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The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes

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Thank you for this opportunity to speak at the annual Woodworth Lecture. Larry Woodworth died shortly after I began practicing law in New York City; as a result, I never had the opportunity to meet him. The staff of the Joint Committee on Taxation cherishes his memory, and he is still regarded as the paragon of how a Chief of Staff should comport himself. I am particularly honored, therefore, to conclude my time as Chief of Staff by speaking at an event held to commemorate Larry's profound contributions to tax legislation.

I wish today to address the tax legislative process, and in particular how tax expenditures distort not only tax policy, but also our whole concept of the size and activities of the Federal Government. As most of you know, I stand at the cusp of a new career as a professor at the University of Southern California's Gould School of Law. I speak to you today wearing this new metaphorical hat, and I offer my thoughts as an outline of future work I hope to pursue in more formal fashion in my new position. I welcome any thoughts or reactions that any of you might have.

I. THE END OF PARODY

The late David Bradford was fond of a little joke that he constructed to illustrate the intersection of tax law and the budget process.[1] He would propose a marvelous new way to cut taxes without affecting Government services.[2]

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* Professor of Law, University of Southern California Gould School of Law. I wish to thank Joseph Bankman, Cheryl Block, Elizabeth Garrett, Daniel Shaviro, and George Yin for the many helpful suggestions I received in preparing this lecture. Any errors of fact or logic remain exclusively my own.

1. Professors Daniel Shaviro and Eric Toder have kept the memory of this anecdote alive in their work in the area. DANIEL SHAVIRO, DO DEFICITS MATTER? 101-02 (1997) [hereinafter DEFICITS MATTER]; Eric J. Toder, *Tax Cuts or Spending – Does It Make a Difference?*, 53 NAT'L TAX J. 361, 363 (2000); Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 197 (2004) [hereinafter Rethinking Tax].

2. DEFICITS MATTER, *supra* note 1, at 101-02.

Instead of wasting tax revenues on military equipment purchases, Congress instead could implement a "Weapons Supply Tax Credit" ("WSTC") under which arms manufacturers would receive a tax credit for delivering weapons meeting certain specifications to the Government.[3] The amount of the credit would equal what the Government might formerly have spent on purchasing those weapons.[4] Then, the Government could announce that, through this "targeted tax relief," taxes had been slashed without jeopardizing our security or increasing the deficit.[5]

The joke, of course, was that nothing at all would have changed; our Government still would obtain the same weapons and incur the same economic cost to do so. Our accounting for the transactions, however, would differ. Instead of recording Government revenues from taxes collected and Government expenditures for national defense, we would just report net lower taxes collected. Where before the Government took in $1000 and spent $100 on fighter planes, it would now record just $900 in revenues (net of the WSTC) and some free planes would arrive at the doorstep of the Air Force. In form, the Government had gotten smaller; in reality, it was as large as ever.

David's joke was meant as a gentle parody to illustrate the empty formalism of our concepts of Government revenues and Government expenditures. Like all parody, it relied on hyperbole to make its point. How, then, would David have reacted to a little news release that the Internal Revenue Service ("IRS") published on April 6th, 2009, in which it announced the publication of Notices 2009-23[6] and 2009-24[7]? The first of these Notices explained to taxpayers how to apply for $250 million in tax credits to be allocated by the IRS and the Department of Energy (surely a bureaucratic odd couple) for delivery of certain "Phase II [qualifying] gasification projects."[8] The second announced a qualifying round of $1.25 billion in tax credits to be awarded, again by the same two agencies, for certain advanced coal facilities.[9]

Having read these recent Notices, the WSTC joke has lost its punch line. We now find ourselves living inside the parody and thinking it normal. My talk today is a meditation on this depressing observation.

The qualifying gasification tax credit, the advanced coal project tax credit, and hundreds of similar provisions embedded in our tax law are, of course, examples of tax expenditures. That term has been a staple of tax policy

3. *See id*. at 101.
4. *See* Toder, *supra* note 1, at 363.
5. *See* DEFICIT MATTER, *supra* note 1, at 101-02.
6. 2009-16 I.R.B. 802.
7. 2009-16 I.R.B. 817.
8. 2009-16 I.R.B. 802.
9. 2009-16 I.R.B. 817.

discussions for the past forty years, but only in the most pedestrian sort of applications. Tax expenditure analysis *should* serve as an important pragmatic tool for policymakers to use in sorting out their priorities, and in understanding in a straightforward way both the economic consequences of their decisions and the policy alternatives that might be relevant to the implementation of their ideas. Instead, a significant strand of legal academic work has deprecated the normative basis of tax expenditure analysis.[10] On the other side, most policymakers and congressional staff have viewed tax expenditure tables as simply a convenient fishing ground, where they can troll for new revenue "payfors" to offer in tandem with still another new tax break.[11]

Tax expenditures have grown in importance to the point where they are now the dominant instruments for implementing new discretionary spending policies. While it is certainly true that some forms of government intervention are best delivered through the tax system, it cannot be the case that neutral design principles would lead to the current situation, where we spend more than twice as much through tax expenditures as we do through old-fashioned explicit spending programs. As a result, tax expenditures are filling a role that goes well beyond just another available policy device in Congress's toolkit.

As I will describe, our extraordinary reliance on tax expenditures explains the central paradox of the American tax system, which is why the United States is a low-tax country with relatively high marginal tax rates. More fundamentally, tax expenditures dissolve the boundaries between government revenues and government spending. In doing so, tax expenditures reduce both the coherence of the tax law and our ability to conceptualize the very size and activities of our Government.

Tax expenditures not only distort tax policy and obfuscate our understanding of our Government's operations; they also adversely affect the workings of Congress. Contemporary tax expenditure practices have elevated the tax-writing committees into a special status: a *Congress within the Congress*. Through the adroit use of tax expenditures, tax-writing committees now fill *both* fundamental functions of a legislature: they raise revenues (through the traditional tax function, including the periodic search for payfors), and they spend those revenues themselves through the tax subsidies that they marry to the payfors in shaping "revenue neutral" legislation. These three consequences of our overreliance on tax expenditures – the growing incoherence of tax policy, the obfuscation of the size and activities of our Government, and the elevation of the tax-writing committees to this special

10. *See* STAFF OF THE J. COMM. ON TAX'N, 110TH CONG., A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS 18-38 (Comm. Print 2008) [hereinafter JCT RECONSIDERATION].

11. See Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501, 516-17 (1998).

status – are all profoundly corrosive phenomena.

II. RECENT TAX EXPENDITURE WORK

During my tenure on the staff of the Joint Committee on Taxation ("JCT"), we devoted a great deal of time to developing a new framework for tax expenditure analysis and applying that new framework to some important case studies. In light of its status as a nonpartisan congressional resource, the recent work of the JCT staff appropriately emphasized the central role of tax expenditures in the articulation of tax policies. Today, in contrast, I wish to build on the work of the JCT staff by speculating about how tax expenditures affect the larger budget process.

The JCT staff's recent tax expenditure work attempted to restore some credibility to tax expenditure analysis among academics, and to ignite some enthusiasm for it among policymakers. I think this enterprise succeeded, at least, in dampening some of the most virulent criticism and in attracting a few tentative nibbles of interest among policymakers. I also believe that some of the subsequent case studies that the JCT staff has published demonstrate that tax expenditure analysis is a useful framework in which to present difficult tax policy issues to policymakers in a principled and neutral way.[12]

The JCT staff's principal theoretical contribution in this area, *A Reconsideration of Tax Expenditure Analysis*,[13] reviewed the development of tax expenditure analysis, and considered the principal academic criticisms of tax expenditure analysis as implemented by the JCT staff and the Treasury Department.

> Many tax academics and policy experts [had] criticized [previous implementations of] tax expenditure analysis as resting on insufficiently rigorous foundations. These critics argue[d] that the ideal "normal" tax system from which tax expenditures are indentified [did] not correspond to any generally accepted formal definition of net income.[14]

Some observers further viewed the promulgation of the "normal" tax baseline "as a thinly veiled agenda for a specific form of tax reform."[15]

12. *See generally* Staff of the J. Comm. on Tax'n, 110th Cong., Tax Expenditures for Health Care (Comm. Print 2008); Staff of the J. Comm. on Tax'n, 111th Cong., Tax Expenditures for Energy Production and Conservation (Comm. Print 2009).
13. *See generally* JCT RECONSIDERATION, *supra* note 10.
14. *Id.* at 7.
15. *Id.*

> Under this view, the normative tax system at the heart of tax expenditure analysis [was] not simply an analytical tool, but is also an aspirational goal of the process. Others . . . questioned whether tax expenditure analysis serve[d] any purpose at all, because the doctrine appears to these critics to rest on the unexamined premise that the tax laws should be uniquely "privileged," through not being burdened by the political compromises and policy agendas reflected in appropriations legislation.[16]

All these criticisms were important, particularly the charge that the "normal" tax baseline had no logical foundation and appeared to be used to advance a normative agenda.

