive to let the others do the work.

These two Mancur Olson problems help predict both what politically effective interest groups will emerge and what policies they will support. Critical to success is not just the extent of benefits—more, of course, is better than less—but also their distribution: the larger the per capita benefits, the smaller the group need be to cover the costs of political participation. The smaller the group, the smaller the coordination

[4] Definition of free-riding and citation.

problems. Further lessening the free-rider problem is the extent to which the small group exclusively benefits from the policy. Non-member beneficiaries, through their free-riding example, impose a negative externality on the conscientious participants. Hence small groups with high stakes tightly fitting a potential policy objective are the most likely special interest groups to flourish.

In this now familiar story, politicians enter at a relatively late stage. Special interest groups form on their own, out somewhere in the hustings: spontaneously generating themselves as the occasions (small group/high stakes) arise. The groups then come to legislators, offering them votes and/or money in exchange for their sought-after ends. Political theory in this special interest vein divides into two branches, following the two basic goods—money and votes—that the interest groups offer to legislators. The money side helps to illuminate many commercially oriented public policies, such as the regulation of business[5] and foreign trade,[6] where a "capture" or "rent-seeking" model of politics flourishes. The vote side plays out when interest groups with geographic concentration help shape congressional support for public

[5] Seminal works in the area are George Stigler, *The Theory of Economic Regulation*, BELL J. OF ECON. & MGMT. SCI. Vol.2, Issue 1 (1971) [hereinafter Stigler, *Economic Regulation*] (modeling how policies benefit regulated firms) and See Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, QUARTERLY J. OF ECON. , 98 (August 1983) [hereinafter Becker, *Theory of Competition*] (developing a model of interest group competition that may lead to more efficient government tax and spending policies.) Recent summaries and interpretations of the literature are contained in See Sam Peltzman, *The Economic Theory of Regulation after a Decade of Deregulation*, BROOKINGS PAPERS ON ECON. ACTIVITY - MICROECONOMICS (1989) [hereinafter Peltzman, *Economic Theory*] and See Roger G. Noll, *Economic Perspectives on the Politics of Regulation*, *in* Ch. 22 HANDBOOK OF INDUSTRIAL ORGANIZATION VOL. 2 (Schmalensee and Willig, 1989) [hereinafter Noll, ECONOMIC PERSPECTIVES].

works bills, some spending "earmarks," and other traditional "pork barrel" legislation.[7]

So goes the traditional tale. To be clear, we accept this story as far as it goes; special interest groups are undeniably a major part of the American political landscape. We just do not think the traditional tale goes far enough—specifically, far enough back in time.

In this article, we push the standard view of special interest politics back to a stage prior to the formation of the groups. We argue that, at least in a wide and important set of cases, lawmakers themselves, addicted to the money that special interests provide, actually proactively solve the Mancur Olson problems of group formation. Lawmakers give birth to the very special interests that later "plague" them. Congress, our primary focus, through its powers, importantly including its taxing and agenda-setting powers, helps to create small interest groups with high stakes in the first instance, which it can then "shake down" for campaign contributions in the second instance. This "reverse Mancur Olson" phenomenon—reverse because, in our conception, the politicians come first and the special interest groups second; ironically, the groups thereby become the victims of the political process, the prey and

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[6] See Gene Grossman and Elhanan Helpman, *Protection for Sale*, 84 AM. ECON. REV. 833-850 (1994) [hereinafter Grossman and Helpman, *Protection*].

[7] John A. Ferejohn, *Pork Barrel Politics: Rivers and Harbors Legislation, 1947-1968*, Stanford: Stanford University Press, 1974.

not the predators—is simply an analytic possibility, a prediction easily derived on the chalkboard or from an armchair. We set it out in Part II.

An extended example helps to illustrate the possibility—and to confirm the real world occurrence—of the reverse Mancur Olson phenomenon. We believe that the estate tax, and the recent legislation to repeal—or not—this tax, is a perfect case study. Here is a tax falling on a very few people, but at high stakes. The tax is largely avoided through private planning: transactions that generate large financial returns to a small, highly remunerated group of "players." Thus there are two Mancur Olson groups, counterpoised on both sides of the issue. Repeal of the estate or so-called death tax has an important and plausible asymmetry to it: if the tax ever dies, it is unlikely to be revived. Thus, private parties harmed by the presence of the tax—the putative taxpayers—would rationally pay to kill the tax. On the other side, parties benefited by the existence of the tax—financiers such as insurance companies, lawyers, accountants, sophisticated nonprofits—would rationally pay to keep the tax. Congress has perfect "shake down" territory. The reverse Mancur Olson phenomenon suggests that Congress will milk this lucrative cow for all it is worth (to add another metaphor to the fray), voting over and over and coming up short—just short—of permanent repeal. And so they have. In spades.

Anticipating here at the start the two most likely objections, we emphasize, first, that nothing in the reverse Mancur Olson phenomenon depends on Herculean acts of foresight, prescience, or, for that matter, ex ante coordination. Congress may not have known what a good thing it had, in estate tax repeal/non-repeal, until history dumped the issue in its collective lap. But once they stumbled onto the example, like the proverbial drunken sailor, the conception predicts what they would—and did—do. In general, the reverse Mancur Olson technique predicts that Congress will generally avoid "ballot box" issues, preferring instead to devote its time to issues of high stakes to small groups. When it finds such issues, it will often string matters along. It will avoid sensible, good-faith compromises, and often produce laws unintelligible except as signals of its power to help, harm—or help to form—special interest groups.

Second, we do not suggest that the reverse Mancur Olson effect explains all or even any specifically quantifiable part of politics today. American politics are complex. Sometimes lawmakers do indeed respond reactively to special interest pressure; sometimes they respond to popular sentiment; sometimes they even act on principle. We mean merely to suggest, and illustrate with one extended and several short examples, that in at least some important cases, Congress is acting to create and perpetuate special interests in order to extract money from them.

As noted above, Part II sets out the reverse Mancur Olson phenomenon in broad outline.

Part III gives background about the estate tax and the recent estate tax legislation.

Part IV connects the dots by arguing that the contemporary estate tax story is best explained by the reverse Mancur Olson model of politics.

Part V offers some additional possible extensions of the model, and brief conclusions—hoping, perhaps against hope, to suggest some way to stop the insanity.

II. The Reverse Mancur Olson Phenomenon

A. The Basics: Two Facts

The reverse Mancur Olson phenomenon places the legislator front and center, and makes the special interest groups themselves the creatures of the political process. At the outset, this is simply an analytic possibility. It follows from emphasizing two aspects of politics.

1. Fact No. 1: Money Matters

The first fact is that politicians care about money. A lot.

The traditional conception of special interest group politics still often emphasizes the centrality of legislators' getting votes: the reelection motive. Clearly, getting votes is fundamental to legislative motives. Yet the centrality of vote-oriented behavior in theoretical models has endured long past the point where votes have centrally mattered in real-world politics. Today, most congressional seats are safe: incumbents not only are overwhelmingly reelected, but do so with large majorities and only token opposition. In 2002, for example, 96% of House members were reelected (down slightly from the 98% in 1998 and 2000), 86% of Senate incumbents were reelected as well.[8] The very electoral security of most legislators provides them with wide latitude to support interest groups whose goals might be inimical to a narrowly vote-centric reelection model. Indeed most bills and issues promoted by interest groups simply have no ballot-box implications for a large majority (that is, a decisive group) of legislators, because these issues are low-salient ones in crude, multi-issue, "winner take all" election contests.

At the same time, and in part because of these factors, the financial benefits provided by interest groups remain intensely important to legislators. Representatives from the safest of districts almost always devote enormous time and effort to fund-raising. Politics today is much more the story of money.[9] Its importance, as claimed by Perot, Nader, McCain, Schwarzenegger, and countless others, and as verified by a plethora of statistics, has intensified over time.[10] Well over one billion dollars was

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[8] See http://www.opensecrets.org/bigpicture/reelect.asp?cycle=2002, visited December, 2003.

[9] See Norman J. Ornstein, *Lobbyists often get More Shakedowns than they Give*, Roll Call, February 25, 2004.

[10] Ansolabehere et al dispute this conclusion in their important new paper, "Why is There So Little Money in U.S. Politics," Stephen Ansolabehere, John de Figueiredo and James M. Snyder, Jr, Journal of Economic Perspectives, Spring 2003. They point out that whereas the absolute level of real campaign contributions has increased substantially over the past hundred years, the share of GNP or income (contributions divided by gross national product) has been essentially constant. They argue that the latter measure is the important one, as contributions allegedly affect the size of government. Their paper concludes with three puzzles: the first, an old puzzle formulated by Gordon Tullock over thirty years ago is why contributions aren't larger, given the importance of government to business. The second is why contributions appear ineffective, as the link between contributions and votes appears so tenuous. The third is why anyone gives at all, when it appears useless. We are by no means able to address their puzzles or conclusions at this time, but note that the combination of puzzles saves our

raised by Democrats and Republicans in the 2001-02 election cycle, with slightly more than half coming from "hard" money (relatively small donations to individual candidates) as opposed to "soft" money then unlimited contributions to political parties.[11] The 2004 presidential campaign will easily become the most costly ever, with both major party candidates, George W. Bush and John Kerry, having sworn off federal matching funds during the primary, thus freeing themselves to spend all that they could raise. And they raised a lot.

Why do legislators at lower levels in the government hierarchy continue to seek ever-higher amounts of money, when their own reelections are rarely at stake? The answer is complex, but we believe that it has much to do with the rise of party politics. The two main political parties, Democrats and Republicans, act as large, coercive coordinating devices. They require their members to raise large sums of money. They police this requirement in various ways, most importantly by allocating scarce and prized committee chairpersonships—committee and subcommittee chairs literally have quotas for the funds that they must raise—by supporting or not intra-party challenges in political primaries, by helping or not with ambitions for higher electoral office, and even by assisting in post-elective office career placements.[12] In turn, the parties use the money that they compel members to provide to wage pitched

analysis from irrelevance even if their conclusions are accepted. Moreover, they concede that policy in the small -- as is discussed here -- may well be affected by contributions.

[11] Opensecrets.org, supra. Soft money is now limited by McCain-Feingold, upheld in [complete, with case citation, etc.]

battles in those surprisingly few marginal contests there are to gain control of the chambers of Congress, and to throw into the increasingly expensive presidential campaigns every four years.

This is the modern game of politics in a nutshell, and there is solid reason to believe that perfectly rational individuals would form parties to effect these ends, even if, viewed from afar, an irrational "arms race" results.[13] The increasingly expensive elections of the last decade have underscored how partisan control of the houses of Congress and the executive branch of government are still up for grabs—and with them the power each of the members of Congress can wield. The 2002 midterm election in particular was fought in a few districts and a few states, with parties redistributing campaign funds and dispatching important players to campaign for a handful of candidates in marginal races.[14] In sum, even with more than ninety percent of legislative seats "safe," the fundamental things apply: money matters.

