

TAX EXPENDITURE FRAMEWORK LEGISLATION

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Explicit federal outlays are determined through elaborate budget procedural rules (framework laws), but tax expenditures in many respects fall outside these established Congressional procedures. The preparation of the annual federal budget therefore privileges tax subsidies over outlays, even though each can substitute for the other. As a consequence, tax expenditures have become the preferred vehicle for delivering new spending programs. Moreover, the low salience of tax expenditures clouds understanding of the government's allocative interventions among not only the public but also many policymakers. This paper considers how tax expenditures might be brought more directly into the federal budget-setting process. The analysis considers three types of tax subsidies — fixed-dollar allocations, subsidies that are open-ended but offered for a fixed term, and subsidies that are both open-ended and indefinite in term. Just as the federal budget today follows different processes for discretionary spending (appropriations) and direct expenditures (entitlements), so too it is necessary to develop different framework rules for fixed-dollar and uncapped tax subsidies.

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I. INTRODUCTION

A. Salience of Tax Expenditures

Tax expenditures have been closely analyzed in the United States for over 40 years, but the U.S. Congress has failed to consider them explicitly in its budget decisions.¹ Well-designed “framework” legislation (a law setting out the ground rules for considering substantive legislation) provides processes and information to enable Congress to conduct a disciplined debate on the size and contents of the federal budget — that

¹ Joint Committee on Taxation (JCT) (2008a) reviews the voluminous tax expenditure literature. As a matter of disclosure, the author was chief of staff of the JCT at the time the cited paper was prepared.

is, the terms under which the federal government will provide public goods and intervene in the private sector. Explicit federal outlays in fact are developed through such a process, but current budget frameworks are incomplete, because they largely ignore tax expenditures.

By excluding tax expenditures from the reach of most budget framework processes, Congress privileges tax expenditures over explicit spending. In doing so, Congress largely ignores the social costs of using tax subsidies to distort private sector allocations of goods and services, and the deadweight loss of higher taxes used to pay for these subsidies (Kleinbard, 2010). And at the same time, Congress both operates through and capitalizes on the prism of fiscal illusion.

Tax expenditures are thus extraordinarily low-salience policy instruments, which explains why Congress has come to rely on them expansively. Tax expenditures in fact have become the preferred vehicle for delivering new spending programs — even appropriation-equivalent programs — in cases where the tax system offers no particular advantage as the delivery mechanism.

The low salience of tax subsidies is not fully addressed by Congressional “Pay-As-You-Go” (PAYGO) procedures, because a PAYGO-compliant tax subsidy combined with a revenue offset is falsely described for budget purposes as if nothing had changed, rather than as a new form of allocative intervention by the legislature (Shaviro, 2004). In theory, there is no difference between new explicit spending coupled with a revenue “pay for,” and a new tax expenditure of equal magnitude paired with the same “pay for.” In practice, however, the two are not comparable, because the first is presented as a federal budget line item and as a political matter as a tax increase (a “tax and spend” proposal), while in the second the government is presented as constant in size, when in fact its handprint on the private economy has grown as much as in the first case (Kleinbard, 2010).

Imagine, for example, that the recent “Cash for Clunkers” federal subsidy (a lump sum made available to individuals who traded in old and inefficient automobiles for new more efficient vehicles) was instead developed by the Congressional tax writing committees as a “Refundable Tax Credit for Clunkers” program. The allocative effect would have been essentially identical, but the program would not necessarily have competed on a level playing field with other stimulus proposals for funding, and the program itself would not even have appeared as a component of the federal budget’s expenditures for the year.

The data suggest a consistent pattern of increasing reliance on tax expenditures, interrupted principally by the base-broadening convulsion of the Tax Reform Act of 1986. In 1974, when federal accounting for tax expenditures was first officially adopted, the simple sum of all tax expenditures amounted to 5.7 percent of GDP.² By fiscal year 2008, the simple sum of all tax expenditures had reached an extraordinary 8.6 percent of GDP.³ The list of tax expenditures published in Joint Committee on Taxation (2008b) comprised 247 tax expenditures, the simple sum of which for fiscal year 2008 totaled some \$1.2 trillion

² These figures come from the data underlying Figure 2 in Hungerford (2009).

³ Dr. Hungerford has confirmed to the author that the 2008 entry in Figure 2 was based on preliminary data, and that the correct entry should be 8.6 percent.

(Congressional Research Service, 2008). This sum is greater than the entire amount of revenue 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 (Congressional Budget Office (CBO), 2009). Indeed, it is more than twice as much as all nondefense discretionary spending in 2008 of \$522 billion (U.S. Office of Management and Budget, 2010).

The 2008 figure is very close to the situation in 1985 (i.e., immediately prior to the passage of the Tax Reform Act of 1986), when tax expenditures amounted to 8.7 percent of GDP (Hungerford, 2009).⁴ At the same time, explicit discretionary spending 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 (Hungerford, 2009). 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 \$412 billion lower than the actual estimates.

Tax expenditures can be the most efficient means of delivering certain government subsidies, but it is greatly improbable that optimal policy design explains why the aggregate growth in tax expenditures has outstripped the growth in explicit government spending. The more straightforward explanation is that the ever-increasing reliance on tax expenditures to deliver government programs is a symptom of an institutional weakness in the design of current federal budget processes. New tax expenditures are not constrained at all by the tax expenditure budget or the spending targets of the Budget Resolution, and are only partially constrained by the latter's revenue targets. Existing tax expenditures hide in plain sight, appearing in the operative Budget Resolution only as an undifferentiated component of baseline revenues. The low salience of tax expenditures, when compared with the spending programs for which they substitute, affects not only public perceptions but also Congressional consideration. What is needed now is to shift focus away from the identification of the tax expenditure problem to the specification of a budget framework solution.⁵

B. Framework Legislation

The budget process, reflected in several statutes since the landmark Congressional Budget and Impoundment Control Act of 1974, is the best-known example of what Garrett has termed “framework legislation” Garrett (1998, 2005, 2006, 2008). Very

⁴ Aggregate tax expenditures as a percentage of all income taxes also were very similar in 1985 as compared to 2008 (87 percent in 1985 and 84 percent in 2008). (Total taxes as a percentage of GDP were 17.7 percent in both 1985 and 2008.) This is 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. In general, 2008 was a much lower tax rate environment than was the case in 1985: for tax expenditures today to be 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.

⁵ One recent paper that also focuses on specifying a possible procedural solution is Yin (2009). Kleinbard (2010) describes some points of disagreement. The most important for present purposes is that Yin's solution would not directly address the low salience of tax expenditures in the PAYGO environment, when those forms of synthetic spending are combined with revenue offsets and presented to the Congress as a whole, and the public, as budget “nothings.”

simply, the term describes a statute that embodies internal rules of procedure by which a legislature goes about developing substantive legislation in a specific area. Framework legislation helps legislatures to develop substantive outcomes — for example, how much money the government should spend and raise in taxes in a year — but does not directly dictate those substantive outcomes.

Framework legislation is sometimes called a “precommitment” mechanism: the legislation’s procedural rules and timetables are specified in advance of knowing the specific legislation or substantive issues to which the framework will be applied (Kysar, 2006). Because framework legislation ordinarily is developed in an environment removed from the drama of any particular contentious substantive debate, legislatures can adopt processes that improve their ability to come to a substantive resolution, without prejudging how the processes will affect any particular outcome. The result, it is hoped, is a higher-quality final legislative product.

Framework laws ordinarily are designed to apply only to new policies. To take one example, in 1995 Congress adopted the Unfunded Mandates Reform Act of 1995. The 1995 statute adopted new framework rules aimed at discouraging the natural inclination of Congress (if unimpeded) to “enact more unfunded mandates than is socially optimal because of a fiscal illusion” (Garrett, 2008). The new unfunded mandates framework legislation has affected the outcomes of subsequent legislation, but has not been employed to tabulate the costs of pre-existing unfunded mandates, with a view to revisiting their wisdom or fairness.

Framework legislation may itself not resolve substantive controversies, but of course framework legislation directly affects those substantive outcomes, albeit in ways that ordinarily are opaque to legislators at the time the framework rules are adopted. One need only look to the 2009 debates on healthcare for a vivid example of how framework rules (in particular, the rules of the Senate, which determine how that chamber will conduct debate) have driven substantive outcomes.