To address these concerns, the JCT staff in 2008 introduced a new taxonomy of tax expenditures.[17] The new paradigm:

> [D]ivides the universe of such provisions into two main categories: tax expenditures in a narrow sense . . ., which [were] label[ed] "[t]ax [s]ubsidies," and a new category . . . termed "[t]ax-[i]nduced [s]tructural [d]istortions." The two categories together cover much the same ground as [did] the [previous methodology for defining] tax expenditures, and in some cases extends the application of the concept further. The revised approach does so, however, without relying on a hypothetical "normal" tax to determine what constitutes a tax expenditure, and without holding up that "normal" tax as an implicit criticism of present law. The result should be a more principled and neutral approach to the issues.[18]

The JCT staff now defines a "tax subsidy" as a specific tax provision that is deliberately inconsistent with an identifiable general rule of the present tax law (not a hypothetical "normal" tax), that collects less revenue than does the general rule.

> The [t]ax [s]ubsidy tax base is constructed by asking what constitutes the general rule, and what the exception, under actual present law. [The JCT staff's] determination of [t]ax [s]ubsidies in most cases thus is made, not by reference to an alternative and hypothetical "normal" tax chosen by the JCT Staff, but rather by reference to the face of the

16. *Id.*
17. *See generally* JCT RECONSIDERATION, *supra* note 10.
18. *Id.* at 9.

> Internal Revenue Code itself (along with its legislative history and similar straightforward tools for identifying legislative intent).[19]

The JCT staff's new approach further divides tax subsidies into three subcategories: "tax transfers" (e.g., the refundable portion of the earned income tax credit); "social spending" (e.g., charitable contribution deductions); and "business synthetic spending" (incentives intended to subsidize or induce behavior directly related to the production of business or investment income).[20] These subdivisions are intended simply to help policymakers compare tax subsidies to others with a similar purpose. "All tax subsidies raise questions of equity, efficiency, and ease of administration. The three subcategories can be useful, however, to suggest that these factors may have different weights across the different subcategories."[21]

Tax subsidies form the bulk (by number) of tax expenditures under both the old and new definitions of the term, but the tax subsidy category by design excludes some important policies formerly classified as tax exependitures, because the general rule to which the policy is arguably an exception is not clear from the face of the Internal Revenue Code.[22] Accelerated depreciation and the treatment of the foreign earnings of U.S. multinational corporations are examples. "In light of this ambiguity, such a provision cannot properly be classified as a tax [subsidy]" in the sense now used by the JCT staff.[23]

In response, the JCT staff created:

> [A] second major category of tax expenditures alongside [t]ax [s]ubsidies, . . . labeled "[t]ax-[i]nduced [s]tructural [d]istortions." These [are] define[d] as structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not [t]ax [s]ubsidies . . .) that materially affect economic decisions in a manner that imposes substantial efficiency costs.[24]

Tax-induced structural distortions are analyzed solely under economic efficiency principles and not from any normative perspective.

The analysis of tax-induced structural distortions is extremely important. To my way of thinking, one of the real successes of *A Reconsideration of Tax Expenditure Analysis* was the development of a framework for analyzing tax-

19. *Id.*
20. *Id.* at 12-13.
21. *Id.* at 46.
22. JCT RECONSIDERATION, *supra* note 10, at 9.
23. *Id.*
24. *Id.* at 41.

induced structural distortions that could withstand any allegation of a political or policy prejudgment of the issues. For my purposes today, however, I will focus exclusively on positive tax subsidies – specific tax provisions that are deliberately inconsistent with an identifiable general rule of the present tax law (not a hypothetical "normal" tax), and that collect less revenue than does the general rule.[25]

I do not wish to use my time today to belabor any further the arguments presented in *A Reconsideration of Tax Expenditure Analysis*. I will say, however, that having read a large swath of the academic literature in this area, I believe much of the criticism has been overblown, and that the legislative process has been the worse for it. Tax expenditure analysis is a pragmatic exercise, and the existence of a handful of close questions should not obscure the fact that literally hundreds of other cases can be labeled as tax expenditures without much controversy.

III. A TAX EXPENDITURE FABLE

How exactly do tax expenditures erode our ability to conceptualize the size and activities of government? And how can tax expenditure analysis improve political discourse in the real world?

To answer these questions, I have constructed a little example involving the small but self-reliant country of Freedonia. Its economy comprises fruit and vegetable producers (because everyone in Freedonia is a vegetarian and dresses in home-spun clothing). Freedonia's ten fruit and vegetable growers each earn $1,000 pre-tax (for a total gross domestic product ("GDP") of $10,000) and each pays income tax to support the Freedonian army and post office at a flat rate of fifteen percent, for total tax revenues of $1,500.

Freedonia's sole kumquat producer is particularly resourceful. Armed with scientific reports showing the many health benefits of kumquat consumption, the kumquat farmer convinces the Freedonian legislature that kumquat production deserves tax incentives, to bring kumquats within the reach of every Freedonian family. The Freedonian legislature therefore responds by effectively exempting kumquat production from its income tax through an innovative kumquat production tax credit (the "kumquat credit"). But, Freedonia is not a profligate state, and it believes in fiscal discipline in the form of pay-as-you-go ("PAYGO") budget rules. Therefore, to keep the kumquat credit revenue neutral, the Freedonian legislature pairs the new preference with an 11.1 percent tax hike to maintain tax revenues at $1500. (Freedonian tax policy allows for rounding error.) That means that the nine

25. The converse case, an exception that deliberately overtaxes compared to the general rule, is a "negative tax subsidy." *See generally* JCT RECONSIDERATION, *supra* note 10, at 39.

other fruit and vegetable farmers will now each pay $167 in tax on their $1000 of income.

In a world without tax expenditure analysis, the Freedonian legislature can argue that nothing has changed: government revenues are constant, and there is no increase in government spending (or borrowing). But, this is plainly wrong: things have changed, in both the private and public sectors.

First, the tax incentive can be expected to have its intended effect of increasing kumquat production and consumption. How kumquat consumers and the producer share the improvement in the producer's bottom line income is not terribly important to the story. What is important, however, is that the equilibrium price and quantities sold of kumquats will be different relative to other fruits and vegetables after the tax incentive than was the case before. This is a first order consequence of the incentive, and it is one that, in the absence of some demonstrated externality that the incentive solves, economists greet with dismay. Economists believe that, in the absence of some identifiable market failure, markets set prices better than legislatures do; by virtue of the kumquat credit intervention, however, the quantity of kumquats sold in the markets will be distorted relative to the constant tax burden that all fruit and vegetable growers previously had faced. Unless the overall health of Freedonians really is improved by the Kumquat credit (perhaps because of prior rampant borderline scurvy among the population), the result will be a less efficient allocation of our collective resources.

Many tax expenditures, particularly those that are designed as business incentives, thus distort market prices and behavior through legislative fiat. Think how difficult it would be to enact into law a new tax expenditure benefitting one industry, if only the sponsor were required to describe his proposal as a "government economic five-year plan" rather than "targeted tax relief." Tax expenditure analysis is a way of demonstrating to policymakers the fundamental equivalence of "targeted tax relief" with a "tax and spend" big government.

Second, the introduction of the kumquat credit in an apparently virtuous "revenue neutral" fashion has another profound economic effect, which is that the tax rate imposed on the incomes of all the fruit and vegetable producers not adroit enough to have lobbied for their own targeted tax relief has increased. Here again economists have something really important to say: all taxes, no matter how beautifully implemented, impose "deadweight losses." "Deadweight loss" means that some transactions that are rational in a world without taxes become unaffordable in a world with those taxes, and therefore simply do not take place, and society as a whole becomes less wealthy. Because of deadweight loss (the transactions that remain unconsummated, or, as Sherlock Holmes might have said, the economic dog that didn't bark), the cost to the private sector of paying taxes is greater than the value of those taxes transferred to the public sector (and in turn recycled back to individuals). What is more, deadweight loss goes up faster than does the tax rate – in standard presentations, in fact, it goes up at the square of the tax rate.

Think of taxes as a precious liquid delivered to the government in a bucket. Deadweight loss means that the bucket is leaky – some of what the taxpayer puts into the bucket (as measured by the taxpayer's actual burden in filling the bucket, not the quantity of liquid in it) never reaches the government. And, every time tax rates go up, it is as if some mischievous elf drilled more holes in the bucket – indeed, more and more holes with every ratcheting up of rates. The taxpayer must work that much harder to fill it up to the level required by the government.

What all this means is that, by virtue of granting "revenue neutral targeted tax relief," the Freedonian government may raise the same aggregate revenues as it did previously, but in doing so is imposing disproportionately more deadweight loss on the remaining taxable Freedonian private sector. Government revenues may stay constant, but the country as a whole is poorer by virtue of the incentive. This result is one of the great ironies of many tax expenditures, particularly those that fall into the category of business incentives – once the incentive's impact on tax burdens for others is considered, it impoverishes the country even more than it enriches the beneficiaries of the legislative largesse.