2. Fact No. 2: Legislators are (Rational) People

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[12] support

[13] Thomas C. Schelling, *The Strategy of Conflict*, Cambridge: Harvard University Press, 1960.

[14] According to watchdog organization OpenSecrets.org, redistribution of campaign contributions grew from essentially zero in 1992 to over 10% of the total raised by incumbent congressmen in the 2002 election cycle. See http://www.opensecrets.org/bigpicture/wealth.asp?cycle=2002. Note that over the same period, the rules regarding disposition of campaign contributions (in particular, the ability of representatives to convert those funds to personal use on retirement) changed as well.

The second fact is even more elemental than the first has come to be. It is that legislators are rational, in the simple sense of acting consistently on the basis of a well-defined utility function.[15] As rational persons, they will seek out what they want, measuring marginal costs against marginal benefits.

Emphasizing the role of money in politics, as the first fact does, leads to a change in emphasis from the traditional special interest conception of politics with the further fact of legislative rationality taken as given. In the usual setup, the legislator is passive: she sits there, waiting for the special interest groups to come to her. Indeed, more often than not, the politician laments this sorry state of affairs: she complains that she must spend all her time dealing with lobbyists, and yearns for some higher path of enlightenment.[16] Thus the Perot-McCain-Nader-Schwarzenegger line of critique places blame at the feet of the special interest groups themselves, who must be "reined" in, or exposed for what they are: corrupt predators on the socio-economic landscape.

Yet given the political addiction to campaign contributions, it would be surprising indeed if legislators simply sat around and waited to be approached by interest groups in search of a policy favor. We do not believe that they do. A rational person who needs money and has power will use that power fully within the confines of the

[15] Becker and Sen.

[16] Examples of laments.

law, mind you to obtain money. Of these simple premises, the revers Mancur Olson phenomenon arises.

B. Rent-Seeking and Rent-Extraction

Political theorists refer to lobbying activities initiated by interest groups as "rent-seeking," the term referring to non-market economic returns. An alternative perspective, explored at length by one of us,[17] posits an activist legislator who threatens to take the rent away from a relevant interest group. This model is one of "rent extraction." Rent seeking is to rent extraction as bribery is to extortion. In a rent-seeking/bribery game, potential beneficiaries from political action pay politicians for their gains. In a rent-extraction/extortion game, potential victims pay politicians not have losses imposed on them. Of course gains and losses are but opposite sides of a single coin: not to get a gain is a loss, not to suffer a loss is a gain. What matters more to a deeper understanding of the political story is who initiates the action. The traditional special interest conception is a rent seeking model , because the groups come first, offering bribes. The reverse Mancur Olson phenomenon is a rent extracting model, because the politicians come first, establishing the groups and then asking them to pay or be harmed/not-benefited.[18]

[17] Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion*, Cambridge, Mass: Harvard University Press, 1997.

[18] Ornstein, supra.

The importance of rent-extraction emerges from studies of legislative responses to campaign contributions. The idea that money buys votes is surprisingly difficult to prove.[19] The empirical literature on campaign contributions has in fact established such a link, but the results are qualified, as by the tenure of the legislator, and typically require sophisticated econometrics to perceive small effects. At the core of the econometric difficulty is a "simultaneous equations" problem: money flows from interest groups to politicians who support them, but which came first, the money or the support? Compounding the difficulty is the complexity of the political process. Log-rolling among members of Congress, the mediating effect of parties, and rules limiting campaign contributions from individual interest groups to individual legislators all muddy the trail of rent-seeking.[20] We wish to emphasize that rent-extraction complicates the link further, as the "payoff" from campaign contributions might not be a vote at all, but rather the absence of any vote, and indeed any bill, to change a current policy.

We do not intend in this article to solve the difficulty of proving that money buys influence; indeed, the reverse Mancur Olson model suggests that payments to politicians might be needed simply to maintain the status quo. Instead, we mean to explore further the implications of the two basic facts note above: that legislators need money, and that they are rational. These two facts alone suggest the reverse Mancur

[19] Ansolabehere et al., op cit. provide an excellent summary and critique of this literature.

Olson phenomenon: a lawmaking individual or body such as Congress can use its agenda-setting powers to create the conditions under which special interest groups can arise. In technical terms we argue that the formation of interest groups is or can be *endogenous* to the political process; in the traditional view, the groups arise *exogenously* to that process In less formal terms, we argue that Congress first helps to create the groups that it can later "shake down" to elicit campaign contributions.

Rent-seeking by special interest groups ties directly into fund-raising. Politicians are compensated for transferring wealth in the rent-seeking game. But rather than waiting for the groups to form and come to them, politicians can go further. They can threaten to take private wealth and then, for a price, forebear from doing so, a process known as rent extraction.[21] Rent extraction is, in effect, a perfectly legal form of political extortion.

The taxing power creates a prototype for rent extraction. Congress has the constitutional power to tax. This ability to tax necessarily entails the ability *not* to tax, that is, to propose taxation but then not levy the tax threatened. Proposing onerous legislation and then—for a price—agreeing not to push or even withdrawing the legislation proposed is the essence of rent extraction. Rent-extracting games are observed

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[20] See Ansolabehere *et al., op cit.*

[21] See generally Fred S. McChesney, Money for Nothing: Politicians, Rent Extraction and Political Extortion (1997). For a recent update, see Fred S. McChesney, "Rent Extraction," in The Elgar Companion to Public Choice, W. Shughart II & L. Razzolini, eds. (2001).

routinely as part of tax legislation proposals: private individuals pay, not to for special favors, but to avoid disfavor.[22]

Note that both rent-seeking and rent-extraction activities can only come after the Mancur Olson problems have been solved. The special interest groups need to form themselves in order to seek rents (except in those rare cases where an individual alone can command the resources to play the game, but we can think of this as a special case where the group number is 1). Similarly, Congress will typically need a group to extort in the rent-extraction game. This is where the reverse Mancur Olson phenomenon comes into play.

C. A New Beginning

In the traditional version of special interests politics, the groups arise independently, exogenous to the political process on which they hold such sway.[23] Politicians are mere "pawns" of special interests, as the saying goes. In the reverse Mancur Olson phenomenon, in contrast, Congress creates the occasions for the special interests to form in the first place. That is, Congress "solves" the collective action problem for political groups largely through its power over the political agenda and the economy, importantly supplemented by its taxing authority, allowing groups to be small enough—and with large enough stakes—to organize into effective advocacy units.

[22] For various examples, see Doernberg and McChesney, supra note __.

[23] This is true also by stipulation in Becker's classic 1983 text, supra.

Congress then proceeds to "shakedown" the groups.[24] Special interests become the victims of politicians.

Once again, the taxing power is especially important and illustrative. The traditional Mancur Olson style approach, as applied by Gary Becker for example,[25] suggests the likely nature of tax bills. Specifically, a tax that is evenly distributed—so that its per capita incidence is small—has clear political benefits, for it may raise money without promoting interest group outcry. The interest group in question would be all taxpayers and each member has small stakes: precisely the framework that promotes free riding and non-cooperation. This perspective does indeed help explain the two major taxes in America, the personal income and payroll taxes, which impose broadly diffuse taxes at (relatively) low marginal rates.[26]

The reverse Mancur Olson phenomenon, in contrast, suggests that the precise *opposite* form of tax may also be attractive: taxes that fall heavily (not lightly) on a small (not large) group, most likely to organize and be politically vocal. These are groups with rent-extraction potential. The estate tax is of course a perfect example of such a tax, as we discuss below. Regulation that falls heavily on a small group, such as the tort-reform proposals we discuss in Part V, act in much the same way as a tax for the affected group.

[24] See infra Part II.B.iii.

[25] Becker 1983 QJE, see also Becker and Mulligan, 2003 JLS.

D. Properties

We do not intend to offer a formal model of the reverse Mancur Olson phenomenon. Rather, we rest its possibility on two simple, axiomatic assumptions (lawmakers want money and are rational), and argue for its existence on the basis of one extended and several suggested examples. It is difficult to model the actual activities of large, complex political institutions such as Congress and special interest groups writ large. But we believe that the phenomenon obtains in the real world and is important to understanding contemporary politics. We can sketch the general properties that will accompany the reverse Mancur Olson phenomenon.

One, there will be an issue of high stakes to a small, well-focused group, with a tight-fitting policy option capable of inflicting pain or gain on the identifiable group. These are simply the Mancur Olson conditions. In the reverse Mancur Olson phenomenon, Congress will have played a role in creating and/or perpetuating these conditions.

Two, the issue will likely have low salience for most voters, and so have little or no ballot-box significance, aside from its effect on lawmakers' abilities to raise money (which can of course affect electability). Lawmakers will feel little pressure to cease the rent-extracting activities on account of any narrow reelection motive.

[26] Citation and data.

Three, the issue had best be two-sided: there will be small, well-funded issues on both (or more) sides of the policy issues. This allows lawmakers to reap financial benefits regardless of where they stand on the issue; it prevents a tipping phenomenon wherein legislators would cluster together and actually do something.

Four, action on one or the other side of the issue must be plausible. People will not pay for long-shots.

Five, there ought to be something in the nature of the issue such that any legislative action will be plausibly long-lived. This feature is needed for lawmakers to "capitalize" the rents.[27] If Congress could easily undo in one term what it had done in the prior one, why would any individual or group pay a large amount of money to effect the initial result?

Of course, on the final two conditions, plausibility and plausible longevity, the phenomenon is spectral, not binary. The bigger the stakes, the lower the odds need to be, and the shorter the time horizon. It is all a matter of math.

Our primary example, the estate tax repeal/non-repeal efforts over the last few years, satisfy all these conditions. The tax itself, on account of its high marginal rates and exemption levels, is of intense interest to a small group of real or putative taxpayers, and Congress has clearly played a role in creating and perpetuating this state of affairs (as opposed to enacting a lower rate tax on a broader base). The issue is highly unlikely to be a decisive one in too many voters' ballot-box decisions. The issue is two-sided; there are small, specific, well-financed groups opposed to repeal as well as for it. Action, in the form of repeal, has become highly plausible over the last several years. Finally, there is a plausible case to be made that any ultimate, final repeal of the estate tax would be unlikely to be reversed by any subsequent Congress, on account of several factors we discuss below.

The conditions also obtain in the other examples we canvass briefly in the final section: tort reform, defense spending programs, and broadcast spectrum sales and licensing. These issues feature big stakes, small groups, low salience, two (or more) sides, plausible action, and long-term effects. They also take up a good deal of the legislative agenda, often with nothing really happening.

