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TIME TO TAKE TAX POLICY OFF OF AUTOPILOT

Why Congress Should Reconsider Tax Extenders

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Many policymakers and pundits argue our foremost legislative priority should be to reduce the federal budget deficit. This is clearly wrong. In the near term, the first priority should be to generate a full recovery from the Great Recession, which could reliably be achieved by using *larger* budget deficits to finance job-creating investments and safety net spending. In fact, as former Treasury Secretary Larry Summers has pointed out, deficit-financed infrastructure spending in coming years would almost surely *reduce* the nation's debt-to-GDP ratio by spurring so much extra economic activity that tax collections would increase and need-based safety net spending would fall.[1]

However, assume for the sake of argument that these pundits and policymakers are correct and the federal budget deficit actually must be shrunk. It would be odd indeed if these same policymakers then proceeded to routinely give away tens of billions of dollars of deficit savings, with virtually no public debate. And yet they do.

At the stroke of midnight on January 1, 55 separate tax provisions expired (Joint Committee on Taxation 2014).[2] The vast majority of these tax provisions were originally legislated to be in effect for two years. But because Congress routinely extends virtually all of them each time they expire, they are collectively referred to as "tax extenders." Some of these tax incentives at least target useful public policy goals. However, there may well be better ways to meet these goals than regularly extending the same tax breaks. Worse, a large portion of these tax extenders are simply giveaways to select groups of individuals (particularly high-income taxpayers) and corporations.

Sen. Ron Wyden (D-Ore.), who took the gavel as chairman of the Senate Finance Committee earlier in February, has stated he would like his committee to get a tax extender package "re-enacted promptly," before it turns to other pri-

orities, such as reforming the tax code (Bloomberg 2014). As Congress yet again considers blindly extending an entire portfolio of unrelated tax incentives, with little desire to either investigate each provision's effectiveness or offset the costs, this issue brief argues that the policy drift of regularly rubber-stamping the entire suite of tax extenders must stop. Its key findings are:

- Collectively, tax extenders represent an enormous budgetary cost, with the benefits accruing to a narrow slice of the population. The Congressional Budget Office found that extending through 2024 just the provisions that expired on January 1 of this year would have an annual cost of $46.6 billion, most of which is directed at corporations. The 15 percent aimed at individuals is highly regressive, meaning higher-earning filers receive a greater benefit.
- As large as the $46.6 billion figure is, it does not even account for all of the routinely extended tax provisions. Including those that will expire between now and 2023, regularly reinstating for the next decade the 79 provisions that make up all tax extenders would have a 10-year cost of $517 billion, according to the Center on Budget and Policy Priorities.[3]
- While many of the provisions attempt to advance laudable social goals, most of these aims could be achieved more efficiently and effectively through methods other than temporary tax incentives.
- In dollar terms, the four largest tax extenders are the research and development tax credit (the last two-year extension cost $14.3 billion); the renewable electricity production credit ($12 billion); the active financing exception, which allows financial services firms and manufacturers to defer U.S. taxes on certain types of income earned overseas ($11.2 billion); and the deduction for state and local sales taxes ($5.5 billion). Combined, these account for 60 percent of the value of the most recently passed extender package.
  - All four of these extenders are problematic in their current form because they are regressive, inefficient, and/or because they provide benefits to individuals or businesses that act in ways they would have acted even without the tax provision.
- The savings from jettisoning the tax extenders that are poorly targeted and/or inefficient could finance a large reduction in the cuts to discretionary spending projected over the next decade. These discretionary spending cuts are much more damaging to macroeconomic stabilization and job growth than would be a cancellation of these extenders. Further, the benefits of these tax extenders are distributed far more regressively than benefits from a comparable amount of discretionary spending.
  - To get a sense of the discretionary spending that could be supported by rolling back the ineffective extenders, consider that the cost of the previous two-year extension of 52 of these temporary tax incentives was roughly equal to the 10-year federal price tag of President Obama's "Preschool for All" proposal.
- Instead of renewing the entire slate of tax extenders, federal policymakers should conduct thorough analyses of all extenders to see if they efficiently target useful policy goals. Congress should improve and make permanent those that pass muster, and simply shelve those that do not.