Third, by virtue of its new kumquat credit, the Freedonian government just got bigger, even though aggregate nominal tax revenues remain constant. The Freedonian public sector is larger, in the meaningful sense that its imprint on the private sector – the metaphorical handprint of the government bearing down on market transactions – has grown. The best way to see this effect is to employ Louis Kaplow's favorite mode of analysis, and analogize the new kumquat credit to a uniform 11.1 percent tax hike on *all* of Freedonia's fruit and vegetable producers, followed by a $167 kumquat crop farm subsidy payment to the kumquat producer. By recasting the tax expenditure in this way, as a constant tax burden and a separate transfer payment, the two different functions of government are restored to their customary formal presentation, and the words "revenue" and "spending" can be applied consistently to economically identical (but formally different) modes of implementation.[26] As

26. Professor Shaviro has forcefully argued that because words like "taxes" and "spending" are so elastic in meaning that tax expenditure analysis could be placed on firmer analytical footing if the construct were "defined in terms of function, rather than of the direction of cash flow between taxpayers and the government." Rethinking Tax, *supra* note 1, at 207. To do so, he would rely on the public finance distinctions between the "distributive" and "allocative" functions of government. *Id.* Applying this functional approach to this example–and indeed in the case of most tax expenditures – leads to the conclusion that the

so recast, it is easy to see that Freedonia's economic handprint on the private sector is no longer $1500 in tax revenues, but rather $1667 in economic terms. The government is bigger in every meaningful sense of the word.

Fourth, deadweight loss cannot be avoided by electing "targeted tax relief" *without* revenue offsets. This point may seem obvious to many readers, but I am confident that, without explicit discussion of the point, at least some policymakers would draw from the above discussion the mistaken impression that the only problem with tax expenditures is trying to pay for them.

The simple fact is that, as the third lesson sought to demonstrate, the kumquat credit is a form of government spending, and accordingly *will* be paid for. That is, government spending must be financed. The government has four choices as to how to finance its spending. First, it can pay for its incremental spending on a current basis, by raising taxes on someone else: we think of this as revenue-neutral tax legislation. Second, the government can borrow money today and repay it with future revenues – that is, future taxes. This strategy therefore also implies higher taxes, although it saves for another day the question of who will bear the brunt of those higher rates (which explains the strategy's popularity). Third, the government can borrow today, and inflate its way out of the problem. But, inflation itself is just another kind of a tax: in this case, it is one imposed haphazardly and often cruelly on capital owners or claimants to fixed revenue streams, like pensioners. Fourth, the government can borrow today and default on its debt in the future. Those are the entirety of the options available.

If you agree with me that the fourth way is probably a bad idea, then you are left with the realization that each new tax expenditure necessarily implies a tax increase. In this regard, tax expenditures are just one more application of Milton Friedman's marvelous aphorism, "[T]o spend is to tax." I can think of no more important principle of public finance for policymakers to absorb and meditate on, and tax expenditure analysis can help to focus the mind on this inescapable truth.

Finally, by carefully examining the design and implementation of the kumquat credit, we can ask a lot of important questions about how the kumquat subsidy in fact works.[27] We can begin by inquiring, is the tax system the best

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kumquat credit is an allocative function lurking below the surface of the primarily distributive Freedonian income tax.

Shaviro's proposal would add to the analytical precision of tax expenditure analysis, but at the same time would decrease the accessibility of tax expenditure analysis to policymakers and others not comfortable with the rhetoric of public finance. For that reason I believe that the ultimate objectives of tax expenditure analysis are better served by retaining the less precise but more accessible language of "taxing" and "spending."

27. For an excellent discussion of the utility of tax expenditures as policy implements in specific applications, see David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113

way to deliver the subsidy? Can the Freedonian Revenue Service ("FRS") audit and enforce the distinctions that the new law contemplates? Can revenue agents distinguish a kumquat from a kiwi, to ensure that kiwi producers are not improperly claiming the credit, or dyeing kiwis orange to pass them off as kumquats?

The fact is that the Government has multiple levers through which it can influence the behavior of the private sector. The Government can use the tax system, either as an incentive (as we have been discussing to this point) or as a deliberate incremental cost (for example, to internalize negative externalities). Alternatively, the Government can impose mandates through regulation; from the perspective of the private sector, these mandates impose costs that function much like taxes on the burdened sectors. Or, the Government can appropriate funds to spend on awards, grants, below-market loans, or similar subsidies for favored activities. Each is a valid tool for implementing policies; but, by the same token one will dominate the others in particular applications. The interesting question about tax expenditures in the United States, as opposed to Freedonia, is whether we are using tax expenditures more systematically than would be expected from a dispassionate review of the available policy implements.

Another useful design and implementation question that tax expenditure analysis can help to resolve is whether the tax subsidy in question is properly targeted. Did the Freedonian legislature, for example, mean for the subsidy to be available only to family kumquat farmers? If so, is the subsidy designed to ensure that large corporations are ineligible?

As another example, is the kumquat credit regularly rethought? Are the conditions that prompted the subsidy still extant? At least intuitively, many observers believe that appropriations (which must be renewed regularly) are subject to greater scrutiny than are tax expenditures, which if permanent are on autopilot, and if temporary are typically renewed in a pack along with dozens or hundreds of other "expiring provisions."

As the final lesson, tax expenditure analysis can usefully tee up the question of whether we are getting enough bang – or kumquats – for the buck. The Congressional Research Service's biennial Compendium of U.S. Tax Expenditures contains the apparent rationale for each tax subsidy, which is one of the reasons why the book is over 900 pages long.[28] (Sadly, no Freedonian equivalent analysis is known to exist.) Without having read every page, I

YALE L.J. 955 (2004). As described below, I believe that there are good reasons to approach program designs with a presumption against using tax expenditures as the delivery mechanism, but that presumption can and should be overcome in certain cases, *e.g.*, the earned income credit.

28. S. Comm. on the Budget on Individual Provisions, 110th Cong., Tax Expenditures: Compendium of Background Material on Individual Provisions 1 (Comm. Print. 2008) [hereinafter CRS Compendium].

nonetheless am confident that the Compendium contains no entry that reads, "No possible justification exists for this subsidy." In every case, the question is one of priorities and, as this fable has sought to demonstrate, tax expenditure analysis can provide policymakers with a straightforward framework through which they can obtain the information necessary to choose their priorities well.

IV. THE MEASURE OF TAX EXPENDITURES

Let us now turn from little Freedonia to the fractious political realities of the United States.

By any measure, tax expenditures represent an enormous part of the U.S. Government's operations. The JCT staff does not sum up tax expenditures, on the grounds that there are important interactive effects across the different items (so that the revenue consequences of repealing all or a group of tax expenditures differ from the simple sum of the consequences of repealing each). Nonetheless, the Congressional Research Service has bravely done the arithmetic; it reported that the JCT staff list published in October 2008[29] comprised 247 tax expenditures, the simple sum of which for fiscal year 2008 totaled some $1.2 *trillion*.[30] Ninety percent of this $1.2 trillion represented tax expenditures for individuals and 10 percent ($118 billion) represented a reduction of corporate income tax.[31]

In an important recent study, Burman, Geissler, and Toder concluded that, while the interactive effects among non-business tax expenditures are real, with the exception of itemized deductions, those effects do not change the bottom line aggregate impact all that much.[32] The study concluded, in fact, that eliminating a very large share of non-business tax expenditures would *raise* about eight percent more revenue than would the simple sum of those same items.[33] As a result, while I acknowledge the imprecision of working with

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29. H. Committee on Ways and Means and S. Comm. on Finance, 110th Cong., Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012 (Comm. Print 2008).

30. CRS Compendium, *supra* note 28, at 6, 13; see Staff of J. Comm. on Tax'n, 110th Cong., Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012, at 69, tbl.4 (Comm. Print 2008) (for the source of the CRS Compendium's figures for 2008, which also include those items described as tax subsidies under the new framework adopted by the JCT Reconsideration). These items (primarily the "deferral" of the income of controlled foreign corporations and accelerated depreciation) are now treated by the JCT staff as tax-induced structural distortions, not tax subsidies, but are carried in the annual tax expenditure lists for the sake of historical continuity. The simple sum of these items for 2008 was about $46 billion. *Id.*

31. CRS COMPENDIUM, *supra* note 28, at 13.

32. *See* Leonard E. Burman, Christopher Geissler, & Eric J. Toder, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?*, 98 THE AM. ECON. REV. 79, 83 (2008).

33. *Id.* Very generally, the driver behind the observation that eliminating a large group of expenditures raises more revenue than does the simple sum of those items is that, in the former case, taxpayers' incomes would move up into higher tax brackets. *Id.* The Burman, Geissler, and Toder study presumably applies tax expenditure rather than revenue estimating methodologies. The two differ principally

simple aggregates, I think that they are good enough for my present purpose, which is only to illustrate orders of magnitude.