With some or all of the conditions in place, we predict that reverse Mancur Olson phenomena are likely to transpire. These will have at least two salient features. One, Congress is likely to string the issue along, often voting, never finally resolving the issue. Two, sensible compromises will be ignored or defeated. A pitched, "all or nothing" battle will ensue, seemingly partisan, but in fact reflecting the common interest of all insiders against any potential invaders at the gate.

We see all this play out, perfectly, in the estate tax story.

[27] Explain, and cite to Doernberg-McChesney.

III Setting the Stage: The Facts of the Estate Tax

The saga of estate tax "reform" over the last decade or so provides an excellent case study for the reverse Mancur Olson phenomenon. In this Part, we give the background facts and information to understand that story.

A. Estate Tax Basics

The estate tax began in 1916, at a now modest-sounding top marginal rate of ten percent. We have little doubt that the initial motivation for the tax was public-spirited, in two senses we later describe: the tax was designed both to raise revenue and, in the progressive spirit of the times, to break up large concentrations of wealth.[28] To close an obvious loophole—the ability to gift everything away on death—Congress added the gift tax in 1922. The two taxes were unified in 1976 (although they have been somewhat torn asunder by recent law). We shall refer to the unified gift and estate tax as the "estate tax" for convenience.[29]

[28] For background on the history of and reasons for the estate tax, See Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223 (1956) [hereinafter Eisenstein, *Rise and Decline*]; see also McCaffery etc.

[29] For a history of the estate tax see JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX (University of Wisconsin Press 1985) [hereinafter WITTE, POLITICS AND DEVELOPMENT]. See also THOMAS J. STANLEY & WILLIAM D. DANKO, THE MILLIONAIRE NEXT DOOR: THE SURPRISING SECRETS OF AMERICA'S WEALTHY (1996) [hereinafter STANLEY & DANKO, MILLIONAIRE NEXT DOOR]. See also Debra R. Silberstein, *A History of the Death Tax - A Source of Revenue or a Vehicle for Wealth Redistribution, at* http://www.debrasilberstein.com/deathtax.htm (visited Nov. 11, 2003). See also http://www.plannersindex.com/estate_tax_history.

The estate tax is a wealth *transfer* tax, as opposed to a wealth tax per se or an accessions tax that would fall on the recipients of gratuitously transferred wealth. The estate tax is levied on the transferor of wealth: the giver in the case of *inter vivos* transfers or the estate in the case of a decedent. Three major—and very many minor (in scope, not in economic significance)[30]—exceptions and exclusions whittle down the number of people subject to the tax.

One is the marital deduction.[31] Either spouse can transfer to the other, in life or on death, an unlimited *amount*—there are limits on the *forms* of transfer—of wealth or assets. The marital deduction means that the estate tax usually falls on the second-to-die in the case of a married couple, giving more time and ability to plan for its incidence—or avoidance. Proper use of the marital deduction also means that the next two features of the tax, the annual gift exclusion and the unified credit or exemption level, can easily be doubled for a married couple, with proper planning.

Two is the annual gift exclusion.[32] This is a per donor, per donee, per year exception from the tax. The amount (in cash or fair market value of non-cash gifts) was raised to $10,000 in 1981; it has since been indexed for inflation, and is currently set at

[30] explain, and see below.

[31] IRC § 2056 etc.

[32] IRC § 2503.

$11,000.[33] Under the annual gift exclusion, therefore, two parents can transfer $22,000 a year to each of their children, on and on. The amount of wealth that can be gotten out of one's estate through sophisticated use of the annual exclusion is significant. Consider a married couple, age 40, with 3 young children. Were the couple to give each child $22,000, cash, on January 1 of each year for 40 years; and were the cash invested in a vehicle yielding 6 per cent, compounded daily—about the inflation free rate of return on the stock market over the past 70 years, the inflation adjustment allowing us to keep the example simple in current dollar terms[34]—*each* child would have approximately $3.5 million by their parents' 80th birthdays. The couple would have extracted over $10 million from their combined estates, altogether tax-free.[35]

Nor does the annual exclusion story end there. By now longstanding administrative practice, the Internal Revenue Service (IRS) allows a "discount" to be given to fractional shares of a "family limited partnership," which can be a vehicle simply hold-

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33 IRS Publication 950, *Introduction to Estate and Gift Taxes*, *at* http://www.irs.gov/pub/irs-pdf/p950.pdf (last modified March 2002).

34 Ibbottson etc for stock market returns; explain inflation point. See Roger G. Ibbotson and Peng Chen, *Stock Market Returns in the Long Run: Participating in the Real Economy*, YALE ICF WORKING PAPER NO. 00-44 (March 2002) [hereinafter Ibbotson and Chen, *Stock Market Returns*].

35 See Cooper, A Voluntary Tax? Perspectives on Sophisticated Estate Tax Avoidance, at 191 ("The most important technique for avoiding high taxation of extant wealth has traditionally been the making of lifetime giftes"); McCaffery, Fair Not Flat, at Chapter 4 (discussing "Estate Planning 101": Give early, often, and in trust.).

ing the family's investment portfolio.[36] Assuming a not-untypical discount of 50%, a family can double the wealth-transmission values countenanced above. By putting even liquid assets such as stocks and bonds into a family limited partnership, and giving each child a fractional share worth $44,000 in undiscounted form each January 1, the couple in the running example can double their transfer-tax free wealth transmission from the above example, more than $20 million out of their estates, altogether gift and estate tax free, and also income tax free to the children at least.[37] The outlines of the estate tax as a "voluntary" one ought to be becoming clear. But note that the more ambitious strategies require some planning piper to be paid: more on this, anon.

Three, over and above the annual exclusion, there is an exemption level, set out in a so-called unified credit, from the combined gift and estate tax regime.[38] This is the "zero bracket" of the tax. The amount was raised to $600,000 in 1981, gradually raised starting in the late 1990s, was initially set at $1,000,000 by EGTRRA, became

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[36] See Martin A. Sullivan, *Estate Tax Compromise or Repeal: The Rich versus Super Rich*, 87 TAX NOTES 298-300 (2000) [hereinafter Sullivan, *Rich v. Super Rich*]. See Martin A. Sullivan, *For Richest Americans, Two-Thirds of Wealth Escapes Estate Tax*, 87 TAX NOTES 328 (2000) [hereinafter Sullivan, *For Richest Americans*]. See EDWARD J. MCCAFFERY, FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM BETTER AND SIMPLER (The University of Chicago Press 2002) [hereinafter MCCAFFERY, FAIR NOT FLAT]. Recent cases, such as Strangi I and II and Kimball, have injected some uncertainty into the family limited partnership field, but the device, as well as similar devices, continues to be used.

[37] Explain income tax, See Edward J. McCaffery, *A Voluntary Tax? Revisited*, NATIONAL TAX JOURNAL PROCEEDINGS 268-274 (2000) [hereinafter McCaffery, *A Voluntary Tax? Revisited*]. See also MCCAFFERY, FAIR NOT FLAT, *supra* note 23.

$1,500,000 by 2004 on its way to $3,500,000 in 2009 and, in effect, to infinity in 2010.[39] During this gradual weakening of the estate tax via a higher exemption level, the gift tax exclusion stays at $1,000,000 per donor, meaning that the gift and estate taxes are no longer fully unified.[40] A large effect of keeping the gift-tax exemption frozen at $1,000,000 is to assure that one must, in fact, die to take advantage of the higher estate-tax exemption, indeed its 2010 repeal: that year quickly got dubbed the "throw Momma from the train" year by the usually not-so-witty estate tax profession.

In any event, a husband and wife with proper planning can once again double any of the numbers noted in the prior paragraph. By using the gift exemption early on in one's life, significant leveraging can be obtained. Suppose, for example, that the couple in the running example gives each of their three children fractional shares of a family limited partnership valued for tax purposes at 50% of its underlying asset value, using one-third of their combined exemptions when they, the parents, are 40, on each child, in addition to commencing the program of annual gift exclusions described above. Under the $1,000,000 per person exemption, each child's fortune would increase by an additional $17 million, to roughly $25 million, by their parents'

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[38] See I.R.C. § 2505 (Unified credit against gift tax). See I.R.C. § 2010 (Unified credit against estate tax). See IRS Publication 950, *Introduction to Estate and Gift Taxes.*

[39] See Section I.D, *infra*, for more detail on EGTRRA.

[40] See John Buckley, *Estate and Gift Taxes: What Will Congress Do Next?,* 91 Tax Notes 2069 (June 18, 2001).

80th birthday party. Using the $7,000,000 death-time exemption available in 2009—as we shall see, 99 out of the present 100 senators have voted at least for so much (although not necessarily raising the gift exemption, as well)[41]—the per child fortunes would have grown by an additional $50 million.

Summing this all up, the way the estate tax works is as follows. Once a donor has gone over the annual exclusion amount (more than $11,000 to one particular person in one particular year), she fills out a gift tax form and begins to subtract from her $1,000,000 (or otherwise applicable) lifetime exemption. On her death, the government adds up the value of her estate and then subtracts debt to get at a net financial figure for her estate. Qualified transfers to a surviving spouse are further subtracted. Finally, the government takes off $1,500,000 or the then prevailing death-time exclusion, less if any taxable gifts have diminished the exemption level during the decedent's life. Any value left in the estate is then taxed at a rate that starts at 37.5 percent and quickly reaches a maximum of 50 percent.

B. Revenue and Rates

Rather few decedents leave an estate large enough to ever actually pay the tax: one to two percent of decedents a year, to be more precise. In total, the tax does not raise much revenue, and never really has, as Table 1 illustrates. There is heated dispute

[41] Explain this, with EGTRRA, Blatmacher's critique, etc. Also check whether alternative bills raise gift tax—r.a.s. But there is some reason to believe that in equilibrium, such as it is, the gift tax exemption would fall into line with the death time level.

over the administrative costs of the tax, and also over its effects in equilibrium: opponents of the tax claim that it costs money because of its effects on work, savings, and investment behaviors; proponents tend to dismiss this idea.[42] Another claim of interest is that the estate tax as now constituted loses money in a static sense for the fisc, because the types of complex planning it helps to induce—especially the sophisticated insurance and charitable trusts we discuss below—generate greater *income* tax losses than the estate tax brings in.[43] Whatever one thinks of these diverse claims, it is hard to argue under just about any light that the revenue effects of the estate tax are significant in a budget of two trillion dollars.

Year	**Gift and Estate Tax revenues (in billions)**	**Percent of federal revenues**
1950	.7	1.8
1955	.9	1.4
1960	1.6	1.7
1965	2.7	2.3
1970	3.6	1.9
1975	4.6	1.7

[42] References. See JOEL B. SLEMROD, DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH (Harvard University Press 2000) [hereinafter SLEMROD, DOES ATLAS SHRUG?]. See WILLIAM G. GALE, JAMES R. HINES JR., AND JOEL SLEMROD, RETHINKING ESTATE AND GIFT TAXATION (The Brookings Institution 2001) [hereinafter GALE, HINES, & SLEMROD, RETHINKING ESTATE AND GIFT TAXATION]; Joint Economic Council Report, by Dan Mitchell.

