

Summers on Social Tax Expenditures (Part 2 of 2)

Part Two: Where He's Wrong...or at Least Incomplete

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Secretary of the Treasury Lawrence H. Summers' recent defense of social tax expenditures is not without merit. Indeed, there are a number of standards under which one can justify some amount of social spending being administered through the tax authorities.

There is another side, however. Standards and principles can also be used to tell us when social spending through the tax system does not work well or is handled inappropriately in the budget process.

Perhaps the foremost case against almost all tax expenditures is a budgetary one. Tax expenditures are all subject to bad budget accounting; they are counted as negative taxes rather than positive expenditures. Tax expenditures clearly involve some interference in the economy, whether for good or ill, and they should be accounted for as such. Imagine a world in which all taxes were returned to taxpayers as tax expenditures. Total expenditures would be recorded as zero and so would total taxes. In effect, tax expenditures lack transparency, and transparency is a desirable quality of government activity.

This lack of transparency is one reason why tax expenditures are so popular today. They allow politicians to appear to be reducing the size of government (reducing taxes) while actually increasing it (increasing spending).

Traditionally, tax expenditures were opposed by Democrats and favored by Republicans; that was in an era when many or most such expenditures tended to favor investment. Today, however, the business side of the 1986 tax reform has held up: lower rates on business income in exchange for reduced investment tax expenditures. Growing rapidly, however, have been the social expenditures. As a consequence, social tax expenditures now dominate the tax expenditure budget, and Democrats increasingly find themselves favoring them.

As a political matter, the Clinton administration liked to promote social tax spending as a way to have its cake and eat it too. That is, it would advocate such spending in lieu of direct spending, then appeal to the public for this type of targeted tax cut or that type of targeted tax cut rather than some other—usually larger and broader—tax cut being considered by the Republicans in Congress. In that way, social tax expenditures became soldiers in the much larger battle over the deficit, the budget, and the size of the tax cut to be achieved. At the same time, this approach made life difficult for Republicans and others who treat almost all tax cuts as being somehow good because they reduce the size of the government.

The danger in this game is that the tax code starts to mirror the expenditure system—with its evolution geared mainly toward the latest fad and the special interests of multiple legislators who demand something in the process of logrolling budget and tax bills toward enactment. Soon there are no tax principles at all guiding action.

Over the long run, politicians who think they are achieving good by hiding what they are doing may end up with just the opposite result. They breed cynicism among the public, who then approach government from the standpoint of self-interest ("at least I'll get mine"), abandon support for government altogether, or become disinterested and fail to engage in the building up of a better civil society. For a Secretary of the Treasury caution is required: He cannot remove all sentinels from Treasury's gate and allow anyone to walk out with a bag of taxpayer money by simply claiming how much social good he or she is doing in achieving smaller government.

To make matters worse, the IRS still does not organize itself even in part around the expenditure programs it administers. Thus, the public usually does not receive reports on how well tax expenditure programs, such as

enterprise zones, are running, nor are studies undertaken or commissioned to see how such programs might be improved. Even if the IRS could administer some of these expenditures better than other departments of the government, often it is not geared to do that.

It is true that tax authorities on occasion can do a better job of administering certain types of spending than can some other agency or department. However, balance is required. For example, spending on education is favored by the tax system generally because it is nontaxable to individuals—this type of exclusion is accomplished with little effort by the tax authorities. This virtue of administrative ease may not extend to educational credits, and they are interjected into an existing multitude of direct spending programs. A more coherent and coordinated approach to educational credits and grants is clearly called for but has been dodged by public officials because of the budgetary and political appeal of constantly adding new types of educational spending in the tax code.

Similarly, there are many types of health tax expenditures that are promoted but not coordinated with other forms of health spending. The consequence is not only duplication of administration but poor targeting.

Still another concern is that tax expenditures often violate standards of horizontal equity—the equal treatment of equals. Special breaks for special interests often fail to qualify individuals in equal need or with equal means. At the same time, they often violate efficiency concerns by treating as special some particular source of income or consumption.

In sum, there remains a substantial case against tax expenditures. They almost always violate principles of budget policy by being accounted for inaccurately in the budget. They lack transparency. A presumption cannot be made either that the tax authorities or the spending authorities could administer such programs better; it depends. However, the IRS is seldom set up to monitor such expenditures, and when expenditure departments are already in charge of a function of the budget, tax expenditures often result in unnecessary complication and duplication. Finally, tax expenditures can and often do violate traditional principles of horizontal equity and efficiency.

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