How can I put $1.2 trillion of 2008 tax expenditures into context? That sum is greater than the entire amount raised by the individual income tax in 2008, or for that matter all federal discretionary spending in that year (in each case, about $1.1 trillion).[34] Indeed, it is more than twice as much as all nondefense discretionary spending in 2008 ($528 billion).[35] What is more, tax expenditures have grown rapidly in number over the years, from 60 items in the JCT staff's first tax expenditure list in 1972 to 247 in 2008.[36] And, lest $118 billion in 2008 corporate tax expenditures sounds small in relation to the amount spent on individual tax subsidies, bear in mind that this sum represents roughly 39 percent of 2008 corporate tax receipts ($304 billion) or, if you prefer a somewhat less aberrational year, 32 percent of 2007 corporate tax receipts ($370 billion).[37]

More relevantly, and despite David Bradford's little joke, very few tax expenditures relate to national defense.[38] Therefore, it is instructive to compare tax expenditures to explicit nondefense discretionary outlays. To do so, I started with The Center on Budget and Policy Priorities' ("CBPP") regularly-published overview of the functional components of the federal budget.[39] That document separates the budget into six high-level categories: defense, social security, Medicare/Medicaid/CHIP, "safety net programs," "interest on the national debt," and "everything else."[40] Both the CBPP and the Congressional Research Service Compendium of Tax Expenditures follow the standard federal budget presentation to construct their categories, except that the CBPP puts payments to federal government retirees and veterans in the "everything else" category.[41] Eliminating that item, about 13 percent of the federal budget

in that the latter takes into account behavioral reactions to a proposed tax law change, while the former does not, other than "tax form" behavior (e.g., claiming a standard deduction rather than itemized deductions). *See* JCT RECONSIDERATION, *supra* note 10, at 81-82.

34. Cong. Budget Office, 111st Cong., A Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook, at 3, tbl. 1-2 (2009) [hereinafter CBO PRELIMINARY ANALYSIS].

35. Off. of Mgmt. and Budget, A New Era of Responsibility: Renewing America's Promise, H.R. Doc. No. 111-19, at 117, tbl. S-3 (1st Sess. 2009).

36. JCT RECONSIDERATION, *supra* note 10, at 4; CRS COMPENDIUM, supra note 28, at 6.

37. CRS COMPENDIUM, *supra* note 28, at 13; CBO PRELIMINARY ANALYSIS, *supra* note 34, at 3, tbl. 1-2, 83, tbl. 4-1.

38. The simple sum of national defense and veterans' affairs tax expenditures for 2008 totaled $8.9 billion. CRS COMPENDIUM, *supra* note 28, at 17, 23, 27, 31, 903, 907.

39. Center on Budget & Policy Priorities, Policy Basics: Where Do Our Tax Dollars Go? (2009), http://www.cbpp.org/files/4-14-08tax.pdf [hereinafter POLICY PRIORITIES].

40. *Id.* at 4.

41. *Id.*

($390 billion) was spent in 2008 on "everything else" in its more ordinary sense.[42]

To compare explicit outlays to tax expenditures in the areas of Government services, to which most tax expenditures actually are directed, I subtracted from the $1.222 trillion in total 2008 tax expenditures those items that the Congressional Research Service categorized as (i) "social services" expenditures (other than the charitable contribution deduction), (ii) "income security" expenditures (excluding employer-provided life or disability insurance and tax expenditures relating to private pensions, as they are above and beyond the "safety net"), and (iii) veterans' affairs expenditures.[43] The result ($1.074 trillion) can then usefully be compared to the magnitude of explicit outlays in the CBPP's "everything else" category, excluding payments to federal retirees and veterans' benefits ($390 billion).[44] By doing so, one discovers that our nondefense, non-safety net annual spending through tax subsidies is about 275 percent of the amount of explicit Government outlays in these areas. In other words, when looking at education, transportation, scientific research, and every other activity by which the Federal Government touches the day-to-day lives of middle class and affluent Americans under the age of 65, our official scorekeeping captures only 27 percent of the Government's actual spending.

So tax expenditures are enormous in absolute terms, and are even more outsized when compared to explicit government spending in comparable areas. The amounts of money involved have risen at a pace that outstrips even mandatory spending programs.[45] Moreover, as a share of GDP, tax expenditures are now at a much higher level than was true in 1974, when federal accounting for tax expenditures was first officially adopted.[46] At the same time, explicit discretionary spending actually has declined substantially as a percentage of GDP, from levels around 10 percent of GDP in the early 1980s to less than eight percent today.[47]

In 1974, for example, the simple sum of all tax expenditures amounted to

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42. *Id.* at 1-4.

43. *See* CRS COMPENDIUM, *supra* note 28, at 13, 565, 823, 907.

44. *See* POLICY PRIORITIES, *supra* note 39, at 2.

45. See George K. Yin, *Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint*, 84 N.Y.U. L. REV. 174, 177, 255-57 (2009).

46. *See* Thomas L. Hungerford, *Tax Expenditures: Good, Bad, or Ugly?*, TAX NOTES, Oct. 23, 2006, at 325, 326 [hereinafter Hungerford].

47. Thomas L. Hungerford, *Tax Expenditures and the Federal Budget*, CONG. RES. SERVICE, at 5, fig.2, Sept. 20, 2008, https://www.policyarchive.org/bitstream/handle/10207/20065/RL34622_20080910.pdf?sequence=3 [hereinafter Federal Budget]; Hungerford, *supra* note 46, at 325, 326 fig.1 (an earlier version of the same material).

5.7 percent of GDP.[48] Tax expenditures climbed from that level to an all time high in the mid-1980s of 9.7 percent of GDP and then fell by virtue of the base broadening and rate reductions of the Tax Reform Act of 1986, reaching a modern low of 5.3 percent of GDP in 1991.[49] The rate stayed in the neighborhood of 6 percent of GDP during most of the 1990s, but then began a steep climb.[50]

By my calculations, the simple sum of all tax expenditures in fiscal year 2008 totaled an extraordinary 8.6 percent of GDP,[51] the highest percentage since the mid-1980s.[52] To put this number in context, if tax expenditures today were the same percentage of GDP as was the case in 1974, the simple sum of 2008 tax expenditures would have been some $412 billion lower than the actual estimates! Contrast this number with Congress's fiscal year 2010 budget resolution, which calls on the tax-writing committees to scrounge up a total of $97 billion in tax "loophole closers" over the next five years – less than $20 billion per annum.[53]

The 2008 figure is very close to the situation in 1985, just before the Tax Reform Act of 1986, when tax expenditures amounted to 8.7 percent of GDP.[54] Aggregate tax expenditures as a percentage of income taxes also were very close in the two years (87 percent in 1985 and 84 percent in 2008).[55] This fact is particularly telling, because most tax expenditures are expressed as deductions or exclusions, and their value fluctuates with tax rates: in lower rate environments, non-credit tax expenditures have lower value.[56] In general, 2008

48. Hungerford, supra note 46, at 325, 326 fig.1. Dr. Hungerford has confirmed that the 2008 entry in Figure 2 was based on preliminary data, and the correct entry should be 8.6 percent. *Id.*

49. Federal Budget, *supra* note 47, at 5, fig. 2.

50. *Id.*

51. The following are the author's calculations: $1.222 FY 2008 tax expenditures divided by $14.224 FY 2008 GDP. *See* Cong. Budget Office, The Budget and Economic Outlook: Fiscal Years 2009 to 2019 16 (2009) (pertinent for the GDP figure).

52. *See* Hungerford, *supra* note 46, at 5.

53. Floor Statement by Senate Budget Committee Chairman Kent Conrad (D-ND) on Budget Conference Agreement April 29, 2009, reprinted as Tax Analysts Document 2009-9727, at 8 ("Those tax cuts . . .are offset by loophole closers of $97 billion.).

54. Federal Budget, *supra* note 47, at 5, fig.2.

55. Interestingly, total taxes as a percentage of GDP were 17.7 percent in both 1985 and 2008. OFFICE OF MGMT. & BUDGET, HISTORICAL TABLES: BUDGET OF THE U.S. GOVERNMENT: FISCAL YEAR 2010 322-23, tbl. 15.1 (2009). Tax expenditures generally are measured only for income taxes. The JCT staff, for example, does not calculate excise tax expenditures. For this reason, the text looks to tax expenditures as a percentage of income taxes only.

56. *See generally* Yair Litsokin, *Tax Expenditures and Business Cycle Fluctuations* (John M. Olin Center for Studies in L., Econ., & Pub. Pol'y, Working Paper No. 378), *available at* http://ssrn.com/abstract=1372782. One can see the effect of tax rate cuts, for example, by looking at *nonbusiness* tax expenditures on either side of the 2001-2003 tax cuts. Nonbusiness tax expenditures amounted to 6.5 percent of GDP in 2001, but only 5.7 percent in 2006, reflecting the sharp tax rate cuts

was a much lower tax rate environment than was the case in 1985. The fact that tax expenditures today are running at roughly the same percentage of GDP and income tax revenues as in 1985 confirms that tax expenditures have multiplied in degree as well as in number.

Official tax expenditure estimates by the Treasury Department and the JCT staff look only to income tax expenditures. This estimate understates the importance of tax subsidies in some important areas, particularly energy policies. A recent Department of Energy study, for example, found that tax expenditures for energy production amounted to $10.4 billion in 2007; of this amount, nearly $3 billion was attributable to excise tax credits for ethanol production alone.[57] As an excise rather than an income tax, this item is absent from official JCT staff and Treasury Department lists of income tax expenditures. Likewise, the recent controversy over "black liquor" alternative fuel credits, which has widely been reported as a multibillion dollar issue,[58] involves the scope of an excise tax subsidy, and as such would not be visible in the traditional income tax expenditure lists. Consistent with my larger theme, that Department of Energy study also found that, in constant 2007 dollars, tax expenditures for energy production and conservation more than tripled over eight years, from $3.2 billion in 1999 to $10.4 billion in 2007, while total Federal Government financial support (including tax expenditures) only doubled.[59]

One could argue that in presenting this data I have identified a phenomenon, but have not demonstrated it to be a problem. I agree, of course, that there are good reasons in particular applications to use tax expenditures as the vehicle for delivering federal interventions.[60] Tax expenditures take advantage of the preexisting reach of the Internal Revenue Service as a delivery mechanism and permit fine-tuning benefits to family circumstances (data

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introduced in 2001 and 2003. GILLIAN REYNOLDS & C. EUGENE STEUERLE, TAX POL'Y CENTER, TAX EXPENDITURES: HOW HAVE THEY CHANGED OVER TIME? (2009), http://www.taxpolicycenter.org/ briefing-book/background/expenditures/change.cfm.