[43] See B. Douglas Bernheim, *Does the Estate Tax Raise Revenue?*, 1 TAX POLICY & THE ECONOMY 113, 121-32 (1987) [hereinafter Bernheim, *Raise Revenue?*].

Year	Gift and Estate Tax revenues (in billions)	Percent of federal revenues
1980	6.4	1.2
1985	6.4	0.9
1990	11.5	1.1
1995	14.7	1.1
2000	21.6	1.2

Table 1: Gift and estate tax revenues, 1950-2000. Source: U.S. Office of Management and Budget, 2000.

These revenue figures are hardly critical to the Treasury. But they are central to the political story. The low yield of the tax is due the conjunction of three factors: high exemption levels, high marginal tax rates, and the very structure of the tax. The first factor dampens the numbers of persons and estates even possibly subject to the tax.it makes the group small. The second factor makes the stakes high. The third factor makes the stakes, or the tax, largely avoidable, thereby creating a second set of players in the reverse Mancur Olson phenomenon. The key element of the structure of the tax is that it is a back-ended wealth transfer tax—it applies to wealth that is left over after a taxpayer's life—and hence it is a tax that is easily anticipated. The high marginal tax rates give wealthy persons living in the shadows of the tax every incentive to plan to avoid it. From a traditional public finance perspective, this combination of structural elements is puzzling.

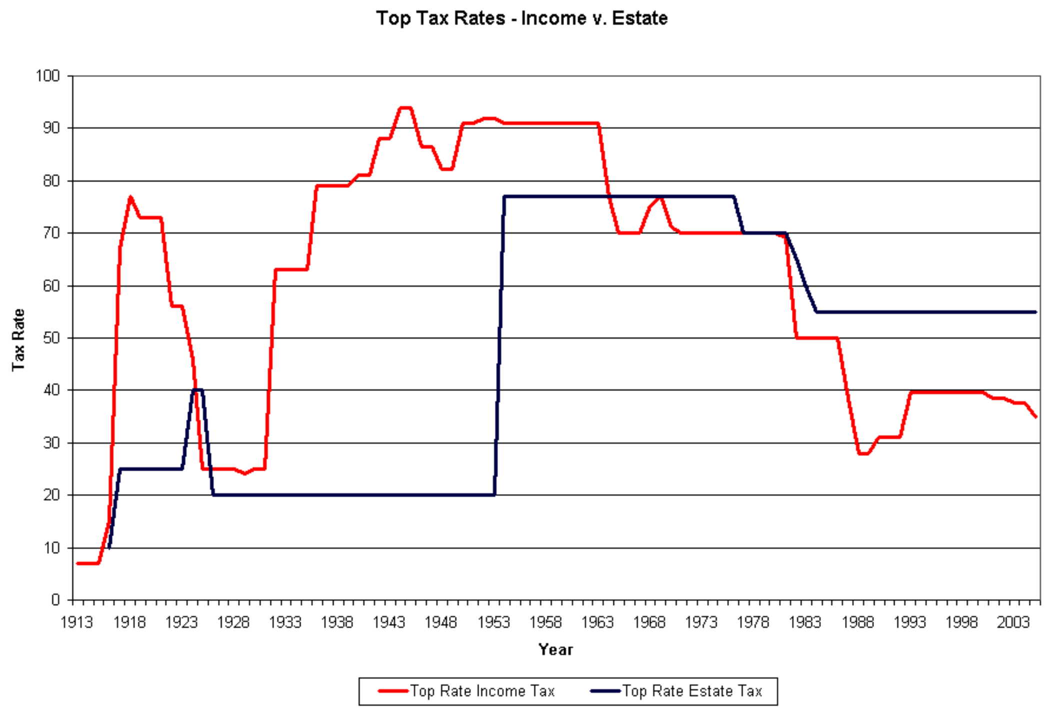

Figure 1: Marginal Tax Rates under Income and Estate Taxes

Basic principles of optimal taxation—supplemented with common sense and recent political economic history—suggest that *lowering* both the exemption and marginal tax rate levels would most likely increase the revenue yield while enhancing efficiency and diminishing incentives to evade or avoid the tax. This has in fact been a motif in basic comprehensive tax policy since Ronald Reagan, the lowering of rates ands the broadening of bases.[44] A fundamental principle of public finance, the Ramsey inverse elasticity rule, maintains that the deadweight loss associated with a tax is

[44] McCaffery, The Missing Links in Tax Reform.

proportional to its tax rate *squared*.[45] All things being equal, a tax at a 50 percent rate is more than four times as inefficient as one at a 25 percent rate. It is thus no surprise that many academics and other tax reformers have proposed lowering the estate tax's rate and broadening its base.[46] Congress, however, has moved in almost precisely the opposite direction. The exemption level of the tax has continually increased over time—with proposals afoot to raise it further—while its marginal tax rates have remained stubbornly higher than the parallel income tax rates, as Figure 1 reveals.

The central political attributes of the estate tax are that: (1) very few people are subject to it, but (2) those that are are very wealthy, and stand to lose, for their families, a great deal of money on account of its very presence, and (3) there are indeed sophisticated ways to avoid the tax through planning involving lawyers, accountants and other financial intermediaries, such as insurance companies. The practitioner/academic George Cooper dubbed the estate tax in an influential Brookings Insti-

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[45] Define terms, cites, See Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905 (1987) [hereinafter Bankman & Griffith, *Social Welfare*], See EDWARD J. MCCAFFERY, TAXING WOMEN, Ch. 7 (The University of Chicago Press, 1997) [hereinafter MCCAFFERY, TAXING WOMEN], See Edward J. McCaffery, *Slouching Toward Equality: Gender Discrimination, Market Efficiency, and Social Change*, 103 YALE L. J. 595 (1993) [hereinafter McCaffery, *Slouching*], Atkinson.

[46] See Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L. J. 261 (2002) [hereinafter Graetz, *100 Million Unnecessary Returns*], etc.

tute study from 1979 a "voluntary tax."[47] And so it is—for those willing to pay a price.

This sets the stage for a discussion of the dramatis personae in the play that follows.

C. The Players

Aside from the government and the public writ large, which might in good faith care about the revenue yield and other effects, good and bad, from the estate tax, who cares? What individuals or entities have a direct monetary stake in the struggles over the estate tax's life and death? There are several groups, all comparatively small, each of whom plays an important role in the story.

1. **Putative Taxpayers**

One group, of course, is the individuals whose estates would pay up to one-half of their value to the federal government absent some planning, or their families. There are not many such people, as we have just seen: the size of the group is directly related to the size of the exemption level. Few Americans have net wealth in excess of one and a half million dollars per person, three million dollars per married couple. But those that do, or reasonably expect to, have such estates live in the shadows, the target range of the tax.

[47] See GEORGE COOPER, A VOLUNTARY TAX? NEW PERSPECTIVES ON SOPHISTICATED ESTATE TAX AVOIDANCE (The Brookings Institution 1979) [hereinafter COOPER, A VOLUNTARY TAX?], See also McCaffery, *A Voluntary Tax? Revisited.*

Not all wealthy individuals care about avoiding or minimizing the estate tax, of course. Cooper anecdotally found that wealthy people fell into three distinct, roughly equal groups. One was unconcerned about the tax, whether out of unease with considering their own mortality, an affirmative sense that the tax was just, or a negative preference against leaving their personal heirs excess wealth. Andrew Carnegie actually thought the latter, at least insofar as his *male* heirs went; today prominent spokespersons for retention of the estate tax include Warren Buffett and Bill Gates Sr.[48] Two are people willing to engage in moderate planning to minimize the tax. Three are people who, in the words of one quoted by Cooper, "would stand on one ear, wiggle their four toes, and disavow their families to save $20 in tax."[49] The latter two groups—especially the latter—generate a large pool of what we call *putative* tax, waiting to be saved by the next groups of players. It is a putative tax because few of the wealthy pay it in full; estimates are that the effective yield of the estate tax is close to one-half or less of its nominal yield of fifty percent.[50] This means that something closer to 25 percent of the value of taxable estates is paid out in actual taxes. This figure far overstates the actual yield of the tax as a fraction of its potential yield, however, because many—probably most—wealthy people living in its shadows have engaged in years of planning to avoid being caught with the loot on their deathbeds. We have already seen, for example, how a married couple that

[48] Citations, including sources in McCaffery 1994.

[49] See COOPER, A VOLUNTARY TAX?, *supra* note 32, at 7.

begins planning at age 40 could—fairly easily—get nearly large amounts of wealth out of their estates by their 80th birthdays. Cooper devoted nearly a chapter of his study to explaining—in the context of the DuPont family, no less—that "zero-based budgeting is a reasonable starting point for any person with serious estate tax avoidance designs."[51] The record shows that the gift and estate tax has been weakened in significant ways since Cooper wrote in the mid 1970s.[52]

In any event, imagine that the married couple had already provided for their own lifetime needs, through a combination of insurance and annuities and the like. Imagine further that they have, as many wealthy Americans clearly do, a bequest motive: they want, that is, to pass some wealth onto their children and other personal (non-charitable) heirs.[53] Note, for the political story still unfolding, that these restrictions—very wealthy people with bequest motives—further narrow the pool of people who care enough to engage in some lobbying or other tax avoidance/minimization activity. Many members of this group will be small business owners, including farmers. Groups in this category have indeed organized and lobbied against the estate tax, such as the National Federation of Independent Businesses (NFIB), the

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[50] See Sullivan, *Rich v. Super Rich.* OR See Sullivan, *For Richest Americans.* etc.

[51] See COOPER, A VOLUNTARY TAX?, *supra* note 32, at 77.

[52] See McCaffery, *A Voluntary Tax? Revisited*, *supra* note 24.

[53] See Laurence J. Kotlikoff, Avia Spivak & Lawrence H. Summers, *The Adequacy of Savings (1982)*, *in* WHAT DETERMINES SAVINGS? 429 (Laurence J. Kotlikoff, 1989) [hereinafter Kotlikoff, Spivak & Summers, ADEQUACY OF SAVINGS] and more on bequest motives, good sources in McCaffery 1994 and 1992 (Texas) but need to be updated.

Newspaper Owner's Association, Beer Manufacturers and Wholesalers, Farmer's groups, and more. In any event, back to our couple, the extent of their concern is rather easily mapped out:

putative tax = tax rate (intended bequest – exempt level)

With a nominal tax rate of 50 percent, this putative tax is quite high, indeed, for the very wealthiest Americans.