Federal framework legislation has the odd property of being nonbinding: although passed by both chambers of Congress and signed into law by the President, federal framework laws generally have no different status than the internal rules by which each chamber regulates its processes. As a result, each chamber of Congress can waive, modify or abandon the rules adopted in framework legislation, as it can do in respect of any other of its internal rules of procedure.⁶ Nonetheless, Members of Congress and

⁶ Framework legislation has at least three important practical advantages over the internal rules of each chamber of Congress. First, Congress appears more reluctant to waive the application of its own legislative frameworks than to do so for its internal rules of procedure; as a result, framework legislation can be more efficacious in channeling a substantive debate towards a resolution. Second, framework legislation can impose identical rules on each chamber; by contrast, the House of Representatives and the Senate adopt their own internal rules. Third, some remedies for breach of framework legislation protocols (e.g., the sequester mechanism employed to enforce budget agreements) can be implemented only through legislation. Nonetheless, given that the strictures imposed by framework legislation ultimately can be waived by either chamber, the difference between adopting a set of processes as law or as internal rules is one of degree, not kind.

the public alike see framework legislation as a stronger form of precommitment than internal rules.⁷

II. CURRENT TAX EXPENDITURE FRAMEWORK RULES

This section briefly describes current framework statutes (or analogous internal Congressional rules) that relate to tax expenditures, and demonstrates that they either are impotent or aimed at different policy concerns than ensuring a disciplined debate on government's allocative interventions in the private sector. Notwithstanding the regular publication of a "tax expenditure budget," tax expenditures hide from scrutiny in plain sight, both in the annual federal budget and in the presentation of new revenue legislation. Moreover, the internal Congressional rules restricting limited tax benefit legislation are routinely ignored. Finally, the PAYGO rules are designed to limit budget deficits, not spending as such; so long as revenue "pay fors" can be located, PAYGO does not limit the quantum of government subsidies delivered through the tax system.

A. The Tax Expenditure Budget

The phrases "tax expenditure" and "tax expenditure budget" first appeared in a 1967 speech delivered by Assistant Secretary for Tax Policy Stanley Surrey (Surrey, 1967). The speech defined "tax expenditures" in passing as "deliberate departures from accepted concepts of net income" that operated "to affect the private economy in ways that are usually accomplished by [explicit] expenditures." Surrey called for a "full accounting" of tax expenditures, in order both to encourage "expenditure control" and to facilitate "tax reform" (Surrey, 1967, pp. 322–323, 326).⁸ Thus, from the outset Surrey saw tax expenditure analysis as a budget tool as well as a device for advancing his tax policy desiderata.

Concurrently with Stanley Surrey's 1967 speech introducing the term "tax expenditures" to public discourse, the U.S. Department of the Treasury (hereafter, the Treasury Department) under his leadership released its first tax expenditure budget (U.S. Department of the Treasury, 1969). This document sought to identify "the major respects in which the current income tax bases deviate from widely accepted definitions of income and standards of business accounting and from the generally accepted structure of an income tax" and to provide "estimates of the amount by which each of these deviations reduces revenues." (U.S. Department of the Treasury, 1969, p. 327). In each case, a tax expenditure's cost was calculated as the revenues forgone by the provision in question, presumptively calculated on a "static" basis (that is, without regard to anticipated

⁷ The recent and ultimately successful effort to reinstate PAYGO as framework legislation rather than as framework internal rules is an example of the consensus view that framework legislation carries greater authority than do internal rules. The issue is discussed in Section II.C.

⁸ Surrey (1973) describes the uses of a tax expenditure budget.

taxpayer behavioral responses to the hypothetical removal of the tax benefit, other than changes in tax return filing elections). The 1968 effort was reprised in 1970.

The first tax expenditure budget had no formal role in the budget process, and the Bureau of the Budget had no great interest in the concept (Forman, 1986). The Senate, however, was an early subscriber to the idea (Surrey and McDaniel, 1976). The Senate version of the Revenue Act of 1971 would have required the inclusion in the budget of estimates of "losses in revenue" from provisions of the Federal income tax laws and also estimates of indirect expenditures through the operation of the Federal tax laws. The Senate receded from its amendment in conference after the Treasury Department indicated its willingness to supply the desired information to the Congressional tax writing committees as requested. In response to this Congressional interest, the Staff of the U.S. Congress's JCT and the Treasury Department issued a joint report on tax expenditures in 1972; it followed in form and concept the earlier work of the Treasury Department.⁹

Congress more formally embraced Surrey's concept of tax expenditure analysis in the Congressional Budget and Impoundment Control Act of 1974 (the "Budget Act").¹⁰ Consistent with Surrey's vision of expenditure control, the newly-constituted House and Senate Budget Committees were charged under the Budget Act with the duty "to request and evaluate continuing studies of tax expenditures, to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and to report the results of such studies" to the respective chamber of Congress on a recurring basis (P.L. 93-344 §101(c) and §102(a)). To assist in that effort, Congress directed the CBO, which also was created by the Budget Act, to produce an annual tax expenditure budget. Moreover, the Executive Branch was required to include a tax expenditure budget in the annual President's Budget transmittal to Congress.

In light of the traditional expertise of the JCT in respect of revenue matters, and a separate statutory requirement that Congress rely on JCT estimates when considering the revenue effects of proposed legislation, the CBO essentially delegated to JCT the production of the mandated annual tax expenditure publication. These arrangements continue to the present day.

The Budget Act contemplated that the Concurrent Resolution could address "such other matters . . . as may be appropriate to carry out the purposes of this Act" (2 U.S.C. § 301(a)(6)). Immediately following the passage of the Budget Act, proponents of tax expenditure analysis had reason to be optimistic that this authority could be used to subject tax expenditures to the same vetting to which explicit outlays were subject. These hopes went largely unmet, however, in large part because of the intransigence of the

⁹ The early history of the tax expenditure budget is described in more detail in Forman (1986) and Surrey and McDaniel (1976).

¹⁰ The Budget Act defined tax expenditures as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability, and the term 'tax expenditure budget' means an enumeration of such tax expenditures" (2 U.S.C. §622(3)).

Chairman of the Senate Finance Committee, Russell Long, who was unwilling to cede any authority to the new Budget Committees (Schick, 1980; Surrey and McDaniel, 1980).

For example, the Concurrent Resolution for Fiscal Year 1977 directed the Finance Committee to reduce tax expenditures by a specified sum. In response, Senator Long made an extraordinary appearance as a witness before the Senate Budget Committee, where he told his colleagues, "I am simply here to urge that the Budget Committee stay within its jurisdiction" (Schick, 1980). The bill reported out by the Finance Committee (which ultimately became the Tax Reform Act of 1976) came close to meeting its assigned net revenue target, but ignored the instruction to reduce tax expenditures, and relied instead on budget accounting gimmicks for its purported savings. And in 1977 an attempt to revise the Senate Rules to permit each authorizing (substantive subject-matter) committee to "study and review tax expenditures related to subject matters within its jurisdiction" was defeated, following objection by Senator Long.

Within a few years of the enactment of the Budget Act, the Senate Budget Committee apparently conceded defeat to the Finance Committee, by abandoning any effort to use the budget process to direct particular levels of tax expenditures. In a sense this was the defining moment for tax expenditure analysis as a budget tool, because the Budget Committee's retreat meant that going forward tax expenditure analysis would be employed solely as an informational tool, rather than a vehicle by which the Budget Committee could impose on the tax writing committees either a hard cap on new tax subsidies or a mandatory revisiting of existing ones. By contrast, the budget framework laws contemplate that the Budget Committees will establish through the annual Budget Resolution a firm ceiling on explicit discretionary outlays.