57. Energy Information Administration, U.S. Department of Energy, Federal Financial Interventions and Subsidies in Energy Markets 2007, at xi, xviii, tbl. ES6 (2008), *available at* http://www.eia.doe.gov/oiaf/servicerpt /subsidy2/index.html [hereinafter EIA Report]; *see also* Gilbert E. Metcalf, Professor of Economics, Tufts University, Statement before the Senate Comm. on Finance of the 111th Cong. on Technology Neutrality in Energy Tax: Issues and Options (2009), *available at* http://finance.senate.gov/hearings/testimony/2009test/042309 gmtest.pdf.

58. Peter Cohn, *Rangel Says He, Too, Will Look to Close Paper Mill Benefit*, CONGRESS DAILY, Apr. 30, 2009 (citing estimates of the one-year revenue cost of "black liquor" excise tax benefit as ranging from $3.3 to $7 billion).

59. EIA REPORT, *supra* note 57, at xii, tbl. ES1.

60. *See generally* Weisbach, *supra* note 27; Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197 (2006); *see also* JCT RECONSIDERATION, *supra* note 10, at 62-67 (extensively discussing the design elements of tax expenditures).

collected by the IRS anyway). Tax expenditures (except in the silliest applications like the gasification credit) effectively allow self-certification for qualification (that is, one can simply claim the benefit without applying for approval to a bureaucracy), which encourages broad participation in the program in question at relatively low administrative cost. Finally, a "permanent" tax expenditure offers a reasonably secure guarantee of the subsidy's long-term viability.[61]

The sheer bulk of the numbers, however, belies the suggestion that tax expenditures as actually employed are simply one rational implement in the congressional toolkit. Tax expenditures today constitute a truly extraordinary proportion of Government intervention in the allocation of capital and labor in the private markets. Tax expenditures have grown at rates much faster than explicit Government spending and at rates that exceed even increases in mandatory spending.[62] This implement, in fact, has largely crowded out others, even in cases where, on its face, the connection of the Government intervention to the tax system is risible – for example, in the energy tax credit examples with which I began.

One way of looking at whether the United States channels its use of tax expenditures to those cases where the tax code is the superior delivery system is to compare U.S. tax expenditure practice with the practices of other countries. My academic work here is at its inception, but, as a very preliminary matter, it does appear that quite a few other countries also use the tax system to deliver what the JCT staff now calls tax transfers and social spending. In particular, "making work pay" tax subsidies are surprisingly common in peer countries. The United States appears, however, to be among the leaders in the proportion of benefits delivered through the tax system. And, very interestingly, the United States appears to be an outlier in its extensive use of tax subsidies for business and capital investments, which the JCT staff now labels business synthetic spending. It is ironic that the United States, bastion of both free markets and low-tax ideologies, operates an ersatz industrial policy through its patchwork of business tax subsidies.

I hope that I have demonstrated that Congress's heavy reliance on tax expenditures cannot be explained by arguing that in each such case a tax subsidy, rather than explicit spending, is the most appropriate tool for the job.

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61. Professor Staudt goes further and argues that there are important organizational benefits to multiple competing efforts to solve the same problem. *See generally*, Staudt, *supra* note 60, at 1222-23. She further points out that redundancy can have important benefits in assuring the robustness of a system: her metaphor is the modern passenger aircraft, which relies on several jet engines so that it can safely fly even if one fails. *Id.* My tongue in cheek response is that the difference between Congress and the modern passenger aircraft is that only aircraft engineers can be relied on to point their redundant engines in the same direction.

62. Yin, *supra* note 45, at 177, 255-57.

In turn, the current congressional predilection for tax expenditures is a dangerous phenomenon. It distorts tax policy, it distorts our entire comprehension of the size and activities of the Federal Government, and it distorts the workings of Congress itself. The next part of my presentation, therefore, turns to these critical issues.

V. EXPLAINING THE GROWTH IN TAX EXPENDITURES

Think back to the two energy tax credit programs with which I began: does anyone believe that the IRS actually has a useful role to play in soliciting applications for the allocation of a fixed quantity of cash equivalents (in the form of tax credits) for innovative energy technologies?

Something else is afoot, and that something else, of course, is politics. Tax subsidies (that is, tax expenditures in the narrow sense used here) permit a marvelous muddling of budget terminology: they increase government spending in economic terms but can be presented as "targeted tax cuts." By relying on tax expenditures, Congress can pander to important constituencies that for the last three decades have agitated for lower taxes and smaller government, while giving us what we actually want – more discretionary spending and, implicitly, a larger government.

What makes tax expenditures irresistible to a member of Congress from either political party is this ability to describe oneself as a tax cutter while actually spending money, thereby guaranteeing that some future cohort of Americans will pay more in tax. Notwithstanding the regular publication of tax expenditure budgets, tax expenditures hide from scrutiny in plain sight, both in our budget and in our presentation of new revenue legislation.[63] Ironically, revenue neutral legislation has the effect of making tax expenditures even less apparent to the average observer.

But paying for tax expenditures, as a PAYGO environment requires, has another unappreciated consequence, which in some ways is even more corrosive to the political process: it elevates the tax-writing committees into the special status of a *Congress within the Congress.* The discovery by the tax-writing committees that any spending program, even a fixed dollar grant program (like the gasification project program with which I began, or the low-income housing credit), can be recast as a tax subsidy means that the tax-writing committees now fill *both* fundamental functions of a legislature: they raise revenues (through the traditional tax function, including the periodic

63. *Accord* Tim Westmoreland, *Standard Errors: How Budget Rules Distort Lawmaking*, 95 GEO. L.J. 1555, 1585-86 (2007) (describing opacity of tax expenditures); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1171 (1988) (Tax-writing committees "can trade tax expenditures off against tax rates[.]").

search for payfors), and they spend those revenues themselves, through the tax subsidies that they marry to the payfors in shaping "revenue neutral" legislation.

The resulting bill is presented to the House or the Senate floor as revenue neutral tax legislation, but the committees of Congress with substance-matter expertise have been deprived of the opportunity to fight for the ability to spend that money themselves. The substantive committees do not supervise how tax subsidies are designed or spent; they do not track the efficacy of the tax programs; they do not necessarily coordinate that spending with their own spending; and, they even have lost the ability to argue that their priorities should be preferred over those reflected in the tax legislation.

In more formal terms, my argument is that the tax-writing committees have latched onto a method to increase spending on policies of their choosing through decreasing the salience of those benefits to most observers (but not, of course, to the beneficiaries), and in turn decreasing the salience of the tax costs incurred to finance those spending policies.[64] Lower tax salience is associated with bigger government (that is, a larger tax base).[65] The result is a classic example of fiscal illusion, in which, arguably, both taxpayers and many members of Congress underestimate the tax increases implicit even in "revenue neutral" legislation. The vehicles for accomplishing this reduction in the salience of spending and tax policies through the utilization of tax expenditures are twofold: first, the formal presentation of the budget (in particular revenue legislation); and second, the framing of the policies.[66] Members promote new

64. *See generally* Amy Finkelstein, *E-Z Tax: Tax Salience and Tax Rates* (Nat'l. Bureau of Econ. Research, Working Paper No. 12924, 2007), *available at* http://www.nber.org/~afinkels/papers/EZTax_Finkelstein _February_07.pdf (discussing tax salience).

65. *Id.* at 1-2. The efficiency consequences of raising taxes through low salience mechanisms are more ambiguous, and depend on taxpayer starting expectations about government revenue policies. *See id.*; *see generally* Gary S. Becker & Casey B. Mulligan, *Deadweight Costs and the Size of Government*, 46 J.L. & ECON. 293 (2003).

66. My argument is related to that developed by Edward Zelinsky. *See generally* Edward A. Zelinsky, *Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditure Analysis*, 24 VA. TAX. REV. 797 (2005). Zelinsky offers empirical evidence that many voters (and presumptively, many policymakers) are vulnerable to "framing effects," in which the outcome to a policy question – here, a question of choosing between a tax expenditure and an explicit government outlay – depends on how the question is presented (e.g., "framed"). See *id.* at 798-99. In this particular case, survey participants did not view a local property tax exemption offered to volunteer firefighters as imperiling their "volunteer" status to the same extent as participants did when the same dollar value was expressed as an explicit payment. *Id.* at 821; *see generally* Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1994) (for an earlier application of framing analysis to tax policy questions). The fundamental difference between much framing literature, including Zelinsky's article, and my argument is that in the framing literature, participants are asked to choose between two policies. My point is that tax expenditures today are framed in a way that both policymakers and the public are unaware that they are making any choice at all. But framing unquestionably is directly relevant to tax expenditures, particularly

spending programs as "targeted tax cuts," and they defend existing tax expenditures by framing their repeal as "tax hikes."