Now for a rational person in this situation concerned only with making a bequest—the fact that the high tax rate may well push people away from their bequest motive is a complication we can plausibly set aside—the decision metric is simple enough. Such a person will spend $1 in estate tax avoidance or minimization in order to save at least $1 in tax. In fact, as we discuss further in the next subsection but have already hinted at, estate tax avoidance expenditures are far more efficient than that. The actual private cost of the tax, in other words, which consists in the sum of taxes paid plus the transaction costs of avoiding the tax, is much smaller than the putative tax that sets an upper bound to the range. But these costs are nontrivial.

The high exemption level of the estate tax means that most Americans do not need pay it much heed, dampening its ballot-box effects; this also keeps low the number of experts specializing in escaping or minimizing the tax. At the same time, the high nominal tax rate attracts the attention of those wealthy people who are bequest motivated. Such people will rationally spend money to avoid or minimize the tax, creating a market—on the demand side—for estate tax specialists. The fees paid over to these experts, plus the taxes paid and other transaction costs, combine to create the "rent" of the estate tax as it exists: the non-market economic impact. Eliminating the tax completely would save wealthy individuals this much money. Some of this money goes to the government; the rather small, in relative terms, dollars in Table 1. Some of this money goes to the next three groups of players we discuss. Because a rational bequest minded donor would pay a $1 to a politician for a chance worth more than a dollar of potentially avoided private costs, some of this money can also go to Congress, as we shall develop later on.

2. **Estate-tax Specialists**

Some portion of the dollars that would otherwise go to the government in estate taxes gets paid out in fees to estate-tax practitioners: lawyers, accountants, financial planners who specialize in whole or in part in estate tax minimization, trust companies and other fiduciaries.

As a first cut, the rational bequest motivated individual or family would pay out almost as much in fees as she would otherwise pay to the government: the fees would approach the putative tax sketched out above. Aside from the obvious fact that individuals may not be so bequest-motivated (that is, they might be willing to leave their wealth to heirs if it could all pass through, but not if one-half of it would be taken by the government),[54] the forces of competition on the supply side drive down the costs of estate tax avoidance. Yet these costs do not fall all the way, to approach zero. There are several reasons for this.

One, estate tax specialists serve a relatively small market, on the demand side, as we have just sketched out.

Two, there are significant entry barriers to becoming an estate-tax specialist: not only need most specialists obtain some advanced professional degree (j.d., cpa), but they must also invest a significant amount of human capital to master the techniques of estate tax minimization. These techniques change frequently and remain complex, on account of legislative and administrative developments, insuring that the pool of estate tax specialists remains small. A looming cloud of repeal further suppresses the numbers, deterring young practitioners from entering the field.

Three, there is considerable inelasticity on the demand side. Wealthy individuals in the shadows of the estate tax are unlikely to trust their intimate family and financial details to anonymous firms. The estate tax specialist does not simply dispense relatively simple advice, such as to use the annual exclusion gift amounts each year, or to take advantage of the lifetime exemption level as soon as possible. Most sophisticated wealthy donors do not want to pass unfettered control of significant economic assets to their children when the kids are young, and so the simplest forms of wealth

[54] See Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L. J. 283

transfer (outright gifts) are rarely used. Various forms of complex ownership structures, such as the family limited partnerships alluded to above or the popular *Crummey* trusts, operate to use the donor's exemptions and inclusions while keeping present control out of the hands of young beneficiaries.[55] Hence the advice becomes more and more complex, and ever-changing. At the same time, the estate-tax specialist must be acquainted with the personal and psychological relationships within the family, for she will be crafting documents about passing on large amounts of wealth, perhaps including a family business. Most wealthy, bequest-minded persons are unlikely to trust such details to associates in large anonymous firms; the world of the estate-tax specialist is small and intimate, with relatively little turnover. Estate-tax specialists are well compensated for their time and loyalties.

3. **Insurance Industry**

The insurance industry plays a large and important role in estate-tax minimization. The reasons sound in three inter-connected provisions of the tax laws. One, the proceeds of life insurance are not included in one's income tax.[56] Two, by longstanding legislative exemption, the "inside buildup" of a cash-value, whole life, or (all synonymously) universal life insurance policy is not income to the policy holder.[57]

(1994) [hereinafter McCaffery, *The Uneasy Case*], footnote for explanation.

[55] Citations, See Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968). etc.

[56] IRC § 101.

[57] Citation and explanation

Three, as long as an individual is not the "owner" of an insurance policy on her own life—once again sophisticated planning is needed to ensure this result obtains, as by having a life insurance trust "own" the policy—the policy's value is not includible in her estate.[58]

Put this all together and this is what you get: A wealthy individual can use her annual exclusion gifts[59] and/or all or part of her lifetime exemption level to set up an irrevocable life insurance trust for her children. The gifts to the children are sent to the insurance company as policy premia, via the trust. After deducting the current period mortality premium to compensate for the pure (term) risk component of the insurance, the excess is held by the insurance company, on the trust's account, and invested. When the donor dies, the proceeds go to the trust without being brought within the decedent's estate. The money is then distributed, altogether tax-free, to the heirs as beneficiaries of the trust, or used to buy assets from the estate to give it the liquidity with which to pay any remaining tax.

There are even more complex means of estate tax minimization using insurance, including the now notorious "split-dollar" arrangements.[60] Under these plans, a wealthy donor purchases an insurance policy with a high face value and gifts away the cash value component (the complement of the pure risk one) to a beneficiary. A

58 IRC §§ 2038, 2042.

59 Through use of Crummey device.

large portion of the initial, large premium is allocated to the actuarial risk component, leaving a small value to be placed on the gift of the residual interest. The dollars here can be staggering.[61]

4. **Large Nonprofits**

Much sophisticated estate-tax minimization involves charitable giving, typically to large nonprofit organizations, through devices such as charitable lead and remainder trusts and private foundations.[62] While, absent fraud,[63] one needs *some* charitable inclination to give to charity, the combined income and estate tax savings of structured charitable giving can mean that one does not need much. Under today's tax rates, a fairly simple gift to charity by a wealthy person living in the shadows of the estate tax will cost the donor 30 cents on the dollar, the rest coming from her distant Uncle Sam. Any $1 given to charity generates 40 cents in income tax savings to a high bracket taxpayer; the remaining 60 cents would have generated 30 cents in es-

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60 citations.

61 Blattmachr as described by David Cay Johnston, *Death Still Certain, But Taxes May be Subject to a Loophole*, NEW YORK TIMES, July 28, 2002, at Section 1, Page 1, Column 1 [hereinafter Johnston, *Death Still Certain*].

62 See Don R. Weigandt, *Charitable Giving Without Fear of Death*, 54 MAJOR TAX PLANNING 2002 , Ch. 11 (2002) [hereinafter Weigandt, *Charitable Giving*]. See also Edward J. McCaffery & Don R. Weigandt, *Lobbying For Life: Protecting Charitable Giving Without a Death Tax*, 98-1 TAX NOTES 97 (2003) [hereinafter McCaffery & Weigandt, *Lobbying For Life*].

63 See fiddle/violin story in NYTimes, May 2004 for one involving fraud.

tate tax.[64] A sophisticated used of trust and future interests can leverage charitable propensity even further. Thus Ted Turner's $1 billion contribution to the United Nations, for example, was estimated to cost Turner, after taxes, somewhere between $400 and $100 million.[65] The rest was in effect borne by the fisc, as forgone revenue.

5. Lobbyists

Lobbyists form the final group of players in the battle over estate tax repeal or reform. They represent groups of groups of putative taxpayers (including for example the National Federation of Independent Businesses, the Newspaper Association of America, beer manufacturers, and farmers) and those on the other side (large non-profits, insurance companies, gift and estate tax advisers and financial intermediaries such as trust companies).

Lobbyists play a complex and multi-faceted role in the traditional special interest conception of politics as well as under the reverse Mancur Olson phenomenon. They help to form the very groups that they will later help to be shook down.all for a fee, of course. Not surprisingly, tax is the most common specialty listed by registered lobbyists.[66] And also not surprisingly, there is credible evidence that lobbyists often

[64] Explain math etc.

[65] citations etc.

[66] Opensecrets.org, supra, out of more than one hundred possibilities.

feel the brunt of a "shakedown" scheme themselves, as politicians repeatedly against them, personally, to pay to play.[67] Play with fire, and get burned, as they say.

D. The Reverse Mancur Olson Game: A Synthesis

A way to summarize the roster of players in the estate tax drama, aside from the politicians, is to begin with the taxpayers subject to the tax. But since the tax is so highly avoidable, as we have hinted at and others, such as George Cooper, have described, and since the tax is in fact so often avoided, as Table 1 and other statistics show, we have called this category *putative taxpayers*. Putative taxpayers do not avoid the estate tax for free. They must pay estate-tax specialists, insurance company and other financial intermediaries, and, sometimes, charities, in order to avoid the tax. Economists would call the sums paid over to these groups on account of estate-tax avoidance motives *transaction costs*.[68] Thus, in simpler terms, the putative taxpayers stand on one side, and beneficiaries of transaction costs stand on the other. Lobbyists are a transaction cost of interacting with Congress, which both sides have been paying—a lot—lately. This characterization will prove useful later in the analysis.

IV. Shakedown at Gucci Gulch: A Tale of Death and Taxes

[67] Ornstein, supra.

[68] Reference to See Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations.*, 22 JOURNAL OF LAW & ECON. 233-261 (1979) [hereinafter Williamson, *Transaction-Cost Economics*]. , Oliver Hart etc.

In this Part, we connect the dots of the prior two Parts by showing how the story of the estate tax, particularly the recent saga of attempts to repeal it (or not), illustrate the reverse Mancur Olson model of politics.

A. The Road to EGTRRA

We begin the narrative in the early 1990s. Representative Crane and Senator Helms (R-NC) tried in 1991 and again in 1993 to introduce legislation to repeal the estate tax. Various versions of the bills combined a repeal of the gift and estate taxes with repeal or deep cuts of all corporate income taxes and a 10% cap on the individual income tax. Not surprisingly, the whole effort was seen as a fringe cause and the bills were killed in committee.

The tale picked up intensity starting in July, 1993, when Christopher Cox, a conservative Republican congressman from Orange County, California, a bastion of tax aversion, introduced 103 H.R. 2717, the Family Heritage Preservation Act ("FHPA"). FHPA was a clean bill.its dedicated purpose, in its own words, was, "to repeal the Federal estate and gift taxes and the tax on generation-skipping transfers." Cox initially flew solo, with no cosponsors, and FHPA lingered in Congress. But by 1994 the bill began attracting co-sponsors, mainly conservative Republicans, largely from Cox's tax-hating home base of California and the South. Dick Armey of Texas, a rising power in Republican legislative circles, signed on in July, 1994, nearly a year after Cox's initial submission. By the time FHPA died on the legislative vine, in the Fall of 1994, it had 29 cosponsors, including 3 Democrats: still a small drop in the House's 435 total member bucket, but enough to cause a ripple or two. The tide was beginning to turn.; plausibility had arrived.