Today, the Budget Concurrent Resolutions simply establish revenue targets for the tax writing committees to meet. Surrey and McDaniel long ago conceded that "... within this figure the tax writing committees are free to raise or lower tax expenditures, constrained only by the [aggregate] revenue level figures established by the budget resolutions" (Surrey and McDaniel, 1985, p. 47). And on the spending side, the Budget Resolution's spending targets apply only to explicit government disbursements. Tax expenditures effectively fall between the budget cracks, as Paul McDaniel argued some years ago:

"Nonetheless, the budget process [i.e., the tax expenditure budget] has not proved an effective device by which to review, control, and coordinate tax expenditures with direct spending. The review of tax expenditures has been left to ad hoc actions by tax writing committees. Tax expenditures are largely uncontrolled by the budget process because no effective limits are imposed on them. The tax writing committees are not given directions by the budget resolution as to the level of tax expenditures for a given fiscal year. Instead, the committees are given an overall revenue figure that they are to meet. But they can meet this revenue target by increasing or reducing rates, personal exemptions, or the standard deduction for non-itemizers. Finally, there is virtually no coordination between tax expenditures and actions by the authorization-appropriations committees in the same budget area" (McDaniel, 1989, p. 178).

The tax expenditure budget remains an official part of the Budget process, but its role continues to be limited to that of information, rather than constraint, and the disputes between the tax writing and Budget committees of the mid-1970's do not appear to have been revisited. The information gleaned from the tax expenditure budget presentation arguably informs Congressional thinking on particular issues, and in this sense satisfies one goal of framework legislation: the process solves a collective action problem, by providing nonpartisan expert resources (e.g., CBO and JCT) to furnish objective information to the entire Congress and other interested stakeholders. But the result is not a "budget" in any normal sense of the word. The tax expenditure budget serves as simply a sort of hortatory memorandum account (and potential "pay for" fishing ground) in relation to the "real" budget shaped through the annual Budget Resolution.

B. Limited Tax Benefits

Congress also has adopted framework rules (as both statutes and internal rules) to deal with "limited tax benefits," more colloquially referred to as "tax earmarks." Limited tax benefits can be understood as special transition rules or other highly targeted tax expenditures where the principal intended recipients of the federal subsidy are few in number (typically, ten or fewer) and known to the legislation's sponsors.

Following what was perceived in retrospect to have been an excessive use of limited tax benefit provisions in the political deal-making attendant on fashioning Congressional support for the Tax Reform Act of 1986, the Congressional tax writing committees announced a policy of self-restraint in this area. In 1996, Congress formalized its practices by enacting the Line Item Veto Act, a framework statute aimed in part at imposing new procedural constraints on limited tax benefits. That statute required the JCT to identify any "limited tax benefits" in a new revenue statute; these were defined as revenue-losing provisions providing a tax benefit to 100 or fewer beneficiaries, or transition relief to 10 or fewer beneficiaries (unless the provisions fell into certain specified exceptions). The President then could use his new line-item veto authority conferred by the Line Item Veto Act to cancel any limited tax benefit, in which case the benefit would become effective only if both chambers of Congress overrode the veto.

President Clinton exercised his new line item veto authority to cancel several limited tax benefit provisions of the Taxpayer Relief Act of 1997. Litigation ensued, and the Supreme Court eventually ruled that the Line Item Veto Act was unconstitutional. As a result, the Act's procedures for reviewing limited tax benefits were abandoned.

In 2007, the House and the Senate each adopted internal rules designed to operate as frameworks to identify limited tax benefit provisions, and their intended beneficiaries. Unlike framework legislation, however, the two rules differ somewhat in their definitions, as well as in their quasi-legislative history.

The most remarkable difference between 1996's Line Item Veto Act and 2007's internal rules is that the rules adopted by each chamber in 2007 replaced a nonpartisan and expert resource (i.e., JCT) as the agent responsible for identifying limited tax benefits with self certification by the Chairman of the House Ways and Means Committee and

the Senate Finance Committee, respectively. Since legislation favorably reported by the two committees invariably reflects the desires of their chairmen, the result is the appointment of foxes to guard henhouses.

In 2007, for example, the Chairman of the Senate Finance Committee concluded that certain legislation designed to funnel several billion dollars to New York City through an ersatz tax credit mechanism was a limited tax benefit under the relevant Senate rules, but the Chairman of the House Ways and Means Committee, in a heated exchange with a member of the minority, refused to do so when the question was raised on the floor of the House. Instead, the Chairman maintained that, under the House rule, the identification of limited tax benefits was a matter solely within his discretion, so that his decision not to identify a tax provision as a limited tax benefit necessarily foreclosed any debate as to whether his ruling correctly applied the House rule.

The following year the Chairman of the Senate Finance Committee declined to identify as a limited tax benefit another ersatz tax credit provision designed to funnel \$250 million in federal funds to a real estate investment trust that had agreed to sell certain Montana timberlands to the Nature Conservancy and other conservation-oriented buyers. Among other conditions of the statute, lands eligible for the tax credit were required to be subject to a “native fish habitat conservation plan approved by the United States Fish and Wildlife Service,” of which only one such agreement was known to be extant.

C. Pay-As-You-Go Legislation

Current framework internal rules of the House of Representatives and the Senate generally require that any projected net costs from revenue or entitlement bills be “paid for” through offsetting revenue increases or entitlement cuts (the PAYGO rules). (PAYGO is irrelevant for discretionary spending, where the express dollar appropriations of the annual Budget Resolution define the available pot of money.)

In practice, the PAYGO rules today serve as the only precommitment procedural constraint on adding new tax expenditures to the Internal Revenue Code (or augmenting existing ones). PAYGO, however, fundamentally is aimed at policing deficit-control objectives, not ensuring that new government synthetic spending programs are fully vetted by the entire Congress. Explicit spending programs, by contrast, are subject to stricter rules.

For example, the Budget Act of 1974 creates a point of order in the Senate that prohibits consideration of legislation that exceeds the aggregate spending levels in the budget resolution for the current year or the budget year, or causes the aggregate revenue level to fall below the level in the budget resolution for the current year, the budget year, or the sum of the budget year and all subsequent years covered in the most recent budget resolution. Imagine, on the other hand, that the Senate is considering revenue legislation that contains a new tax expenditure that, if characterized as spending, would pierce the aggregate spending ceiling in the relevant Budget Resolution, but which tax expenditure is offset by a new revenue-raising measure. Because the proposal would comply with PAYGO, the revenues clause of the Budget Act would have no applica-

tion, and, precisely because tax expenditures are not treated as “spending” for budget purposes, the first clause also would not be triggered, despite the fact that the proposal was a direct spending substitute.¹¹

PAYGO has undergone many mutations over the years, sometimes finding expression as framework legislation, and sometimes as an internal rule of one or both chambers of Congress. So, too, the remedies for a PAYGO violation have varied, from a point of order at the time legislation is considered to sequestration of funds otherwise available for outlay. One critical difference between statutory and internal rules-based PAYGO is that only the former can invoke a sequestration (a hold-back) of otherwise-available outlays for spending programs as the mechanism for encouraging compliance with the PAYGO rules; however, during the 12 years (1990-2002) in which PAYGO sequestration could have been triggered (prior to that mechanism’s very recent revival), a sequestration of funds was never ordered.

The PAYGO framework statute effectively expired in 2002, only to be revived in February, 2010. In the 110th Congress, however, both chambers of Congress adopted internal PAYGO rules. The House version of PAYGO works on a bill-by-bill basis, while the Senate version is similar to prior statutory PAYGO rules, by judging each bill in relation to a scorecard that reflects the effects of all bills with PAYGO effects since the adoption of the most recent budget resolution.

The idea of PAYGO is to require a one-time matching of projected new entitlement program costs or tax reductions, with projected new revenue streams or entitlement program reductions. The budget process today contains no Procrustean rules for automatically adjusting direct spending (entitlement costs) to reflect weaker than projected revenues — or conversely, to automatically increase tax rates to reflect greater than projected entitlement claims.

In practice, PAYGO budget rules (whether statutory or rules-based) as applied to tax legislation contemplate that a proposed tax decrease be offset by a tax increase elsewhere. The different iterations of PAYGO rules do not apply to continuations of existing “permanent” entitlement or revenue programs.

For example, a new “permanent” tax expenditure, having been notionally paid for at the outset through some countervailing tax measure whose projected revenues equal the projected cost of the tax expenditure over the relevant budget window (generally, 10 years), is thereafter simply subsumed into the budget baseline. The financial consequences of the tax expenditure and its “pay fors” indirectly are tracked, but only in determining aggregate “baseline” projected revenues. The annual budget process then begins with that baseline, rather than scrubbing its components on some scheduled basis. (The ongoing financial consequences of a tax expenditure are separately recorded in the tax expenditure budget described above, but that is purely hortatory in effect.)