All enterprises create their own patois, and Capitol Hill is no exception. A favorite intransitive verb there is "to be Guarinied." It refers to an unfortunate former Congressman, Mr. Guarini, who had the good fortune to stumble onto a pristine new payfor. Payfors are extraordinarily valuable commodities in Congress, because as explained above, they effectively enfranchise the tax-writing committees to spend an equivalent amount of value through "revenue neutral" legislation. Mr. Guarini had his own ideas as to how his new discovery should be applied, but, unfortunately for him, his marvelous discovery was appropriated by more senior members of the tax-writing committees: the payfor was deployed, but the spending associated with it was not of Mr. Guarini's choosing. One way to understand my point that tax expenditures have now turned the tax-writing committees into a Congress within the Congress is to say that every member of Congress not on those committees has now been Guarinied.

Our predilection for spending through tax subsidies thus contributes to a profoundly unhealthy state of affairs for three reasons. First, it leads to less coherent tax policies. Second, it obfuscates the size and activities of our Government as it reduces tax and spending salience. Third, it distorts decision making at every level of Congress.

The pure tax policy consequences are obvious. Tax subsidies raise compliance costs for taxpayers, and they place inappropriate burdens on the IRS. Tax expenditures erode compliance with the self-assessment system by creating the impression that others are obtaining mysterious "tax breaks" by virtue of superior influence over the system. The fact that almost all of us participate directly in the tax system is reason by itself for the tax code to be "privileged" over other federal statutes.[67]

Similarly, notwithstanding the length and complexity of the tax code, every tax practitioner must answer questions every day by reasoning by analogy from the existing framework. Tax expenditures cloud the clarity of tax policies, and in doing so, make it more difficult to predict how the law will evolve.

Moreover, tax subsidies are notoriously difficult to target effectively. As previously discussed, most are available through self-selection by claiming the benefit. Additionally, in many cases, they are difficult to design to apply only to marginal activities, rather than to activities that would have occurred without

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when it comes to repealing one: at that point, a curtailment of a government spending program (in an economic sense) is instead deliberately framed by opponents as a "tax increase."

67. As such, I resist the conclusion of Professors Weisbach and Nussim that the tax law should not be privileged when compared with other government policy instruments. *See generally* Weisbach, *supra* note 27.

regard to the subsidy. Finally, in many business contexts in particular, a tax subsidy is precisely the wrong medicine: the straightforward way to implement rational energy policies through the tax law, for example, is to tax the relevant externalities, not to subsidize preferred technologies or conduct.[68] All of these factors argue for a tax policy presumption against tax expenditures that can be overcome only in clearly compelling cases.

The second fundamental consequence of our overuse of tax expenditures is the obfuscation of the size and activities of our Government. We cannot determine by inspection of our budget how much support the Federal Government provides to the energy sector, nor do we know the nature of those programs. Because the straightforward facts are not presented in a straightforward manner, we cannot debate fairly the efficiency costs of a system where spending and revenues are disguised from both citizens and most legislators. Tax expenditures augment fiscal illusion, and fiscal illusion in turn drives poor policy.[69]

Third, the budgetary imperative to spend through the tax system interferes with the internal workings of Congress. Petitioners for federal largesse can and do file claims with multiple committees: if the Farm Bill does not contain what you want, why then, just ask for it from the Senate Finance Committee. The resulting programs in turn can duplicate, overlap, or conflict with one another. There is no express congressional mechanism designed to ensure that policies are coordinated, or even communicated, among different committees.

This phenomenon has been widely studied with respect to social services,[70] but it also applies to energy policy and most other instances of discretionary spending (other than military procurement where, perhaps mindful of stirring up the ghost of David Bradford, we have not yet implemented the Weapons Supply Tax Credit). Moreover, no government agency is charged with presenting to the public and to Congress as a whole an annual comprehensive picture of the total costs of all the discretionary outlay budget functions, including tax subsidies as well as direct outlays (although admittedly the component data are published and studies of individual areas are prepared from time to time, as in the case of the Energy Information Agency analysis described earlier).

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68. *See* Metcalf, *supra* note 57, at 2. The current Secretary-General of the Organization for Economic Co-operation and Development, Dr. Angel Gurría, was kind enough to explain this last point to me shortly after my arrival at the staff of the Joint Committee on Taxation. I asked him a convoluted question about how to determine the best mix of positive taxes and tax subsidies to implement a particular energy policy. "Look," he said, "it's very simple. Governments aren't very good at picking winners, but they do know how to tax. Just tax what's bad [e.g., externalities], and let the markets sort out what's good."

69. Daniel Shaviro has developed these themes at length. *See generally* DANIEL N. SHAVIRO, TAXES, SPENDING, AND THE U.S. GOVERNMENT'S MARCH TOWARD BANKRUPTCY (2007).

70. *See generally* Staudt, *supra* note 60.

In the same vein, "permanent" tax subsidies are not subject to any sort of review or oversight by the congressional committees charged with substance-matter expertise, and there does not exist any comprehensive congressional efficacy review program for tax subsidies. So tax expenditures, once implemented, are essentially unmonitored by any arm of Congress, and they simply disappear below the surface into the mainstream of baseline revenues.

One response to our collective overuse of tax expenditures is to ensure that these subsidies are paid for through revenues obtained elsewhere. In this regard, Professor George Yin recently published an interesting paper arguing that the appropriate response to some of these issues is to rely more, not less, on temporary legislation.[71] Professor Yin argues that the budget process fails to account for the actual cost of so-called "permanent" tax legislation.[72] By contrast, in a PAYGO world, temporary legislation must be "paid for" each time it is renewed.[73] As applied to tax expenditures, temporary effect legislation thereby puts tax subsidies into a position comparable to that of explicit spending, and requires that each be paid for, not just once, but rather on an ongoing basis.[74]

Professor Yin's paper is a very helpful addition to the literature. It provides an excellent overview of the interaction of the tax legislative process with Congress's budget rules. The paper also forcefully demonstrates that the budget process, with its fixation on undiscounted ten-year revenue estimates, presents a horribly flawed picture of the costs of many policies and is easily gamed.[75] Moreover, the artifice of the ten-year budget window itself distorts

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71. *See* Yin, *supra* note 45, at 174.

72. *See id.*

73. *See id.* at 226-27.

74. *See id.* at 226-31.

75. *See* Cheryl D. Block, *Budget Gimmicks*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY 39 (Elizabeth Garrett, Elizabeth A. Graddy, & Howell E. Jackson, eds., 2008); *see* Cheryl D. Block, *Congress and Accounting Scandals: Is the Pot Calling the Kettle Black?*, 82 NEB. L. REV. 365 (2003) (for a comparison of congressional budget practices to private-sector accounting scandals); *see also* Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Processes*, 43 B.C. L. REV. 863, 916 (2002) (laying out more examples of budget accounting gimmicks and outlining how combination of repealing installment sales reporting and then 'repealing the repeal' effectively was scored for PAYGO purposes as if it were a net revenue raiser, through the mechanism of arbitrarily resetting the sequester meter).

To take one simple example, current budget rules require the preparation of estimates of the revenue consequences of proposed tax legislation for the first five-year period following enactment, and for the first ten-year period (but not separately for the second five year period). PAYGO principles then are applied to each of these periods. In practice, however, Congress has essentially read out of its own rules the application of PAYGO principles to the five-year budget window through a simple artifice. If proposed legislation is revenue neutral over the ten-year budget window, but not over the first five years (as PAYGO requires), Congress simply decrees that corporations will be required to make a specified portion of their year six corporate estimated tax payments in year five, thereby plugging the hole in the first five years, without the shape of substantive legislation, most famously in the bizarre 2001 phase-out of the estate tax to zero in 2010 and its scheduled restoration to its original form in 2011.[76] Professor Yin's remedies are more robust estimating processes applied to temporary tax provisions. By contrast, I believe that this framing of the problem understates both the economic and political corrosiveness of tax expenditures.

I have discussed the economic point earlier in the context of Freedonia: even perfectly calculated "payfors," like all taxes, have costs in the form of deadweight loss. In theory, there is no difference between explicit spending coupled with a revenue payfor, on the one hand, and a tax expenditure of equal magnitude paired with the same payfor, on the other. In practice, however, the two are not comparable: the first is presented as a budget and political matter as a tax increase (more accurately, a "tax and spend" proposal), while the second (like the WSCT) is not observable at all, because the Government, which in fact has grown, is presented as constant in size. So, paying for tax expenditures, even regularly, will not impel Congress to restrict their use only to those cases where the tax system really is the superior delivery mechanism for the subsidy in question. The annual accretions of payfors have economic efficiency consequences. Moreover, the fundamental issues of the size and functions of government will remain invisible in the budget and revenue neutral tax legislation.