Meantime, out in the real world, something else was happening: Americans were getting richer. Throughout the boom time of the 1990s, America spawned thousands of new millionaires.[69] Looking back over time, as Table 1 had suggested, whenever a suitably large percentage of decedents became subject to the estate tax, change—in the form of weakening—was eminent. As many individuals got involved in tax planning, tax avoidance, and even paying estate taxes, pressure for change would mount. The typical way for relief was to raise the exemption level, while maintaining high marginal tax rates—backwards from an optimal tax policy perspective, but consistent with a reverse Mancur Olson play. Back inside the Beltway, while academics and commentators continued to fiddle,[70] Congress seemed ready to burn, showing sympathy for killing the estate tax in toto. Cox kept introducing bills to deliver the fatal blow. By 1996, Cox had enlisted 102 fellow members as cosponsors (up from 0 in 1993 and 29 in 1994), and, by 1998, 204, including the entire Republican leadership.

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[69] See, e.g., David Leonhardt, *The Nation: TopDrawer; Defining the Rich in the World's Wealthiest Nation*, NEW YORK TIMES, January 12, 2003, at Section 4, Page 1, Column 5 [hereinafter Leonhardt, *Defining the Rich*], citing a doubling or more of millionaires in the United States between 1980 and 2000.

[70] Citations.

As the tide tipped tax repeal into the domain of the plausible, other Representatives started spearheading their own legislation. In February 1999, Representatives Jennifer Dunn, (R-Wash) and John Tanner (D-Tenn), introduced 1999 H.R. 8, the "Death Tax Elimination Act," a bill to phase out and ultimately eliminate the gift and estate tax over a ten year period. Unlike Cox's bills, Dunn and Tanner's took off all the way to the legislative floors. It was put up for a vote in the House on June 9, 2000, and passed by the overwhelming margin of 279 to 136, including the votes of 65 Democratic senators.[71] The Senate followed suit a month later, passing the bill 59-39, again with bipartisan support.[72] President Bill Clinton, as he had said he would do all along, vetoed the bill in August, 2000, and the House was just barely unable to over-ride the veto.[73] The estate tax lived to die another day.[74]

B. Senate Rules

We pause at this point in the running story to discuss some procedural aspects of tax and budget legislation that play a major role in the tale. The popular press and even some scholarly accounts have tended to blame, or attribute, the odd and precarious status quo that EGTRRA created for the estate tax on the pathologies of Senate vot-

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[71] see http://thomas.loc.gov for roll-call information.

[72] Nine Democrats voted for the Senate bill, vote #197.

[73] The veto override vote was 274-157. With two-thirds of those voting needed to override a veto, the vote came up short 13 votes.

[74] With (insincere) apologies to James Bond.

ing rules. We believe the blame is misplaced, for two reasons. One, the rules are endogenous, of lawmakers' own making: indeed, at least some of the alleged pathologies appear to have been chosen by the Senate to produce the end result—no permanent repeal but its lingering possibility—without appearing to endorse it. Two, these rules by no means dictated the specific outcomes that arose on several critical occasions. There were choices, throughout, and Congress chose the present route.

Most of the time, the Senate acts by simple majority rule. For some purposes, however, it operates as a super-majority institution, requiring a higher percent than of 51 to pass a law. The two-thirds needed for a veto-override is established in the Constitution. But things go beyond that, by statute. During the period we are analyzing, sixty votes were needed to stop a filibuster on most bills. Finally, in the 1980s the Senate instituted a number of super-majority and other procedures intended to control the size of the budget and reduce budget deficits.

Three such provisions are of direct relevance to the estate tax story.

One is the requirement for an overall budget bill to allocate spending among categories and insure that total spending and estimated revenues stay within certain ranges, sanctioned by the Congressional Budget Office. Such Budget Bills are not subject to the filibuster rules: a simple majority can bring the measure to the floor and pass it.

Two is an allowance for flexibility. The strict budget guidelines can be waived in some specific bills, but these bills are subject to a "point of order," whereby any

Senator can call for a vote on a specific provision that exceeds the Budget Bill guidelines just discussed. The Senate parliamentarian determines whether a point of order is valid. whether or not the provision is "germane" or can be voted on standing alone. If the point of order is upheld, then sixty votes are needed to override it and allow the bill to proceed with the challenged provision. This is the so-called Byrd Rule.

Three is a requirement that no legislative provision that increased the deficit (reduced revenues or increased spending) could be attached to a non-spending bill. If such a provision was attached, any Senator could call a point of order to remove the provision. If the parliamentarian ruled that the provision did have budgetary implications, once again at least sixty senators would have to agree to keep the provision in the bill.

Two points are important to stress. One, other than the veto-override case, all of the supermajoritarian requirements are established by the Senate and can be modified for specific pieces of legislation, as was done for the Budget Act, where filibusters cannot hold up a vote. Similarly, the Byrd rule and other points of order are statutory. Of course, once the super-majoritarian norm is established, modifying it in special cases becomes controversial (as, for example, in the recent threats to void filibuster opportunities on federal judge nominations).

Two, the rules mean that sometimes 50, and other times 60, votes would be needed to deal a final death blow to the estate tax. In order to maintain plausibility, one of the conditions for the reverse Mancur Olson game, the Senate thus had to approach 60 votes on occasion, as it repeatedly has. But in order to maintain and prolong the shakedown scheme, one of the predictions of the reverse Mancur Olson phenomenon, the same Senate then had to find a way not to act when but 50 votes would be needed (the anti-tax crowd having the swing vote, in the person of the Senate's president pro tem and tie-breaker, Vice President Dick Cheney). This they did, perfectly.

C. EGTRRA: The Case Gets Curious

We resume the story with the election of George W. Bush. Now the estate tax seemed dead, for sure. Candidate Bush had been clear in campaigning for a total abolition of the tax. A veto was inconceivable. A majority of the members of Congress were on record as having voted to repeal it as well under H.R 8. In the Senate, 59 Senators had voted to repeal the estate tax in the summer of 2000. Only 51 votes would be needed to include estate tax repeal in the Budget Bill, and if the subsequent bill repealing the estate tax stayed within the guidelines of the Budget Bill, only 51 votes would be needed for passage. On December 16, 2000, Speaker of the House Dennis Hastert was thus both speaking from a position of power and stating the then reigning conventional wisdom when he said:

> Because we had such success in passing bipartisan measures to end the marriage penalty and the death tax in this session of Congress, I believe that these two bills could quickly be enacted in the law at the begin-

> ning of next year. That is why I advocate that we start with these two bills in the 107th Congress.[75]

President-elect Bush showed no signs of disagreeing. By January, 2001, the media was widely reporting the death of the estate tax as an "easy" first step in Bush's tax-cutting plans. On March 14, 2001, Representatives Dunn and Tanner, with 224 co-sponsors, reintroduced H.R. 8, the Death Tax Elimination Act; within weeks, on April 4, the House overwhelmingly approved by a vote of 274-154.[76] But then a funny thing happened on the way to the wake. The Senate never voted on stand-alone death tax repeal. Not this time—not, that is, at the first point in the entire story when they could have actually done something final.

Even as H.R. 8 was making its way through Congress, the nascent Bush Administration was preparing its own general tax reduction bill, in consultation with prominent legislators. The administration's bill became 2001 H.R. 1836, the "Economic Growth and Tax Relief Reconciliation Act of 2001." EGTRRA was introduced into the House on May 15 and passed the next day. The Senate amended the bill and passed it as such on May 23; conference reconciliation followed, with both chambers approving the ultimate act on May 26. President Bush signed PL 107-16, his first major legislative coup, on June 8, 2001.

[75] See, e.g., Lizette Alvarez, *The 43rd President: Congress; Speaker Clarifies Stand on Bush's Tax Plan*, NEW YORK TIMES, December 16, 2000, at Section A, Page 16, Column 1.

[76] Rollcall vote #84.

EGTRRA also killed the estate tax—sort of. More particularly, EGTRRA did indeed repeal the estate tax—but only for one year, and that the year 2010. Over the nine prior years, from 2001 to 2009, the law gradually raises the death tax's exemption level and reduces its rates. Prior law had set the exemption level at $675,000 per person in the year 2000, set to increase to $1,000,000 by 2006. EGTRRA accelerated the increase to $1,000,000, to take effect in Year 2002. The exemption is set to increase to $1.5 million in 2004, $2 million in 2006, and $3.5 million in 2009. The top rate is to be cut—"slashed" would not be accurate—from 55% to 50% in 2002, then by 1% a year for the next five years, until it reaches 45% in 2007, where it stays until 2009. 2010 sees total repeal of the estate tax.

And 2011 sees a total reinstatement, all the way back to 2001 levels.

Year	**Exempt Level**	**Rate**
2002	1,000,000	50
2003	1,000,000	49
2004	1,500,000	48
2005	1,500,000	47
2006	2,000,000	46
2007	2,000,000	45

2008	2,000,000	45
2009	3,500,000	45
2010	Infinite	n/a
2011	1,000,000	55

Table 2: Estate Tax Exemption Level and Rates under EGTRRA

Throughout the whole period, as noted above, the gift tax remains intact, with a $1 million per person exemption level. This assures that wealthy citizens cannot gift away their wealth in the years in which the estate tax has a higher exemption level or is altogether eliminated in 2010. The formal logic for these provisions of EGTRRA was that the bill fit within the $1.3 trillion tax cut budget approved in the Budget Bill by the Senate, and thereby required only 50 votes.

The structure of EGTRRA given the Budget Bill constraint thus only allowed a certain amount of revenue loss from the estate tax reforms in order to accommodate a series of competing tax cuts. But there are deep and disturbing questions to challenge any simplistic view that EGTRRA's bizarre outcome was *dictated* in any sense by those constraints. One, given the strong support for the Death Tax Elimination Act, H.R. 8, including the endorsement of the President, why not vote on it first, outside of EGTRRA? Two, why not allocate some of the funds within the Budget Bill's scope, 1.3 trillion dollars, to repeal of the estate tax? Surely, should the traditional special interest conception be in play, there were more interest groups concerned with total repeal of the estate tax than there were with small rate reductions in the income tax, the kind of broad-based tax relief not predicted by the traditional model. (This is a recurring theme, of Congress spending money in the form of tax relief without permanently repealing the estate tax.) Three, why was there no serious attempt to get a 60 vote majority to override any possible point of order and repeal the estate tax anyway? Four, and most disturbing, why did EGTRRA do what it did vis a vis the estate tax: that is, why did Congress take the funds used for estate tax relief and allocate them so oddly to the years 2009 and, especially, 2010?