¹¹ Kleinbard (2010) describes the analogous issue where tax expenditures are not treated as spending for Senate rule purposes.

Under current House and Senate PAYGO rules, projected incremental revenues and projected incremental entitlement spending of PAYGO-compliant legislation must be in balance for the sum of the first five years after enactment, and for the sum of the 10-year period after enactment (but not the second five years on a standalone basis); in practice, budget accounting legerdemain has rendered the five-year test largely meaningless. Except in special circumstances, such as a reconciliation bill, to which the Senate's "Byrd rule" might apply, projected expenditures or revenues beyond the 10-year window traditionally have been ignored.¹² A relatively new Senate rule, however, does create a point of order against legislation expected to create long-term budget deficits exceeding \$5 billion in any specified 10-year period over the next five decades; this presumably could be used against non-reconciliation legislation designed to be revenue neutral over the first 10 years, when it is not expected to be revenue-neutral in a present value sense.¹³

When budget accounting gimmickry has proved insufficient to cause an inconvenient PAYGO constraint to vanish, Congress has often resolved the problem by simply waiving the bothersome rule.¹⁴ In the previous era of "PAYGO scorecards," and the threat of sequestration of otherwise disburseable funds if a negative scorecard was not remedied, Congress simply reset the scorecard to zero on multiple occasions, thereby effectively waiving the application of the entire sequestration process (Kysar, 2010). And in the 110th Congress, when PAYGO was a matter of internal rules rather than framework legislation, each chamber of Congress waived those rules in 2007 (before any of the fiscal crisis legislation enacted in 2008) in order to extend relief from the alternative minimum tax for millions of individual taxpayers for another year — despite having counted those future revenues in its budget resolution deficit projections.

On February 12, 2010, the President signed into law new PAYGO framework legislation, the "Statutory Pay-As-You-Go Act of 2010."¹⁵ This legislation reintroduces sequestration of outlays for certain mandatory spending programs (subject to numerous exceptions for some of the largest and most visible entitlement programs), but exempts

¹² The Byrd rule has several triggers, but in this context the rule is violated by legislation considered under a reconciliation process that would create or increase a deficit in the "out" years (those beyond the budget window specified in the relevant budget resolution). The Byrd rule is an interesting example of framework legislation in action. It applies only to the Senate, and its only enforcement mechanism is that a point of order on the Senate floor lies against legislation under consideration that violates the rule. Nonetheless it is incorporated in a statute (as section 313 of the Congressional Budget Act of 1974, as adopted in the Budget Enforcement Act of 1990). The Byrd rule not only does not apply to the House of Representatives, but also has no application to legislation that is not considered as a reconciliation bill.

¹³ The FY 2009 Budget Resolution added a new point of order in the Senate against any legislation that would cause a net increase in the deficit in excess of \$5 billion in any of the four consecutive 10-year periods (2020–2029, 2030–2039, 2040–2049, or 2050–2059). This rule is independent of the Byrd rule, and applies to all legislation. The new rule expires on September 30, 2017.

¹⁴ One very recent example is a press release from Senator Judd Gregg (2010), criticizing the Senate's waiver of PAYGO in respect of a \$12 billion tax and highway extension bill.

¹⁵ Orzag (2007) provides a helpful background on recent statutory PAYGO measures.

certain revenue and spending policies (such as continued alternative minimum tax relief and the Administration's proposed extension of certain expiring lower tax rates on individuals) said to total several trillion dollars over the next 10 years from the revived PAYGO protocols.¹⁶

D. Consequences of Current State of Affairs

PAYGO framework legislation or rules (or their close cousins, the Senate's special points of order relating to certain legislation that increases the deficit in "out" years) effectively are the only framework provisions that today limit tax expenditures at all. The PAYGO rules, however, have not been effective in limiting the number or value of tax subsidies, and the effects of those rules often are perverse.

1. *Limited Effectiveness*

Tax expenditures have steadily increased in number and magnitude since 1989, which year for this purpose can be taken as representing the fully phased-in implementation of the Tax Reform Act of 1986. Most of this growth has occurred since 2000, and can be explained in part by the expiration of statutory PAYGO strictures prior to the change in control of the Congress in 2006 — a phenomenon that admittedly cannot fairly be laid at the feet of the PAYGO concept. Even within the 1990s, however, tax expenditures trended steadily upwards, growing from roughly 5.4 percent of GDP in 1989 to 6.6 percent in 1999 (Hungerford, 2009). There are at least four factors at work that explain this.

First, as applied to the 1990s in particular, tax rates also trended up in this period. Higher tax rates generally make tax expenditures more valuable, because so many are designed as deductions or exemptions. This arguably points not to issues with PAYGO as a concept as much as it does to issues with how various tax subsidies are designed.

Second, even when PAYGO framework legislation or rules nominally are operative, Congress can waive them, and has regularly done so. The 2007 and 2008 legislation to extend alternative minimum tax relief for individuals are recent examples.

Even had Congress never waived PAYGO rules and tax rates had remained constant, tax expenditures probably would have crept up over time, as a result of the limitations of the current revenue estimating methodologies. As noted, the rules of engagement for revenue estimating look to a 10-year window, and do not take any sort of time value of money concepts into account. More generally, the simplistic accounting rules governing revenue estimates invite wholesale accounting gimmickry, which means simply that actual tax expenditure costs can be expected to rise while the legislation enabling those new subsidies can be described as PAYGO-compliant.

¹⁶ Like earlier implementations of statutory PAYGO (or, indeed, any framework law), the new legislation is ultimately optional in application, because it can be waived. In February 2010, for example, the Senate waived the application of the new PAYGO rule in approving a \$12 billion tax and highway bill.

Most important, PAYGO by design looks to budget neutrality, not to how that neutrality is achieved. Even if budget accounting methods were robust, tax rates constant, tax subsidies well designed, and PAYGO waivers nonexistent, tax expenditure utilization could be expected to trend upwards over time. The reasons are that tax subsidies (as an exercise in “not-taxing”) would remain privileged over explicit government spending in the budget process, and that PAYGO reduces the salience of spending through tax subsidies. The net result might not be larger deficits (if PAYGO worked perfectly according to its aims), but nonetheless would lead to a larger government, with higher real tax rates (and efficiency costs) imposed on those private sector activities that remained in the tax system, than might be appreciated by legislators and citizens alike (Kleinbard, 2010). The next subsection takes up these last two points.

2. *Perversity*

The perversity introduced by PAYGO comes in part from the distortion of the details of a tax legislative proposal (or package) to achieve an arbitrary revenue target, and in part from the implicit tradeoffs that PAYGO rules encourage between specific “targeted tax cuts,” on the one hand, and higher marginal rates, on the other. The first point is very important for tax policy generally, but the second is more relevant to this paper.

PAYGO framework rules have taught the tax writing committees how to increase spending on policies of their choosing through tax subsidies, but at the same time to couch the resulting legislation as “revenue neutral,” with the attendant implication that nothing much has changed. The result is a decrease in the salience of those government interventions to most observers (but not, of course, to the beneficiaries), and in turn a decrease in the salience of the tax costs incurred to finance those spending policies (Kleinbard, 2010). Lower tax salience is associated with bigger government (that is, a larger tax base) (Finkelstein, 2007).¹⁷ The end result is a classic example of fiscal illusion, in which arguably not just taxpayers but also many members of Congress underestimate the tax increases implicit even in “revenue neutral” legislation, by virtue of the way the legislation is framed. Members promote new spending programs as “targeted tax cuts,” and defend existing tax expenditures by framing their repeal as “tax hikes.”

One consequence of this predilection for 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 supported programs. In practice, we cannot even assure ourselves that tax subsidies and expenditure programs do not embody conflicting objectives.

Tax expenditures thus augment fiscal illusion, and fiscal illusion in turn drives poor policy (Shaviro, 2004, 2006). Because the straightforward facts are not presented in a

¹⁷ Finkelstein further points out that the efficiency consequences of raising taxes through low salience mechanisms are more ambiguous, and depend on taxpayer starting expectations about government revenue policies. Becker and Mulligan (2003) also review the issue.

straightforward manner, neither the public nor many policymakers can debate fairly the efficiency costs of a system whose spending and revenues are so successfully disguised.

