

Judging Tax Expenditures: Summary¹

Spending Programs Buried within the Nation's Tax Code Need to be Reviewed

A new report from Citizens for Tax Justice makes the case for a “performance review” system designed to evaluate the effectiveness of special tax breaks in achieving their stated goals. These special breaks — or “tax expenditures,” as they are frequently called — are an enormous and often overlooked part of the federal government’s operations. In total, over \$1 trillion is spent each year by the federal government via special provisions in the tax code. To put that in perspective, the combined size of all tax expenditure programs is actually larger than the discretionary spending budget in a typical year.

CTJ’s report outlines why tax expenditures are in need of additional scrutiny, and explains how a performance review system should be used to provide that scrutiny. The report also details the long-stalled efforts of Congress and the Executive Branch to create such a system. Among CTJ’s findings are:

- “Procedural biases,” such as the omission of tax expenditures from the authorization and appropriations processes, allow tax expenditures to slip by with a fraction of the scrutiny given to direct spending programs.
- “Political biases,” such as the erroneous belief that government can take a “hands off” approach, or reduce its overall size by offering special tax breaks, also contribute to the current lack of oversight.
- In 1993, after the Senate Report of the Government Performance and Results Act (GPRA) called for the creation of a tax expenditure review system, the Executive Branch began to make real strides toward realizing that goal. Unfortunately, progress on this front slowed considerably by the late 1990’s, and came to a near standstill under the Bush Administration.
- There are at least six reasons why progress toward implementing a tax expenditure review system should be resumed in the near future:
 1. **New Data:** 2008 marked the long-anticipated 10th year of Treasury’s “panel” data sample designed to facilitate the evaluation of savings-related tax expenditures. As recently as 2006, OMB described this data set as permitting “more extensive, and better, analyses of many tax provisions than can be performed using only annual (‘cross-section’) data.”
 2. **Reforming Performance Measurement:** President Obama has promised create a “reformed performance improvement and analysis framework” that will attempt to “break down silos” by ensuring that “cross-program and cross-agency goals [will] receive as much or more focus as program-specific ones.” Since so many of government’s goals are accomplished via a combination of tax expenditures and direct spending, fulfilling

¹ For the full report, visit: <http://www.ctj.org/pdf/judgingtep1109.pdf>

the President's promise will require the inclusion of tax expenditures within the new, "reformed" framework.

3. **Transparency:** President Obama has repeatedly emphasized the need for improved government transparency. The current lack of oversight and review associated with tax expenditures is one of the most obvious examples of insufficient government transparency.
4. **The Breaking Point:** Tax expenditures, whether measured as a share of GDP or as a share of income taxes, have crept up to levels not seen since just before the Tax Reform Act of 1986, which drastically reduced tax expenditures. If history can provide any clues for the future, the number and size of the "holes" poked in the tax base may finally be approaching the level required to inspire a closer look at tax base broadening, and tax expenditure review.
5. **The Deficit:** The dire budgetary outlook facing the federal government will require a search for new revenue sources, both in order to reduce the budget deficit, and to "pay for" new spending priorities without increasing the deficit. Since a tax expenditure review system can help to identify ineffective tax breaks that should be eliminated, such a system should become increasingly well-received in this budgetary environment.
6. **State Laboratories:** Numerous states have taken steps beyond what the federal government has done to facilitate the review of their tax expenditures. Washington State has been the most successful in this regard. The federal government could learn some valuable lessons by looking at state experiences with tax expenditure review.
 - Care should be taken in selecting the criteria used in a tax expenditure review system. Washington State's criteria represent a good starting point from which to build. Other important design issues include timing the reviews to coincide with the budgeting process, allowing similar tax expenditures to be reviewed simultaneously, and attaching some type of "action-forcing" mechanism to the reviews so that policymakers must explicitly consider the reviews' results.
 - For the past fourteen years, the president's budget has lamented that the creation of a tax expenditure review framework will be a "significant challenge." We concur with that assessment, and therefore recommend the creation of a presidential advisory panel, tasked with developing the framework in a public, transparent manner involving input from both stakeholders and experts. The OMB's Chief Performance Officer could chair the panel.
 - Tax expenditure reviews are *necessary*, though they may not be *sufficient* to correct for the biases in favor of tax expenditure policy. A tax expenditure performance review system can play a vital informational role either on its own, or alongside other, more aggressive tax expenditure control techniques such as sunset provisions or caps on tax expenditures' total value.

The full report can be found by visiting:
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