It is hard to overstate how bizarre EGTRRA's "resolution" of the estate tax debate looks from the perspective of normatively appropriate lawmaking. Even before the ink was dry on Bush's signature, letter writers across the country had begun to complain about the fundamental unfairness and arbitrariness of the law's phase in-out-down-and-up provisions. The Year 2010 was already being referred to by witty estate tax practitioners as the "throw momma from the train" year.

EGTRRA's "compromise" on estate tax repeal could hardly stand minimal scrutiny under more principled areas of American law. Consider the noted jurisprudence and constitutional scholar Ronald Dworkin's defense of the principle of integrity, or "principled consistency," in law. We aspire to get the law right, Dworkin argues, to help the "law work itself pure." And so we abstain from "checkerboard" legislation, where a given government benefit or right might be handed out to citizens arbitrarily. Dworkin illustrates this idea with a proposed law to grant the freedom of reproductive autonomy and choice only to persons whose last names begin with the letters A through K, or who reside in areas with zip codes ending in an odd number.[77] The intended rhetorical effect is powerful: readers respond in horror, and see the obvious unattractiveness of such an approach to law.

Yet consider the fate of a widow with an estate of $10 million. Rather roughly, Table 2 presents the tax this woman's estate will pay under EGTRRA if she dies in one of the years 2009-2011:

Year	Tax
2009	$3,000,000
2010	$0
2011	$5,000,000

Table 3: Estate taxes due on a $10 million estate, 2009-2011.

The pattern reflected in Table 3 is suitably inane, even by the standards of contemporary tax law, that few might expect EGTRRA to remain, intact, as the next decade develops. But therein lies the rub.

D. Curiouser Still: Life after EGTRRA

EGTRRA all but guaranteed further legislative action on the estate tax as the first decade of the new millennium wore on, and the country grew closer to the bizarre state of the law reflected in Table 3. Thus EGTRRA, in and of itself, gives reason to

[77] Dworkin, Law's Empire.

suspect that the reverse Mancur Olson game was in play. Congress had, in this one act of legislation, signaled that it had the power *both* to kill the estate tax, as it had been signaling with its votes on H.R. 8 and as it in fact did in EGTRRA for the year 2010, *and* to bring the tax back, as it did in EGTRRA for the year 2011 and as the failures to actually enact H.R. 8 had already suggested. Viewed in the admittedly cynical lens of this public choice model, EGTRRA's estate tax provisions were a thing of genius. But how else can the act's estate-tax provisions be interpreted? From the traditional special interest group perspective, the only "winner" was the set of putative estate-taxpayers who knew with some certainly that they were likely to die in 2010—no sooner, and certainly no later.

A contemporaneous journalistic account of the matter in the influential weekly *Tax Notes* set out how EGTRRA's estate tax provisions appeared to the cognoscenti at the time:

> It is difficult to understand exactly what proponents of repeal have accomplished after several years of bitter debate on this issue. With a sunset provision, the proponents of repeal will find themselves in the same position that they were in before the enactment of the new bill. Once again, they will have to push for new legislation that the president will have to sign. In effect, Congress has done little more than promise to return to the issue of estate and gift taxes in the future.[78]

[78] John Buckley, *Estate and Gift Taxes: What Will Congress Do Next?*, Tax Notes 2069, June 18, 2001.

What this account misses.as the reverse Mancur Olson conception does not.is that this result might have been *exactly* what Congress desired. It is precisely the "return to the issue . . . in the future" that Congress wanted.

Like all rent extraction games, the reverse Mancur Olson phenomenon has a timing dimension; the estate tax seems to satisfy this condition. There is good reason to believe that there is a fundamental asymmetry in estate tax legislation. As long as the tax exists, there can be frequent votes to reform or repeal it. Moreover, as long as the tax exists, there are the Mancur Olson groups that seek to keep or repeal it, the putative taxpayers with their organizations on the one hand, the estate-tax avoidance industries and charitable organizations on the other. All of them are involved in the debate. But once the tax is repealed, it would be hard, as a practical and political matter, to bring it back. The tax raises little net revenue. Re-instituting it would raise howls of alarm from the putative taxpayers, but many of the current beneficiaries will have disbanded. The lawyers, accountants and insurers will move on to other specialties, charitable foundations to alternate targets. The tightly organized special interest groups will dissolve.

What EGTRRA did, then, was to signal that Congress was serious about killing the estate tax, *without really doing so*. Plausibility had arrived. Every wealthy person concerned about estate tax minimization or avoidance—with the exception of those who knew that they would die with certainty in 2010—was given a reason to lobby Congress for permanent repeal. But the opponents of repeal—the estate tax specialists, insurance and nonprofit interests—had reason to hope too. For the "repeal" was suitably off in the future—set to transpire after the conclusion of Bush's second term, should it come to that—that there could be no assurance that it would in fact obtain.[79]

EGTRRA did more than that. The unprincipled state of the 2009-2010-2011 years, shown in Table 3, guaranteed some further votes as the decade wore on and the people began to complain, rightfully, about the arbitrariness and perversity of the law.

Congress was soon to learn what a golden goose they had created, indeed. It turned out that there was little need to wait. In the Spring of 2002, barely half a year after EGTRRA was signed, permanent estate tax repeal, in the guise of H.R. 8 (the Dunn-Tanner Death Tax Elimination Act), reappeared. Congress even voted to have a vote on it: several months removed. This vote passed overwhelmingly, and the floodgates were open. Opponents of repeal admitted to "being caught off guard" by the seriousness and rapidity of the move to make repeal permanent. The bidding window was open, so to speak, and newspapers reported that lobbyists flooded to Washington. Once again, the House overwhelmingly went along with the idea of killing the tax, voting 274 to 154 to make the 2010 repeal permanent.[80] The Senate wavered. With a veto from Bush inconceivable, projections consistently fell into the 50s, short

[79] Indeed, most practitioners viewed repeal as unlikely and uncertainty as good for business. See David Cay Johnston, *Lawyers and Accountants Expect Windfall from Estate Tax Repeal*, New York Times, c.1 (Januray 29, 2001).

just short of the 60 needed under the Byrd rule. In the end, after then Senate Majority Leader Daschle (the Senate having switched party affiliation after Senator Jeffords of Vermont left the Republican party) accelerated the vote, it indeed came up short, with 54 votes to kill the estate tax, 2 abstentions.[81]

The failure to kill the estate tax in the middle of 2002 did not end matters. Not by a long shot; not for a week. On the day of the vote, as reported on the front page of the *New York Times* and other national newspapers, Senator Phil Gramm (R-Tex), a leading opponent of the tax, told his followers not to worry. We could vote again on estate tax repeal, Gramm was quoted as saying, later in the year, after October, when but 50 votes would be needed. Gramm even floated a date for the next vote on permanent repeal: November 5, 2002. That is, Election Day.

What did Gramm mean? He could have been referring to two alternatives for a simple majority vote on repeal. Either the provision could be attached to an autumn reconciliation bill, or it could be voted on after expiration of the Byrd rule, set to expire in October.

Gramm's confident prognostication raised a troubling question. If the Senate could have killed the estate tax with 50 votes in October, 2002, as Gramm knew, why did

[80] House vote # 84, 3/14/01.

[81] . (S Amend.3833, Motion to waive point of order failed 54-44, 6/12/01).

they even bother to vote under the 60 vote rule in place in June (and to vote to have this vote, and so on)?

An even stranger question followed. When it got to October, with the midterm elections looming and Republicans firmly committed to killing the estate tax—or so they said, over and over—there was in fact no vote to kill the estate tax. Instead, there was a vote—to extend the 60 vote Byrd rule! This vote passed overwhelmingly, with significant Republican support. No one even proposed, in public at least, taking advantage of the window after the expiration of the rule to kill the estate tax. Once again, at a moment in the story when they could have killed the estate tax, Congress not only did not do so, but they also made it more difficult to *ever* do so.

The calendar year 2002 would not end until there was one more bizarre twist of fate. Republicans scored important victories in the midterm elections of 2002, regaining control of the Senate that they had lost after the Jeffords defection. Some pundits and Republican politicos opined that tax cutting had much to do with this victory. Making EGTRRA's tax cuts permanent became a mantra, of sorts, and legislation was introduced to do just that. Within weeks, however, the talk had changed: from making all of EGTRRA's cuts permanent to making its *individual income tax* rate cuts permanent. A popular President in control of both chambers of Congress somehow, someway, could not go all the way in killing the estate tax. Once again, the action seems backwards to a traditional special interest group conception: broad stretches of taxpayers were being helped, a little bit each, where the small groups with high stakes were being relegated to the back burner, again.

The story continued into 2003. There was once again major tax legislation, the Jobs and Economic Growth Tax Relief Reconciliation Act, or JGTRRA for short. This act indeed accelerated various income tax provisions of EGTRRA. But it did not touch the estate tax issue, although the very existence of major tax legislation on the agenda kept the issue of estate tax repeal in play.

And as the presidential election year of 2004 bloomed into view, President Bush once again hit the stump, calling for permanent repeal of the estate tax in his State of the Union speech and out on the campaign trail, seemingly unembarrassed that this at times highly popular president had been unable to orchestrate an event deemed inevitable by his allies just four years before.

E. Roads Not Taken

Two aspects of the legislative status quo as we write this stand out as especially odd. One, the estate tax continues to have high exemption levels and high marginal tax rates: a combination that seems perverse from a sensible policy or revenue-raising perspective, and one counter to the trend in tax policy since at least Reagan in the 1980s (individual income tax rates had actually begun their descent under John F. Kennedy in 1963).

Two, EGTRRA has left us with such a high exemption level/high marginal rate tax until 2010, when the tax is altogether repealed, only to be brought back, high marginal tax rates and all, in 2011. The combination of these aspects makes things even more bizarre. The estate tax reductions/repeal in EGTRRA were costly, under the revenue-scoring provisions in effect in Washington. Congress could have taken the money it in fact used in estate tax reduction and used it instead to lower the rates across the ten year period. It did not do so.

The status quo did not arise from lack of more logical alternatives. Like most major legislation, EGTRRA was subject to many amendments on the Senate floor. Among the more than thirty substantive amendments (which included thinly veiled spending proposals for education, vaccine research, and other pet projects) were alternative proposals to reform the estate tax.[82] Votes to leave the estate tax out of EGTRRA entirely failed by votes of 42 to 57.that is, not by the 60 vote margin needed for a permanent repeal.[83]

Compromise reform proposals failed as well. Senator Dorgan (D-N.D.) offered an amendment that would have sped up to 2003 and made permanent the increase in the

[82] Senate amendments 695, 703, 713, 726, 748, 770, and 781 to HR 1836 all propose amending EGTRRA to either preserve the estate tax or reform it so that it is not entirely repealed. All of these amendments were either defeated in a roll call or ruled out of order by the majority leader.