Even the repeal of an existing tax expenditure and its replacement with a new one is not a budget “nothing”: if underlying policies favor the repeal of the first expenditure, then the fair question is, how should the incremental revenues from that repeal be allocated? But the change in spending policies from the old tax expenditure to the new one is invisible in the budget, and is explicitly considered (if at all) only in the tax writing committees.

Ironically, then, the PAYGO rules increase the persuasiveness of the fiscal illusion that “revenue neutral” legislation necessarily means that no one’s taxes have risen. At the same time, the annual accretions of revenue “pay fors,” particularly permanent revenue-raising items used to fund temporary tax expenditures like the research tax credit (which expenditures in turn are regularly extended, and require still more “pay fors” to do so) have economic efficiency consequences. Moreover, the fundamental issues of the size and functions of government will remain invisible in revenue neutral tax legislation. And PAYGO rules do not effectively restrict the use of tax subsidies only to those cases where the tax system really is the superior delivery mechanism for the subsidy in question.

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 both authorizing committees (those with substance-matter responsibilities) and tax writing committees. 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. In the same vein, “permanent” tax subsidies are not subject to any sort of review or oversight by authorizing committees (the Congressional committees charged with substance-matter expertise), and there does not exist any comprehensive Congressional efficacy review program for tax subsidies (Davis, 2009). So tax expenditures, once implemented, are essentially unmonitored by any arm of Congress, and simply disappear below the surface into the mainstream of baseline revenues.

Paying for tax expenditures, as a PAYGO environment requires, adds another unappreciated consequence, which in some ways is even more corrosive to the political process: it elevates the tax writing committees into a special status — one I previously have termed a “Congress within the Congress” (Kleinbard, 2010). The discovery by the tax writing committees that any spending program, even a fixed dollar grant program (like the low-income housing tax 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 search for “pay fors”), and they spend those revenues themselves, through the tax subsidies that they marry to the “pay fors” in shaping “revenue neutral” legislation.

The resulting bill is presented to the House or the Senate floor as revenue neutral tax legislation, but in fact 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.

III. DESIGNING TAX EXPENDITURE FRAMEWORK LEGISLATION

A. The Purposes of Tax Expenditure Framework Legislation

Garrett (2005) has proposed five principal goals that framework legislation might serve.¹⁸ The existing tax expenditure budget arguably has at least partially accomplished one of these objectives (providing neutral information for considering future substantive decisions), although of course there is room for improvement, particularly with respect to studies of the performance of tax expenditures in meeting their stated objectives, as opposed to the revenues forgone by them (Davis, 2009). What the current process lacks in particular are neutral rules to address the externalities induced by the current fiscal illusion that tax expenditures (particularly “paid for” tax expenditures) are costless. That is, the purpose of tax expenditure framework legislation should be to internalize those costs, by re-engineering the budget process to ensure that the costs associated with tax expenditures are subject to the same vetting process as are outright expenditures. In turn, developing such rules will require changing the balance of power within Congress, by addressing the “Congress within the Congress” phenomenon that (along with wholly-deficient accounting principles) is the core weakness of PAYGO legislation.

B. The Conditions for Adoption

Several preconditions must be satisfied for the adoption of tax expenditure framework legislation. First, there must be a palpable sense of urgency with respect to a concrete problem. Second, it must be possible to specify that problem in sufficient detail in advance of the consideration of any substantive legislation that Congress can have confidence that the legislation will operate on the intended cases, but not be triggered by unintended ones. This second condition is a predictive exercise, because framework

¹⁸ In Garrett’s formulation, framework legislation can serve any of the following: (1) enacting a symbolic response to a problem, (2) providing neutral rules for considering future substantive decisions, (3) addressing collective action problems (for example, through the adoption of procedures to develop costly information that serves the collective legislative good), (4) entrenching certain substantive policies, and (5) changing the balance of power within different constituencies in Congress. Of these purposes, the second and third resonate most strongly as serving important and objective long-term policy goals. Symbolic acts, for example, can in some cases affect substantive outcomes, but as Garrett emphasizes, only framework legislation can overcome the collective action problems that otherwise hobble the ability of a legislature to develop and evaluate reliable information on new legislative initiatives. In general, while acknowledging that all framework legislation is intensely political, this paper concentrates on the more objective attributes and uses of framework legislation.

legislation by definition is adopted in advance of the substantive legislation to which the framework legislation might apply. Third, the mechanism invoked by the framework legislation to address the problem must itself be perceived as neutral — that is, as not reflecting explicit political agendas. Of course the process in practice influences the outcome, but successful framework legislation typically cannot be described as overtly advancing the political agenda of one party or the other.

A palpable sense of urgency certainly should exist today, in light of the conjunction of the long-term fiscal outlook with the data summarized earlier on our steadily-growing reliance on tax expenditures. The overreliance on tax expenditures as an allocative tool corrodes tax policy and administration, and introduces economic inefficiencies probably not fully appreciated by members of Congress in their decision making, by virtue of the fiscal illusions that tax expenditures promote. Moreover, Congressional resource allocation policies are diffused, and sometimes contradicted, by the completely different paths followed by new spending programs and tax expenditures. Congress could therefore reasonably conclude that a relatively discrete problem exists, and that addressing the problem should be viewed as a matter of urgency.

Moreover, the problem can be defined with the kind of specificity and objectivity necessary to impel Congress to surrender some of its own autonomy to adopt a binding framework that would govern future consideration of new tax expenditures. Until recently, this would have been an impossible condition to satisfy, because even the tax expenditure work of JCT (a nonpartisan organization) was viewed by some as premised on unacceptable ideological conclusions as to the contours of the ideal income tax, dating back to Stanley Surrey's original formulation of the tax expenditure concept (Joint Committee on Taxation, 2008a). While this interpretation might be characterized as overstated, it was deeply felt.

Joint Committee on Taxation (2008a) reviewed the extensive tax expenditure literature, and considered the principal academic criticisms of tax expenditure analysis as previously implemented by the JCT and by the Treasury Department. To address the concerns of critics, JCT proposed a new taxonomy of tax expenditures.¹⁹ The new paradigm divided the universe of such provisions into two main categories: tax expenditures in a narrow sense, which were labeled "tax subsidies," and a new category that termed "tax-induced structural distortions." Joint Committee on Taxation (2008a) defined 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), and that collects less revenue than does the general rule. The tax subsidy tax base thus

¹⁹ More recently, JCT has announced that it will revert to its pre-2008 methodologies in presenting tax expenditure estimates (Joint Committee on Taxation, 2010). That publication explains that the decision was made in light of "the similarity of the two approaches, the generally more expansive list of provisions identified relative to the normal income tax baseline, and continuity with the historical approach of the Joint Committee staff since 1972" (Joint Committee on Taxation, 2010, p. 4). Given that (1) the 2008 application of the approach proposed in Joint Committee on Taxation (2008a) to the JCT Staff's annual tax expenditure estimates (as reflected in Joint Committee on Taxation (2008b) explicitly preserved continuity with prior work through supplemental tables, (2) Joint Committee on Taxation (2010) identifies only five provisions that appear on its "more expansive" list but not the 2008 categorization of tax subsidies, and (3) the new publication does not answer two decades of criticism of the "normal tax," the reasons proffered are not terribly convincing.

is constructed by asking what constitutes the general rule, and what is the exception, under actual present law.²⁰

Joint Committee on Taxation (2008a) created the second category of “tax-induced structural distortions” to incorporate important provisions previously identified as tax expenditures that could not easily be described as exceptions to a general rule of present law, because the general rule was not clear from the face of the Internal Revenue Code. JCT contemplated that tax-induced structural distortions would be analyzed solely under economic efficiency principles, and not from any normative perspective.

One benefit of separating tax-induced structural distortions from tax subsidies is that the division neatly dovetails with a critical condition for developing successful tax subsidy framework legislation. As noted previously, because framework legislation is developed prior to, and without direct knowledge of, the application to which it will be put, framework legislation must be reasonably specific in its scope, and its application must satisfy the preponderance of legislators as reasonably objective. The pre-2008 JCT definition of tax expenditures failed the first leg of this test, in that it did not articulate formal criteria that would be applied to categorize new revenue legislation, and the category of tax-induced structural distortions probably fails the second.

