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### **Raising Revenue: The Options - Opening Remarks**

Thank you. I'd like to begin by reaching out to Charlie Cook's purple voters that we heard about this morning, the individuals who fear the encroachment of government in the private economy and in their private lives. To all of them, I would say, it's too late. You've been encroached on. You and government are much more intimately connected today than you appreciate. Legislators, whether progressive or conservative, for decades have used the fog of fiscal illusion, have given us all what we really want, which is lots of government-spending programs while preserving the illusion of our individual autonomy in neutral markets.

The least appreciated tool of fiscal illusion is the tax expenditure. The concept is very simple. The tax code today is festooned with exceptions which own general rules. These deductions, credits, or income exclusions function exactly like spending programs. In operation, tax expenditures behave as if our government collected more tax revenues from a broader, simpler tax code and then devoted those revenues to certain spending programs. Except that unlike other real spending programs, these are invisible in our budget because they operate simply to reduce government revenues.

So thinking in tax expenditure terms is directly responsive to the new ways of thinking that Bill described a moment ago. By understanding the scope of these spending programs that are baked into the tax code, we can have a tool to understanding the real size of the federal budget, to grasping the complete picture of the allocative and distributive impact of government, and to shattering the invidious fiscal illusion that targeted tax relief in fact is a tax cut. Targeted tax relief is just another name for government spending, in which taxes extracted from those of us who are not targeted fund hidden spending on those who are.

Tax expenditures are not loopholes. They are deliberate forms of government spending. The question is, are they smart spending? Can we afford that spending? And is the program itself well designed? The tax expenditure phenomenon is far larger than is usually appreciated. Jane's colleagues at the Congressional Research Service recently published an analysis that concluded that Federal tax expenditures in 2008 totaled over 1.2 trillion dollars for one year. This is a simple sum of many individual items, and economists point out that that's not strictly fair because of the interactive effects across these different times. But if I were to be permitted to amend the Congressional Research Service report by concluding that tax expenditures in 2008 amounted to a trillion-ish dollars, I think you would still agree with me that that is a considerable sum of money. In fact, 1.2 trillion dollars is more than the entire amount raise by the individual income tax. We give away more in spending than we raise in the individual income tax. So you can get a sense of just how distorted our picture of the budget is. It is as if our budget was 150% the size of the budget that we all decry in the

papers today. As a percentage of GDP, tax expenditures are now at a level that we have not seen since immediately before the tax reform act of 1986.

Many tax expenditures, of course, are both well known and serve useful purposes. You know what -- the same is true of government spending. The charitable contribution deduction is an obvious example. But even tax expenditures that serve useful social goals often are poorly targeted because by burying these social programs inside the tax code, we have not paid enough attention to details of how they're implemented. For example, benefits may be awarded to many people who would have engaged in the desired behavior without the government subsidy. The first-time home buyers credit is a probable example of that. Other tax expenditures like the largest one, the tax exclusion for compensation, paid in the form of health insurance premiums, through inattention to the design has led to systematic overconsumption of the desired good. By designing all of these programs in the form of tax expenditures, the only evidence of them in our budget is a reduction of government revenues, and as a result we have not devoted the requisite energies to reviewing and thinking of how these government programs are designed and implemented, and whether in fact they are delivering the bang for the buck.

Most troubling to me, some tax expenditures are simple subsidies to politically-favored businesses. The CRS study that I mentioned a minute ago listed for 2008, 118 billion dollars in business tax subsidies. That's 118 billion dollars worth of the government's heavy hand on the scale of the market economy. And it's about one third of the amount of revenues that we raise through the corporate tax system.

LIFO inventory accounting, tax exemption status for credit unions, tax credits for energy from renewable sources, tax exemption for private activity bonds or things more exotic like, from my old practice, the inventory property sales source rule, which sounds tedious and innocuous but in fact counts for tens of billions of dollars and reduces the tax liability of US multi-nationals by decreeing that certain US income will be magically treated as foreign income. These are all examples of the heavy hand of government subsidies injected unevenly into a market economy. With the exception of a few subsidies that address an authentic externality, like arguably R&D credits, all of these business tax subsidies can be summed up in one word: stupid.

To me it is ironic that a publicly-owned health insurer can be viewed by so many as unfair competition to the private sector, but these other interjections to support favored business go wholly unchecked, simply by calling them targeted tax relief. Tax expenditure analysis is the tool that dissipates the fog of fiscal illusion in which these subsidies work.

If we can force tax expenditures to the sunlight by subjecting them to the full rigor of the budget process, we can make better choices, both as to the substance of how much money we spend, and to the design of how we spend it. But improving the budget process by itself will not, in my view, lead to a comprehensive review of all the tax expenditures already hard baked into the tax code. For that, we must look I think, still using tax expenditure analysis, but to use it in a different way as a wedge to force a major review, a

zero-based beginning of the entire tax system, in order to accomplish what Bill has described before as the fundamental base-broadening exercise.