[83] The Conrad amendment (#158), which proposed a clean elimination of repeal, failed in a bipartisan vote of 42 to 57, with six Democrats voting against eliminating repeal. The Dodd amendment (#123), which proposed greater spending by both eliminating the estate tax repeal and raising income tax rates, failed by a vote of 39 to 60.

exemption level and the reduction in the top rate that the bill allowed in 2009, but eliminated the temporary repeal. This "reform, don't repeal" amendment was rejected on a vote of 43 to 56, with essentially the same supporters as for the Conrad amendment. Senator Feingold (D–Wi), who by 2002 found himself the only member of the Senate to support neither reform nor repeal, proposed an amendment to retain estate taxes *only* for estates in excess of $100 million.[84] Was this a joke? If so, it was a joke that nearly became law: 48 Senators, mostly Democrats, voted for it.[85] The charade was replayed in 2001, with Senators Reid and Conrad offering amendments to H.R. 8 that would similarly have modified, but not repealed the estate tax, allowing higher deductibles and a lower marginal rate. The Conrad amendment, which would have essentially restored the 2003 version of the estate tax, was defeated by a vote of 38 to 60. The Reid amendment, essentially making permanent the 2009 version of the tax, failed by a vote of 44 to 54.[86]

Logic suggests that all or at least most senators—with the possible exception of Senator Feingold— should support the reform proposals. The proposals sped up the

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[84] As we discuss in more detail in section III, the Senate considered essentially the same range of options in 2002, and have to date failed at passing either permanent repeal nor a permanent reform, apparently preferring deadlock to any rational policy.

[85] Six Republicans voted in favor of Feingold's amendment, barely balanced by the 8 Democrats who voted against -- including four (Baucus, Cleland, Lincoln and Wyden) on record as supporting eliminating the repeal. The switch in votes suggests that the close vote was close in number only, that is, that the leadership ensured that at most 49 votes would be cast in favor of the amendment.

schedule imposed by EGTTRA to increase the exemption level and reduce marginal rates, going to a simpler, higher exemption level across the board. Aside from being far more principled than EGTRRRA, these bills offered significant estate tax reduction for the interim years 2003-2008, and thus would be expected to be popular with opponents of the tax. Recall that 59 Senators had voted for permanent repeal in 2000, prior to Clinton's veto; over 60 voted for EGTRRA with its unprincipled one-year repeal; 54 would vote in June, 2002, for permanent repeal.

Of course, there are reasons why some repeal-supporters may vote against the reform proposals: they may believe that they will eventually succeed in obtaining their first choice of a permanent repeal, and that an interim reform will lower the likelihood of a total victory. But the overall pattern of votes suggests that this attitude would have to be suspiciously rampant to explain the outcome. Consider the three policy options on the table in 2002:

1. Permanent repeal (HR 8),
2. Higher exemption levels, lower tax rates without permanent repeal (Amendments 3832 and 3831 would raise exemption levels to $3.5 to $4 million, while providing additional exemptions for family farms and businesses), and
3. Nothing (keep EGTRRA status quo).

[86] Conrad's amendment, #3831, allowed an individual exclusion of $3.5 million and 50% maximum rate. Reid's amendment #3832 allowed individual deduction of $4 million, the rates specified in EG-TRRA for 2009, and extra deductions for family businesses. Both votes were taken 6/12/01.

Policy Option 2 is in a sense a logical subset of Policy Option 1, as we have suggested. But the actual outcome of the Congressional votes, taken at their face value, suggests, with the exception of Senator Feingold (who preferred Option 3 and possibly even an invigoration of the estate tax that was never on the legislative table), that *every Senator ranked Policy Option 3 as his or her second best outcome*. This made compromises impossible. Repeal supporters (including some Democrats (?!)), ranked matters as:

1 > 3 > 2

whereas repeal opponents (including some Republicans (?!)) ranked matters as:

2 > 3 > 1

Only this policy preference ordering explains the visible votes. Now in neoclassical economic theory, there is no disputing tastes, or preferences, as a general matter,[87] but we suggest that the reverse Mancur Olson phenomenon—in which Congress is milking a lucrative issue for itself—is the most parsimonious explanation of this pattern of revealed preferences.

A second reason for the persistence of the troubling status quo may be that both parties, Republicans and Democrats, felt that they had a good election issue, and so were happy to take their votes to the people. In fact, this argument simply gives a

[87] Becker and Stigler, De Gustibus Non Est Disputandum.

rhetorical reason for the seemingly odd revealed preferences just described. But as such it is not compelling. It is highly doubtful that many voters had deep, well formed preferences on the issue. The particular positions left standing after the Spring, 2002 were votes were especially unlikely to sway many voters. Democrats would have to believe that constituents would support their attempts to weaken but not kill the estate tax, even though this hardly betrayed a commitment to meaningful redistribution of wealth; Republicans would have to believe that they would score votes by holding fast to a "repeal or bust" strategy, even though this strategy hurt people who might die before 2010, and left matters highly uncertain for all. It is simply hard to believe that very many voters had the preferences sketched out above, and would not prefer a sensible compromise and getting on with other issues to the continued preoccupation and unprincipled status quo.

Now it is true that for much of the Spring and Summer of 2002, Republican candidates and President Bush prominently featured their support for repealing the death tax, and the inadequacy of the alternatives offered by Democrats, in campaign speeches. Similarly, some Democrats in what were thought to be the most competitive races, such as Senator Jean Carnahan of Missouri, promoted their reform proposals at every campaign opportunity. But we suspect that these campaign pledges were meant for a different audience than the average voter: that these were messages going out to the groups with money and a stake in the small but monetarily significant game.

F. Summing Up

In sum, we believe that the reverse Mancur Olson phenomenon alone explains what Congress has and has not done in regards to estate tax repeal. A traditional special interest model does not explain the curious twists of fate, because no group really wins in the story. Ballot-box analysis does not carry much weight here, because there has been no strong popular outcry one way or another, estate tax repeal remains a marginal issue to most voters at best, and virtually all lawmakers have signaled a willingness to at least weaken the tax at least.the politically popular position seems to be against the tax, and would certainly not seem to support the inane compromise reached. We also note that various "flippers" .lawmakers who at various times s-witched their votes on repeal or not, paid no apparent price at the polls. Finally, it is extremely hard to justify see what Congress has done as being in the public interest, either from an efficiency perspective (where the better policy of lowering the rates and broadening the base was never even proposed) or from an equity one (because the particular compromise reached is unprincipled, whatever one thinks of thye es-tate tax, and sensible compromises were consistently rejected.)

What is left standing, we suggest, is the reverse Mancur Olson story. The estate tax issue over these pivotal years was an issue of high stakes to small well organized groups. It was two-sided, with money for all. By the late 1990s, repeal had become plausible, and plausibly long-lived. And Congress strung the issue along, repeatedly voting, rejecting sensible compromises, and finding a way at every turn to keep the issue alive.to keep the spigot open, as it were.

V. Extensions and Conclusions

The reverse Mancur Olson phenomenon is a simple, armchair prediction following from two facts: that politicians care about money, and that they are rational. These facts alone suggest that politicians will use their powers where and when they can to generate special interest groups to lobby.or be lobbied by.them.

The properties of the phenomenon are small groups with high stakes that Congress helped in some way to form or shape; generally low-salient issues (to remove ballot-box constraints); two (or more) sides to prevent a tipping phenomenon towards one course of action; plausible action, and plausibly long-term effects. The predictions for legislative action, aside from helping to set the conditions in place for ideal shakedown schemes, is that Congress will prolong matters when it creates or stumbles into rich reverse Mancur Olson territory, resisting sensible compromises at every turn.

Tax is an obvious subject of Congressional power, fertile ground for rent-extraction possibilities, a general phenomenon of which the reverse Mancur Olson game is an instance. And hence it should not surprise that we found a strong, extended example of the syndrome in the estate tax repeal/non-repeal story.though we must admit that some of the rich details surprised even us, hardened cynics by now.

We believe that the reverse Mancur Olson phenomenon is common, though we reiterate that we have no interest in claiming that it explains all or even any specifically quantifiable part of legislative action. But it is not just a tax story. Consider, quickly, three further tales.

One, tort reform. In virtually every session of Congress over the last decade, lawmakers have considered some bill to cap punitive damages, medical malpractice awards, or other settlements. Democrats—for whom lawyers, especially trial lawyers, are the leading campaign contributors[88]—consistently oppose any such caps. Republicans, for whom doctors and insurers are major donors, typically propose excessively restrictive caps. Here again we have an issue of high stakes to small groups; low salience for most voters; plausible, two-sided and potentially long-lived. And votes happen over and over, with obvious compromises (midrange caps) never obtaining support.

Two, it has been well noted that the defense budget is slanted towards "big weapons" programs at the expense of more ordinary matters, such as troop salaries. Large defense (and other programs, such as NASA) create "bidding wars" among the handful of players able to deliver such programs. Here again, high stakes, small groups, multiple sides, plausibility, and lengthy terms obtain.

[88] www.opensecrets.org

Finally.though we could go on.consider Congressional action on the broadcast spectrum. When Congress auctioned this off, it could have allowed a large number of players to bid on bandwidth. Instead, Congress has divided the spectrum into large, discrete chunks, artificially generating bidding wars among small groups with high stakes.

We invite the reader to come up with her own further examples. The tell-tale signs are repeated votes over issues without sensible compromise ever obtaining. And to those who know how to look for it.it can be well hidden, at the source.there is money, money everywhere.

So much is, we think, descriptive. The reverse Mancur Olson can, and we argue, should, happen in theory; we believe we have shown it happens in practice too. What to do about the matter, from a normative point of view, is less clear. What should be done?

Here, we fear, our answers are less readily forthcoming. Ours has been a project in positive or descriptive social science: a hypothesis drawn out on a chalkboard, and tested in the laboratory of practical politics. No part of this project has involved claiming that the reverse-Mancur Olson phenomenon is good, bad, or indifferent. But we cannot avoid the deep-seated instinct that something is awry. The estate tax story illustrates this. Why is Congress voting over and over again on such a limited issue, leaving the law with a clearly unprincipled compromise, unable even to vote on obviously principled ones? At the same time, the perpetuation of the game gives a large reason why money persists in politics, and favors insiders.all insiders.against outsiders.

Reform will not be easy; getting money out of politics never really is. At a minimum, our analysis suggests inverting our gaze, away from the special interests currying favor with legislators, and over to the legislators who, like Dr. Frankenstein, may have created their own monster. Structural reforms to budgeting rules may be more central to campaign finance reform than campaign finance reform itself; we need to pay better attention to the reasons parties give money to politicians rather than just to the facts that they do. As of this point, we do not have answers to this challenge; we hope that our analysis has helped to better pose them.

In the end, it is time to better watch the watchdogs—before they organize all of us.