By removing tax-induced structural distortions from any tax expenditure framework legislation that is developed for budget purposes, one is left with rules governing the process for considering tax subsidies, in the sense used by Joint Committee on Taxation (2008a). This category can be defined with reasonable clarity. Moreover, tax subsidies fall more squarely within the ambit of the classic budgetary tradeoffs among competing allocative agendas than do tax-induced structural distortions.

If it chose to do so, Congress thus could develop framework legislation that would apply to proposed positive tax subsidies. The definition of “tax subsidies” could be based on the 2008 work of the JCT, and the legislative history could signal Congress’ assent to JCT’s 2008 categorization of tax subsidies — or conversely identify places where Congress expected that categorization to be revised. The new JCT definition, combined with the adoption through legislative history of its application at a particular moment in time (subject to such exceptions as Congress might describe) would provide both a reasonably precise definition and a rich set of precedent that could usefully inform the subsequent identification of new tax subsidies.

C. Identifying Tax Subsidies

One advantage of framework legislation generally is that it enables the Congress to invoke the assistance of nonpartisan and expert resources; that is, the framework also acts as a hook from which to hang an infrastructure of independent experts. Those independent experts are critical to giving Congress the information necessary to hold

²⁰ All but five of the individual items that JCT previously defined as tax expenditures by reference to its construction of a hypothetical “normal” tax remained “tax subsidies” in Joint Committee on Taxation (2008a).

informed debates. Moreover, there are good arguments that reliance on trustworthy experts to assist in framing, and offering solutions to, difficult questions can improve social welfare, even in the context of democratic decision-making (McCubbins and Rodriquez, 2005). The presence of qualified and trustworthy experts to act as resources to the legislature therefore can be expected to enhance the quality of legislation.

The identification of tax subsidies in new framework legislation can plug nicely into the existing expert budget infrastructure on which Congress already relies. Tax expenditure framework legislation can follow the format developed in earlier budget framework legislation, when Congress created the CBO to serve as an independent nonpartisan analyst of budget policies and author of economic and budget projections. Just as CBO estimates the budget consequences of all legislation, and CBO identifies and estimates the cost of unfunded mandates (as required by the Unfunded Mandate Reform Act), so too it could identify new tax subsidies in revenue legislation. Relying on the CBO to identify new tax subsidies in revenue bills will be unsurprising to members of Congress, and CBO's findings, while often the subject of grumbling, should not trigger political defections from the larger framework process.²¹

In summary, it appears feasible both to define the scope of those tax expenditure provisions subject to framework legislation (i.e., tax subsidies, as defined by JCT) and to specify a politically acceptable mechanism for identifying those tax subsidies in the course of the legislative process (i.e., CBO). It remains, of course, to propose the actual framework rules that would be invoked once a tax subsidy is identified.

D. Functional Categorization of Tax Subsidies for Budget Purposes

Analysts frequently have maintained that tax expenditures are functionally indistinguishable from explicit government spending (Surrey, 1973; Surrey and McDaniel, 1985). This observation is true, but sometimes is presented in an incomplete manner. If tax subsidies are to be assimilated into comprehensive budget framework legislation, it is important to consider more closely the types of spending programs to which different tax subsidies can be analogized.

The federal budget framework legislation adopted in 1990 (which basically remains the template for budget framework rules today) contemplates different rules for Congressional consideration of annual discretionary spending, on the one hand, and new direct (entitlement) spending or new taxes, on the other. The result can be visualized as two separate pipelines, with different schedules and different enforcement mechanisms for each.

²¹ Current revenue estimating framework rules for proposed tax expenditures are flawed and easily manipulated by the designers of new proposals (for example, through phase-in and phase out rules, or through floors or ceilings on benefits designed only to satisfy a revenue estimating target), but this observation more generally encompasses all revenue estimates. Certainly these rules should be revised, in particular to reflect time value of money principles and to forestall gaming the budget window period, but because this issue applies broadly to all revenue estimates, and because its exposition deserves a paper of its own, this paper does not develop this theme further. See Block (2002 and 2007).

In brief, Congress makes most discretionary spending decisions on an annual basis through the appropriations process. Even long-standing discretionary spending programs must be re-appropriated every year. The annual Budget Resolution in turn ignores a cap on aggregate appropriations.

Direct spending (entitlement) programs, by contrast, generally are not appropriated annually, and (in the absence of a program modification) therefore are not subject to the annual budget or appropriations processes. The same is true of amendments to the tax system. Instead, the budgetary analysis of a new revenue or entitlement proposal can be understood as a single snapshot taken at the time the legislation is considered; the vista captured by the snapshot in turn comprises the differences between two projected streams of future revenues or spending. One projection estimates future revenues or spending over the relevant “budget window” (currently, 10 years) if the proposed policy were enacted; the second projection estimates future outcomes if the law were not amended (the baseline) (Kleinbard and Driessen, 2008). Once enacted, direct spending or provisions of the Internal Revenue Code sail serenely on, unimpeded by any automatic Congressional review or approval, unless by their terms those programs or provisions have a limited life.²²

Tax subsidies can usefully be grouped into three categories for purposes of developing tax framework rules of application. These categories reflect the different paths that on-budget spending programs follow, depending on whether those programs constitute direct or discretionary spending.

Many tax subsidies can best be analogized to entitlement programs (direct or mandatory spending), because they apply indefinitely, and are available to any person that self-certifies that the person meets the specified criteria (Toder, 2000). This paper uses the term “uncapped” tax subsidies to describe these benefits delivered through the tax system that are made available through a self-certification process to any qualifying person, regardless of the ultimate cost, and which as a result are best analogized to entitlement programs. This paper further divides uncapped subsidies into “temporary” and “permanent” categories. This reflects the fact that a great many tax subsidy programs today are unlimited in their total cost, but have a limited life.

In addition to uncapped tax subsidies, the Internal Revenue Code now also contains numerous examples of what can be called “fixed-dollar” tax subsidies. These are programs contained in the Internal Revenue Code that offer benefits collected by taxpayers through the tax system, but where the benefits are limited in amount, and awarded through processes exogenous to the ordinary administration of the tax laws. The low-income housing credit is an important example of a fixed-dollar tax subsidy; the credit is a fixed amount apportioned to each State, and a taxpayer can claim the credit only after being certified by a State agency through a rigorous application process. Fixed-dollar tax subsidies are functionally indistinguishable from appropriations, not entitlements.

²² As a technical matter, funds for some entitlement programs (such as Medicaid, but not Social Security, for example) must be regularly appropriated, but those appropriations occur virtually automatically, so as to avoid a government breach of a contractual obligation.

IV. TAX EXPENDITURE FRAMEWORK RULES OF APPLICATION

A. Fixed-Dollar Tax Subsidies

Fixed-dollar tax subsidies are direct competitors of classic appropriations, and should be treated as discretionary expenditures for all purposes of the federal Budget. The relevant framework legislation should require that the program be created by the relevant authorizing (i.e., substance-matter specialist) committee of each chamber. That committee, not the tax writing committees, should shape the program's purpose and size. The program should be referred to the tax writing committees only for purposes of amending the Internal Revenue Code to adopt the program. Finally and most important, any authorized allocations should be appropriated through the regular Budget process of the Budget and Appropriations Committees. This means that fixed-dollar tax subsidies would become subject to the aggregate spending cap spelled out in every Budget Resolution.

Because a fixed-dollar tax subsidy is indistinguishable in every sense from discretionary spending, the Budget consequences of the subsidy should be measured on an "expenditure-equivalent" basis. This means that the value of the subsidy would be "grossed up" to reflect the implicit treatment of the tax subsidy as tax-exempt in those cases where a corresponding actual government expenditure paid to a taxpayer would be treated as taxable income. (On the other side of the ledger, government tax revenues also would be grossed up to reflect the hypothetical taxes collected.) Failing to do so would retain a systematic bias in favor of establishing fixed-dollar government interventions as tax subsidies, because their Budget consequences would imply lower government spending.