While I agree with much of Professor Yin's analysis, I respectfully disagree with his proposed remedy, which is to require that tax legislation have only temporary effect.[77] If a tax subsidy is a good idea, we can capture economic efficiency gains by permitting taxpayers to count on its continued availability. Otherwise, the pricing of the good in question will reflect the uncertainty of the subsidy's continuation – a phenomenon clearly visible, for example, in the wind and solar power industries, which rely on a "temporary" tax subsidy for their existence. Industry participants, including suppliers like

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affecting the ten-year numbers.

Without more, this would cause great anguish within the corporate sector, which effectively would be required to make interest free loans to the government in the form of artificially accelerated estimated tax payments. But a couple of years later, when both legs of the corporate estimated tax timing shift fall inside the first five-year period, Congress can (and does) reverse the prior acceleration, without any budget implications.

76. *See, e.g.*, Yin, *supra* note 45, at 194-95; *see generally* Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335 (2006) (disputing the purpose of sunset provisions).

77. In fairness, Professor Yin's paper does not make a specific proposal but rather argues in general that temporary effect legislation is superior to permanent effect legislation in capturing the budget costs of the proposal and does not have as many negative implications as previous authors have suggested. *See* Yin, *supra* note 45, at 178, 253-55.

wind turbine manufacturers, are subject to violent swings of fortune as the fate of the subsidy periodically teeters: the result is that the industry is smaller, and its cost of capital is higher, than would be true if there were greater certainty in the program.[78] Moreover, I do not agree that temporary-effect legislation will reduce the present value of tax subsidies to legislators angling for campaign contributions when viewed through the prism of "interest-group" theory.[79]

I also do not believe that increasing the number of temporary provisions in the tax law will lead to superior legislative review or processes.[80] The fact is that temporary tax subsidies are not reviewed for substance when they are renewed. Instead, the entire herd of "extenders" is paraded through the legislative process as a unit, and just as good cowboys do not lose many yearlings, it is virtually unheard of for an "extender" to be separated from the rest of the herd and not renewed.[81] For that reason, the regular "extender"

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78. *See id.* at 244-45 (for a discussion of this issue, in which he argues that a strand of economics literature supports the view that temporary rules can actually lead to more, rather than less, investment). Observations of actual experiences of the renewable energy industry stand in contrast to this theory. In any event, the issue is not more or less investment, but rather the distortions in investment levels introduced by tax policies.

79. *See id*. at 244 (arguing that "interest-group theory" may reduce transaction costs and is not a complete windfall for potential benefited parties and politicians); *see generally* Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C.L. REV. 1159 (2006) (discussing interest-group theory). My reasoning is simply that so-called permanent legislation is only marginally more "permanent" than is temporary legislation and rational buyers will discount the value of "permanent" benefits they obtain through the legislative process to reflect uncertainties about how future Congresses will act. Temporary legislation, by contrast, can be analogized to an annuity for legislators and lobbyists, if one accepts the interest-group premise that legislators are motivated to extract rents from the private sector in this fashion. *See generally* Garret, *supra* note 11, at 526-36 (for an extensive discussion of the political dynamics of temporary effect legislation in a PAYGO environment).

80. Professor Yin acknowledges as much himself. *See* Yin, *supra* note 45, at 250.

81. One example of an extender that was separated from the herd was the exclusion provided in section 120 of the Internal Revenue Code for amounts contributed by an employer to a group legal services plan; the rule was added in 1976, and expired for taxable years beginning after June 30, 1992. I.R.C. § 120 (2009). Another is the tax credit formerly provided by section 46 for ocean thermal projects, originally added in the Crude Oil Windfall Profit Tax Act of 1980, and which expired in 1990. An early wind and residential solar power credit expired in 1985. *See* STAFF OF THE J. COMM. ON TAX'N, 101ST CONG., 2D SESS., PRESENT LAW AND BACKGROUND RELATING TO FEDERAL ENVIRONMENTAL TAX POLICY 32-33 (COMM. PRINT 1990). Wind power now is subsidized through section 45's production tax credit, and solar through the section 48 investment tax credit. *See* I.R.C. §45 (2009); I.R.C. § 48 (2009). The relative obscurity of each proves my point. There are also of course examples of poorly targeted tax expenditures that were substantially revised or revoked because they produced unintended benefits to some taxpayers, that is, they could fairly be identified as "tax loopholes, and other examples of redirected expenditures. The tax credit formerly provided by section 29 for electricity produced from unconventional sources, partially replaced by section 45's production tax credit, arguably is an example of both, in that the new law was rewritten to address perceived abuses in credits claimed for electricity produced from coal that had been subjected to immaterial reprocessing. I.R.C. § 29 (2009) (transferring I.R.C. § 29 to I.R.C. § 45(K)). The removal of solar power from section 45 and its relocation in section 48, or the replacement of the former section 220's

package now numbers six or seven dozen. The tax subsidies may be paid for, but scant attention is paid to the question of whether we are buying anything the least bit useful.

More generally, if one agrees that today's budget process mismeasures the actual costs of proposed legislation and also distorts the substantive terms of that legislation, the solution is to fix the budget measurement processes, not to require Congress only to enact temporary rules. The process could, for example, rely on long-term discounted present value calculations for the cost of legislation, in addition to short-term cash flow figures.[82]

My larger theme, however, is complementary, not competitive, to Professor Yin's. He emphasizes how the current budget process mismeasures the cost of tax legislation.[83] My emphasis, by contrast, is on the policy distortions attendant on our overreliance on tax expenditures as a policy instrument. More robust estimating processes will neither resolve the deadweight losses associated with perfectly revenue neutral tax legislation riddled with new, temporary tax expenditures, nor dissolve the miasma of fiscal illusion that tax expenditures permit.

About 15 years ago, Professor Edward Zelinsky made observations roughly similar to mine concerning the shift toward implementing spending policies through tax expenditures, but he drew from it completely different conclusions.[84] He argued that tax expenditures had one great procedural advantage over explicit spending: substantive congressional committees were more likely to be captured by the industries they oversee than are the tax-writing committees.[85] Further, an industry's scrutiny of the substantive committees relevant to that industry was likely to be closer than its scrutiny of the tax-writing committees. As a result, he argued, tax expenditures are more likely to be objective and serve broader national interests than are spending measures coming from substantive committees.[86]

Other thoughtful commentators (who I believe have the better of the argument) have come to precisely the opposite conclusion to that reached by Zelinsky with respect to the tax-writing committees' success in avoiding

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"Archer Medical Savings Accounts" with section 223's "Health Savings Accounts" are examples of the latter. I.R.C. § 223 (2009).

82. Professor Yin makes a similar suggestion as an alternative to his proposed solution. *See* Yin, *supra* note 45, at 213.

83. *See id.* at 208.

84. *See* Edward A. Zelinsky, James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions, 102 YALE L.J. 1165, 1166 (1993).

85. *See*, *e.g.*, *id.* at 1176-77.

86. "In pluralist terms, the decisions of the tax panels possess greater legitimacy than those of the agriculture committees [Zelinsky's running example] because more numerous and more diverse clienteles shape the former than the latter." *Id.* at 1177.

capture by clienteles.[87] Even taken on its own terms, Zelinsky's analysis proves to be too much. If Madisonian pluralism is better served by relying on the "generalist" tax-writing committees rather than "specialist" substantive committees (because the latter are more likely to be captured by special interests), why rely on committees at all? Why not refer every bill to the committee of the whole? I believe that today, at least, industries follow the tax-writing committees at least as closely as they follow the substantive committees. Moreover, any lobbyist in this town can easily tell you which member of a tax-writing committee is the "go-to" person for a particular industry when it wants tax subsidies or protection from tax increases.

My larger objection to Zelinsky's argument is that it presupposes that we should choose between government monies doled out by specialist committees on the one hand, with all the risk of capture by clienteles that it implies, or government monies doled out by generalist tax-writing committees on the other. That view understates the real issue: how can we ensure that there is at least a presumption against government intervention in the allocative function of private markets without a persuasive reason, such as demonstrated externality, to do so? To address that issue, we require real visibility of all Government expenditures, real competition within Congress for scarce public resources. That competition in turn is the best way to limit as well as to allocate those resources.[88] The last section turns to considering how this goal might be accomplished.

VI. CONTAINING THE GROWTH OF TAX EXPENDITURES

Why have the other committees of Congress allowed their own relevance to be diluted in the manner that I have described? Why do the committees with substantive responsibility for energy policy, for example, tolerate a situation in which 63 percent of all federal energy subsidies and support are routed through the tax system?[89]

Here, I can only offer three tentative observations. First, the other attractions of tax subsidies are simply too irresistible for Congress as a whole to restrict their use. Those attractions include the minor virtues described earlier (permanent authorization, or at worst semi-automatic renewal, self-certification by users, etc.), but they most importantly reflect the ability to spend money invisibly, at least as reflected in standard budget rhetoric. Second, the

87. *See*, *e.g.*, Staudt, *supra* note 60, at 1212 (stating tax writing committees are "notorious for pandering to special interests to the detriment of unorganized and diffuse groups[ ]").

88. See Elizabeth Garrett, *Rethinking the Structures of Decision making in the Federal Budget Process*, 35 HARV. J. ON LEGIS. 387, 415-16 (1998).