The approach recommended here would be salutary in several dimensions. First, it would treat all forms of discretionary spending equally, and in particular would subject fixed-dollar tax subsidies to the same aggregate spending cap that applies to all explicit discretionary outlays. Second, it would end the race between the tax writing committees and the authorizing committees to capture new programs. Third, it would centralize subject-matter control over allocative policies, so that (for example) tax subsidy energy programs in fact are coordinated with overt expenditure energy subsidy programs. Fourth, it should restrict the use of the Internal Revenue Code to those cases where the authorizing committees conclude that the tax system in fact is the most efficient delivery system for the subsidy in question, because in other instances the authorizing committees would have little reason to surrender control of the process through referral to a second committee. Fifth, it would undo the current phenomenon of the "Congress within a Congress," in which the tax writing committees treat new revenue streams from whatever source as their proprietary assets to dispose of (through "revenue neutral" new allocative policies). Instead, each proposed new policy would compete with all others for scarce Budget resources, and as a correlative matter new revenue streams would finance those policies developed by the larger Congressional authorization and appropriation processes. Finally, this approach would mean that the

presentation of the Budget would be more accurate and transparent to all users, both within and outside of Congress.

Underlying the central recommendation to bring tax expenditures within the ambit of authorizing committees is a tentative judgment that the pendulum has swung too far in the long-term dismantlement of the Congressional “fiefdoms” formerly presided over by chairs of authorizing committees. Certainly it is fair to expect, for example, that the Speaker of the House should be able to articulate a strategic goal of the majority party, and then rely on the Chair of the relevant authorizing committee to develop legislation along those lines. But by the same token, it also is fair to expect that members of an authorizing committee develop substantive expertise in the areas within their committee’s jurisdiction, and of course employ and rely on expert staff, all in aid of fashioning effective legislation. The recommendation that tax subsidies (in this case, fixed-dollar allocation tax subsidies) be approved by the relevant authorizing committee is intended to bolster the second point without quarreling with the first.

In the same vein, the coordination between tax writing and authorizing committees required by the proposal outlined here would be costly, in the sense that it would require time, commitment and compromise by Members, but this is a feature, not a bug: it means that framework legislation recommended here would effectively impose a modest procedural presumption against new tax subsidies. This presumption in fact is desirable, for the reasons articulated above.

Weisbach and Nussim (2004) argue that tax expenditure analysis inappropriately implies that the tax system should be “privileged,” by virtue of an implicit presumption in tax expenditure work that the tax system should be kept pristine from all the messy compromises and mixed motives that explain government interventions in the private sector. In fact, as noted earlier, there is a persuasive argument that just such a presumption should exist, for the simple reason that nearly all of us participate directly in the tax system (but not in particular agricultural crop subsidies, for example). The resulting complexity and the bewildering exceptions that provide benefits to only a small fraction of taxpayers erode confidence in, and therefore compliance with, the system. Even if the overall allocative interventions by the government were to remain unaffected by the introduction of the tax expenditure framework legislation proposed here, in a broad-based tax system that relies heavily on self-assessment to collect its revenues, there are important reasons to focus on attitudes towards the apparent fairness of the tax system in isolation.

More fundamentally, the presumption of privilege today runs in exactly the opposite direction from that suggested by Weisbach and Nussim (2004). Tax expenditures today are privileged, in their funding (through the ability of the tax writing committees to siphon off available revenues to fund their preferred allocative interventions in “revenue neutral” legislation not fully tested by the rest of Congress), in their opacity (because they are invisible in the Budget as formally presented), and in their exemption from spending caps that apply to explicit outlays. The purpose of the recommendations made above is not so much to privilege the tax system as it is to eliminate the current privileging of tax subsidies.

B. Temporary Uncapped Tax Subsidies

Temporary uncapped tax subsidies are not comparable to discretionary outlays in one fundamental respect, which is that government's financial commitment is open-ended. Thus, in contrast to the \$1 billion "Cash for Clunkers" program, or a hypothetical \$1 billion "Refundable Tax Credits for Clunkers" program (or the low-income housing tax credit), the 2008 first-time homebuyer's tax credit is available to any individual who satisfies its criteria within the specified time frame. It is for this reason that tax subsidies traditionally have been linked to "entitlement" spending programs, rather than to discretionary appropriations.

The immediate consequence of the open-ended nature of these tax subsidies is that the Congressional appropriations mechanism cannot be invoked, because appropriations almost always are fixed dollar amounts. Instead, tax expenditure framework legislation presumably must treat open-ended tax subsidies like a new entitlement program, which is to say the legislation would be scored as "direct" spending that bypasses the appropriations process. As a result, PAYGO has an important continuing role to play here, subject to the needed reform of the relevant accounting rules (Block, 2002, 2007). It would be a relatively straightforward exercise for CBO and JCT to offer a joint proposal designed to improve these accounting rules, were there Congressional interest in doing so.

Even a perfect matching in present value terms of future revenue costs and "pay fors" does not, however, resolve all of the problems with tax expenditures today. More robust estimating processes will not resolve the deadweight losses associated with perfectly revenue-neutral tax legislation riddled with new temporary tax subsidies, nor will they dissolve the miasma of fiscal illusion that tax expenditures permit. More generally, they will not address the "Congress within the Congress" role of the tax writing committees, which is the other key framework issue in tax expenditures today.

The "Congress within the Congress" problem can be tackled directly by breaking the stranglehold of the tax writing committees on the unilateral disposition of new revenue sources. The fact that the appropriations process is irrelevant to uncapped entitlement programs does not mean that the process should remain wholly within the bailiwick of the tax writing committees. Again, to do so would be to permit the tax writing committees to capture for themselves and their clients assets (in the form of new revenue streams, whether from "loophole closers" or rate increases), rather than to make those assets available for the larger Congressional decision-making apparatus.

One approach would be to revisit the resolution of the war between the Senate Budget and Finance Committees in the mid-1970's described in Section II. Experience suggests, however, that such efforts to revisit old wars rarely succeed. Moreover, it is not obvious why the members of Congress would find it collectively advantageous to transfer the power to dispose of new revenue sources from the tax writing to the Budget committees, particularly if doing so were understood as giving the latter an effective veto over existing as well as new tax subsidies (as the Budget Committees effectively asserted in the mid-1970s).

A more constructive avenue to explore would be to take seriously the analogy of uncapped tax expenditures to entitlement programs. While it is true that the tax writing committees have jurisdiction over many entitlement programs, that is not the invariant case, and where there are substantive authorization committees with more subject-matter expertise (for example, in energy), then the construction of an entitlement program, whether couched as a spending program or an uncapped tax subsidy, ought to be assigned to that committee. Given that a great many more members collectively serve on the authorization committees (in the aggregate) than do on the tax writing or Budget committees, this approach appears to have the virtue of playing to the larger self interest of the members of Congress.

As in the case of fixed-dollar tax subsidies, therefore, and for all the same reasons, the framework legislation should require that the relevant authorizing committee (the committee with subject-matter expertise) develop the tax subsidy legislation, and refer it to the tax writing committees. The Budget Resolution in turn would direct the tax writing committees to raise revenues estimated to offset the projected costs of the tax subsidy (assuming for the moment that the goal of the Resolution in respect of this temporary subsidy was revenue neutrality). And in turn the projected costs would be reflected on the face of the Budget as an on-budget item.

C. "Permanent" Uncapped Tax Subsidies

A new uncapped tax subsidy of indefinite term raises all the same budgetary control issues as do current uncapped entitlement programs, such as Medicare or Social Security. Many proposals have been made to rethink how the federal budget should address uncapped costs in these entitlement programs, but of course no framework legislation today exists to address this phenomenon. Much of the discussion in the immediately preceding subsection is directly relevant here, and I begin with the premise that the authorizing committees again would be required to develop any proposed new permanent uncapped tax subsidy program.

The same remedies proposed above with respect to temporary uncapped tax subsidies would work as well with respect to permanent uncapped ones, with one exception, which is that, even if more robust accounting rules were implemented, permanent uncapped tax expenditures are more susceptible to estimation errors than are temporary ones (Yin, 2009). What is needed here (and what would be useful even in respect of temporary uncapped tax subsidies) is a self-correcting mechanism to keep the system true to the premises on which legislation was adopted.

For reasons of political economy, those novel mechanisms for enforcing the fiscal premises under which Congress considers new uncapped tax subsidies might usefully be limited to a subset of such subsidies, at least at first. In developing its 2008 taxonomy of tax expenditures, JCT divided tax subsidies into three subcategories: Tax Transfers (i.e., refundable credits that are paid regardless of tax liability), Social Spending (tax subsidies that are unrelated to the production of business income and tax subsidies related to the supply of labor), and Business Synthetic Spending (tax subsidies intended to subsidize

or induce behavior directly related to the production of business or investment income, but excluding any tax subsidies related to the supply of labor). The analogy of Tax Transfers to existing uncapped entitlement programs seems to be particularly persuasive, and it therefore is difficult to imagine imposing budgetary framework processes on this subcategory of tax subsidies that do not apply to other means-based entitlement programs. Similarly, while the analogy may not be quite so perfect, it appears exceedingly implausible to imagine imposing the constraints of a hypothetical new framework on a proposed expansion of the charitable contribution deduction.

The last category however — Business Synthetic Spending — arguably is different. Here the moral imperative of “entitlement,” as commonly understood, falls away completely, and one is left with a simple government intervention in the private economy, perhaps to overcome an externality, but even more plausibly to respond to a persuasive political clientele. These programs are likely to have particularly noxious economic efficiency consequences. It therefore would seem desirable to consider novel framework mechanisms that could be applied to uncapped Business Synthetic Spending programs to ensure that the scope of each such subsidy is consistent with the revenue projections that underlay its adoption.

D. Enforcing the Premises of Permanent Uncapped Tax Subsidies

Imagine that Congress has enacted a new permanent uncapped tax subsidy that falls into the category of Business Synthetic Spending, and that, within a few years, it becomes apparent that the cost of the new program was substantially underestimated. What might be done?

As an initial matter, it is important to stress that under current law, nothing need be done. This is as true under the newly-revived statutory PAYGO as it was under the rules-based PAYGO in place since 2007. The revenue “pay for” that offset the subsidy was determined once, at the time the legislation was considered, and is not revisited again. From the point of view of many members of Congress, this is a win-win situation: they exercised apparent constraint in enacting the legislation, but their political clienteles are even happier than the members anticipated at the time of enactment. PAYGO does not change the result, because modern PAYGO does not correct for estimation errors.

It might be possible to respond to estimation errors (or failures in the budget accounting rules) by designing legislation that applied to curb *future* Business Synthetic Spending (for example) as a whole, including future spending on existing tax subsidies. For example, imagine that legislation permits the Budget committees to include in the Budget Resolution a directive that Business Synthetic Spending in general be cut five percent for the next three years, when compared with the baseline. This comes perilously close to reopening the old wounds of the struggles between the Senate Budget and Finance Committees immediately following the enactment of the Budget Act in 1974, but, assuming for the moment that such a legislative impulse were enactable, would it be implementable?

The answer seems to be, only with great difficulty. Tax returns are filed after the fact, and relate to all the activities of a taxpayer for the taxable year in question. A “first come first served” sort of cap, analogous to the Cash-for-Clunkers stampede, where some taxpayers get 100 percent of the standard subsidy, and latecomers are foreclosed, therefore cannot work when applied to tax returns. For the same reason, it is extremely difficult to determine what a taxpayer’s tax liability would be in the absence (or scale-back) of a particular subsidy, because of (1) behavioral responses, and (2) interaction effects within the tax return. Scaling back a corporation’s interest deductions, to take an easy example (although technically not one of a tax subsidy in current law) might cost the corporation a good deal of money, or not, depending on such factors as whether it is profitable for the year in question or whether it has excess foreign tax credits as a result of its high domestic interest costs. Thus, one cannot use a scale-back mechanism to target precisely how much of a subsidy a particular firm or industry would receive.

On the other hand, Congress arguably could implement a decision to reduce all Business Synthetic Spending by five percent for the next year through a *pro rata* scale-back of all business subsidies, in an amount projected to yield on a revenue estimate basis the same present value (in this example) as five percent of the simple sum of all such subsidies. The actual effect of this scale-back on the deficit would again be susceptible to estimation error, but it would be closer to the intended outcome than doing nothing.

The difficulty, however, is that we have now veered away from framework legislation. Congress always can remedy underestimation errors (errors in which tax subsidies turn out to be larger than originally anticipated) or failures in its budget accounting methodologies, or unanticipated revenue shortfalls due to economic circumstances, by changing the law. The difficulty is that Congress does not often do so. What we really want is some sort of automatic pilot device that is integrated into the original process by which legislation is considered — an automatic mechanism for enforcing the intended effect of the improved deliberative process, which mechanism (like all framework legislation) satisfies the conditions of objectivity, specificity, and political neutrality that have been described earlier.

One example of framework legislation that could satisfy these conditions would be to enact as part of the budget process multi-year target ceilings on tax subsidies (or, in this case, a subset of tax subsidies, like Business Synthetic Spending, or even one new tax subsidy), expressed as a percentage of projected GDP. If in any year projected tax subsidies for the relevant tax expenditure budget period (five years) breached the statutory ceiling percentage of CBO’s projection for GDP over that period, then a surcharge would automatically be imposed on all tax rates sufficient to fund the excess spending.²³

Such a mechanism would be more feasible than a spending sequester (with all its attendant disruptions and additional costs). Moreover, by focusing only on the synthetic spending side of the ledger, the rule would not be triggered by estimating errors of

²³ McLure (1989) also proposes an automatic tax surcharge as a budget enforcement tool.

“pay fors” or revenue shortfalls more generally, whether caused by macroeconomic factors or otherwise, thereby emphasizing the constraint’s role as a cap on a form of spending, not a floor on taxes. As a result, the tax rate surcharge in most cases would be triggered, not by uncontrollable events, but by Congress’s own excessive enthusiasm for tax subsidies.²⁴ The tax rate surcharge therefore would not repeat the mistake of Gramm-Rudman-Hollings, which sought to impose spending sequestration as the remedy for economic developments outside the control of Congress — in particular, revenue shortfalls that increased the deficit.

Because the automatic tax surcharge would be triggered by business tax subsidies that exceeded original expectations, the surcharge should be levied on business taxpayers. Corporate taxpayers are one easily-identified group; the other logically could be individual taxpayers with net trade or business income (sometimes called Schedule C income). The rules for applying the surcharge to an individual with both Schedule C and other forms of income would be complex, but the purpose of the rule would not be to foster taxpayer convenience, but rather Congressional action.

E. Tax Framework Legislation and Tax Reform

None of the suggestions made to this point is responsive to what many observers have in mind when they propose framework legislation for tax expenditures, which is to apply some sort of cap or trigger to the cost of existing tax subsidies, so as to curb their growth, or even to shrink their overall magnitude. While the sentiment is understandable, it appears to misconstrue the design of most successful framework legislation, by trying to force a substantive renegotiation of the present tax system with a procedural device best applied to internalize in the consideration of future legislation the social costs of certain externalities.

More generally, tax expenditure analysis has always been the victim of being asked to do too much. Almost from the start, critics saw the “normal” tax system that was constructed as the tax expenditure baseline as an aspirational tax reform proposal, and deprecated tax expenditure analysis for serving this essentially political goal (JCT, 2008a). The same risk applies to tax expenditure framework legislation. If construed as a device to force reconsideration of the \$1 trillion per year in current tax expenditures, proposed tax expenditure framework legislation would repeat the Senate Budget Committee’s tactical error in its wars with the Finance Committee in the mid-1970s. There does not appear to be a satisfying procedural solution to the problem of embedded tax entitlements: Congress instead will revisit them as a substantive matter when Congress decides it is hungry enough for the revenue, or for a more efficient tax system.

One therefore should not expect tax expenditure framework legislation to operate as the stalking horse for classic tax reform. It is more useful to imagine using framework

²⁴ The utilization of some tax subsidies, particularly those relating to Social Spending, might increase in a recession, but that ordinarily would not be true of Business Synthetic Spending.

legislation to protect post-reform tax systems: that is, not as a device to compel the devaluation of existing tax subsidies, but to protect going forward the presumptively broader base of a post-reform tax. Exactly this phenomenon famously happened in 1986 and the years thereafter: a major tax reform effort broadened the tax base, and then years of new tax expenditures whittled it back down again.

The mechanism to do so would be the process described in the preceding subsection: a multi-year constraint on tax subsidies (here, presumably, meaning all tax subsidies, not simply Business Synthetic Spending) as a percentage of GDP, enforced through automatic tax surcharges if those subsidies were projected to pierce the target ceiling. Like an impending execution, the prospect of scheduled tax surcharges that Congress could have avoided, but did not, would wonderfully concentrate the minds of its Members.

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