89. The figure is derived from 2007 data in the EIA Report ($10.44 billion tax subsidies ÷ $16.581 total of all subsidies and support). EIA Report, *supra* note 57, at xii, tbl. ES1.

phenomenon of logrolling – actually a technical term of political science, not an aspersion – may be at play.[90]

Third, and very interestingly, the role of congressional committees is in the process of rapid evolution. As a recent article points out:

> Since the 1970s and '80s, the once-mighty committee system controlled by autocratic chairmen has crumbled. Instead, power has been centralized in recent decades in the leadership, with major legislation often written ad hoc by party leaders working with a few key chairmen or other members behind closed doors, outside of the committees.[91]

While the same article goes on to acknowledge the continuing relevance of inter-committee turf wars,[92] it does seem to be the case that congressional committees with substance-matter responsibilities have waned in influence at the expense of party leadership, the budget committees, and the appropriations committees.[93] My argument today is that the tax-writing committees also have found a way to assert greater influence over substantive legislation, through the adroit use of tax expenditures to drive government interventions in a broad array of social and economic arenas while avoiding significant congressional scrutiny of the choices those committees have made.[94] As a result, it may be the case that leadership and the budget committees are willing to "green light" revenue neutral tax legislation for the first two reasons noted, and in doing so

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90. Logrolling is defined as "mutual aid among politicians, as by reciprocal voting for each other's bills." WEBSTER'S NEW WORLD COLLEGE DICTIONARY 795 (3d ed. 1997).

91. Richard E. Cohen, *Can the Committee System Handle Obama's Ambitious Agenda*?, NAT'L J., May 2, 2009, at 36.

92. *See id.*; *see also* Matthew M. Johnson, *Committees Push Competing Bills to Protect Power Grid from Cyber-Attack*, CQ TODAY, May 1, 2009, at 11 (providing an example of continuing inter-committee rivalries that arise virtually every day).

93. *See generally* William G. Dauster, *The Congressional Budget Process*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY 4-35 (Elizabeth Garret et al. eds., 2008) (providing an excellent summary of how the budget process now favors the budget and appropriations committees, as well as leadership, over the committees with substantive responsibilities); *see also* Alan L. Feld, *The Shrunken Power of the Purse*, 89 B.U.L. REV. 487, 493-94 (2009) (for an argument that the House Appropriations Committee in particular has lost much of its former authority); Westmoreland, *supra* note 63, at 1601-02 (providing an argument that the budget process elevates the budget and, by implication, the budget committees to primacy in the legislative process).

94. As one small example, Dauster explains how a reconciliation bill can direct a taxwriting committee to recommend new legislation that raises a specific dollar amount in new tax revenues. *See* Dauster, *supra* note 93, at 27. At the same time, the instructions may impose limits on how much in new spending within its jurisdiction the committee can recommend. While the "fungibility rule" permits limited tradeoffs between tax and spending programs within the tax-writing committee, tax expenditures would appear to permit unlimited tradeoffs, by allowing the tax-writing committee to create new spending programs, so long as the overall tax objectives of the reconciliation bill are met. *See id.* at 27-28.

are willing to address any institutional objections by legislative committee chairmen in the informal manner suggested by the quotation.

Finally, if one agrees that tax subsidies are perfectly useful and appropriate tools of congressional policy in certain circumstances, but are being systematically overused in ways that materially distort policy decisions, budget presentations, and government resource allocations, the question becomes: what can be done about it? If my analysis is correct, and the irresistible political attraction of tax expenditures lies in their invisibility to normal inspection of the budget, the most important step toward a solution would be to require that all items identified by the JCT staff as tax subsidies (applying the methodologies the JCT staff elaborately articulated in its 2008 publications on the subject) be recorded as spending for *all budget purposes*.[95] That is, tax subsidies not only would be presented as spending in future budgets, but would go through the same legislative processes as do explicit spending proposals, including referral to the appropriate authorization committee.

This proposal essentially would formalize Stanley Surrey's original tax expenditure agenda,[96] but would exclude the cloud of the normative tax system that Surrey sought to introduce as the baseline (thanks to the work done in the *JCT Reconsideration*). It would do so, not in the form of a separate and easily-ignored appendix, but on the face of the budget itself. We would, for the first time, explicitly recognize that the 2008 budget contemplated a $3.7 trillion tax system (against $2.5 trillion as shown in the actual budget) and showed 2008 spending more in the range of $4 trillion, rather than the $3 trillion we usually reckon.[97]

The proposal goes further than simply changing the footings in the Government's accounting statements. By making tax expenditures explicit spending programs for purposes of the legislative process, we can accomplish both objectives identified at the end of the previous part.[98] The size of government – its handprint on the private economy – would no longer be hidden, and the authorization committees which have substance-matter responsibilities in turn would be required to compete to implement their programs, because those committees do not have appropriations authority, and thus cannot behave like a *Congress within the Congress*.

In short, the best practical constraint on legislative largess that I can see is

95. I have left for another day whether the measure of those "on budget" equivalents should be tax-effected, to reflect that some at least would be includible in taxable income if actually recast as explicit spending. This is a second order issue, at most.

96. *See generally* Stanley S. Surrey & Paul R. McDaniel, Tax Expenditures (1985).

97. *See* Congressional Budget Office, Revenues, Outlays, Deficits, Surpluses, and Debt held by the Public, 1969-2008, March 2009, *available at* http://www.cbo.gov/ftpdocs/100xx/doc10014/March2009_Historical Tables.pdf.

98. *See supra* Part V.

the open and highly visible competition, among specialized committees, for the dollars made available in the budget resolutions and appropriations bills. Bringing tax expenditures explicitly "on budget" accomplishes this. In addition, the active involvement of specialized authorization committees offers at least the glimmer of hope that knowledgeable staff will design and monitor the programs their committees propose, both to avoid scandal and to maximize the utility derived from the funds allocated to their committees.

By contrast, current practice, evidenced by "revenue neutral" tax legislation and replete with new tax subsidies paired with tax increases, fulfills neither of these objectives. The process is expressly designed to avoid leaving any visible imprint on the budget, and the programs so favored have not been forced to compete with other spending programs for scarce Government resources in other committees or among the members as a whole. The "revenue neutral" package is analyzed as simply summing to a net zero impact and is accepted by the floor as a unit, rather than having its constituent parts examined with the care that would be devoted to debating a package of explicit spending proposals offset by explicit tax increases.

One can design a slight variation on my proposal that might be more sensitive to political realities, in particular the fact that the tax code always has, and always will have, some irreducible base of tax expenditures. This variation would cap "unarticulated" tax expenditures, by which I mean those that are invisible in the formal budget as under current law, at a percentage of the previous year's GDP. The variation would also require that all tax expenditures above the cap to be expressed as explicit spending. For example, we could cap unarticulated tax expenditures at their 1974 level of 5.7 percent of GDP.[99] As previously described, this cap would bring on budget, as explicit spending for Fiscal Year 2008, over $400 billion of tax expenditures.

I would go one step further and also require that the tax-writing committees not be permitted to take up a tax subsidy measure without referral from the relevant authorization committee with substance-matter jurisdiction. The substantive committee, in turn, would be required periodically to recertify that the subsidy should be renewed. By introducing this measure, substantive oversight and policy design would be centralized in the committee charged with maintaining substance-matter expertise in the area.[100] The larger agenda is to elevate the role of the authorization committees (those with substance-matter responsibility) to serve as the clearing house for *all* proposals touching on their area of competence. My hope would be that by doing so they might serve as a

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99. *See* Hungerford, *supra* note 46, at 326, fig. 1.

100. This suggestion has similarities to an earlier paper by Elizabeth Garrett, which argued for a more "functional" approach to budgeting, and, importantly, recognized tax expenditures as a component of the relevant budget functions. *See* Garrett, *supra* note 88, at 389.

better counterweight to the budget, appropriations, and tax-writing committees. Additionally, I hope that they might, over time, use their collective deeper familiarity with the substantive areas, for which they are responsible, to improve policy decisions. In turn, the division of power within Congress will mean that they will not, by themselves, be able to implement those policies to the extent that federal revenues must be raised or funds appropriated.

VII. FURTHER WORK

To summarize, tax subsidies have grown in importance to a size probably unimaginable to Stanley Surrey, the principal parent of tax expenditure analysis. The current congressional appetite for tax expenditures has distorted not just tax policy, but also the budget process and congressional oversight of the money it spends. The tax-writing committees have employed tax expenditures to extend the committees' reach and to become, in fact, a *Congress within the Congress*, presenting new spending policies embedded in "revenue neutral" tax legislation in ways that are largely invisible in standard budget presentations. It is time to redirect tax expenditures to those cases where they represent the most appropriate technical delivery mechanism for Government spending.

My presentation has touched on at least three important themes that deserve more rigorous examination. First, how has the composition of tax expenditures changed over time? Is the growth that I have described evenly distributed, or instead, have tax expenditures grown disproportionately in only a handful of other areas?[101] Second, how precisely does the United States use tax expenditures when compared to countries that are members of the Organization for Economic Co-Operation and Development? Finally, if I have correctly identified the core problem – the fact that tax expenditures lead to fundamental misrepresentations of the size and activities of the Government – what practical solutions might be developed beyond (or in place of) the tentative suggestions that I have offered?

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101. This analysis would continue pioneering work done by John Witte. *See generally* JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX (1985).