Background on tax extenders

There are several reasons why tax provisions can enter the tax code on a temporary basis, and some of these reasons do indeed make good economic sense. For example, they may be used as temporary economic stimulus (such as the many

temporary tax incentives that were part of the American Recovery and Reinvestment Act of 2009) or disaster relief. Far too often, however, the "temporary" classification of tax provisions is simply deceptive. For example, tax provisions that are extended time after time are labeled "temporary" simply to appear less expensive when compared with provisions scored over a longer budget window, and hence require fewer tax increases or spending cuts to offset their costs.

Further, the politics of routine extensions of otherwise "temporary" breaks removes friction from their regular passage: Lumping together disparate tax provisions means policymakers and lobbyists with vastly different constituencies all have at least one provision within the package they would like to see passed. In this manner, provisions that could never achieve majority support on their own are subsumed into broadly popular legislation.

Collectively, tax extenders represent an enormous budgetary cost, with the benefits accruing to a narrow slice of the population. The Congressional Budget Office (2014b) found that extending through 2024 just the provisions that expired on January 1 of this year would have an annual cost of $46.6 billion, most of which is directed at corporations. The 15 percent aimed at individuals is highly regressive, meaning higher-earning filers receive a greater benefit.

That $46.6 billion figure—as large as it is—does not even account for all of the routinely extended tax provisions. Including those that will expire between now and 2023, regularly reinstating the 79 provisions (JCT 2014) that make up all tax extenders for the next decade would have a 10-year cost of $517 billion (Frentz and Marr 2013), averaging just over $50 billion annually.

For a number of reasons summarized here and explained in greater depth in the following sections, lawmakers should end the practice of blindly passing a cornucopia of unrelated tax incentives, and should instead consider each provision on its own merits.

First, automatically extending all expiring provisions is an abdication of the responsibility to separate the wheat from the chaff. Those provisions actually aimed at worthy policy goals should be kept (or made more effective) and should be made permanent. But those that are simply giveaways to corporations or expensive loopholes for high-income households should be ended.

Second, discretionary *spending* levels have been subject to historically deep cuts in recent years, yet these spending cuts are far more damaging to macroeconomic stabilization—and affect a much broader range of people—than would a rollback of the tax extenders. It is simply irrational that backdoor discretionary spending through the tax code continues to get a free pass. To be very explicit: $50 billion in additional deficit-financed spending would be a political nonstarter, yet $50 billion in deficit-financed tax cuts could sail through Congress despite being comparatively regressive and macroeconomically unhelpful. Put simply, if a tax incentive is so poorly targeted and inefficient that it could not survive the political gauntlet as an equivalent spending program, then it should no longer exist.

Third, the behavioral incentives many of these tax provisions attempt to provide are very much diminished if potential recipients can never be entirely sure the provision will last.

Finally, and most irritating to budget wonks, the expected continual extension of these provisions makes the creation of a single budget baseline that all parties agree on difficult, and this can damage the prospects for having transparent, evidence-based fiscal policy debates.

Separating the wheat from the chaff

In dollar terms, the four largest tax extenders are the research and experimentation (more commonly called research and development, or R&D) tax credit (the last two-year extension cost $14.3 billion), the renewable electricity production credit ($12 billion), the active financing exception ($11.2 billion), and the deduction for state and local sales taxes ($5.5 billion).[4] Combined, these account for 60 percent of the value of the most recently passed extender package. All of these are problematic in their current form, due to their regressivity, inframarginality (i.e., providing benefits to individuals or businesses that act in ways they would have acted even without the tax provision), inefficiency, or all three. They demonstrate why it is ill-advised for policymakers to automatically renew all tax extenders without separating the wheat from the chaff or considering how tax extenders' goals could be achieved more effectively.

R&D credit

The R&D credit is based on the widely accepted premise that some private research has positive externalities, or "spillover effects," meaning that a company's research may not just improve the quality and lower the prices of goods and services produced by that specific firm, but may also spur productivity growth across an entire industry or the entire economy. The R&D credit is designed to offset only the costs of a company's *new* research, rather than the entirety of its research budget.

There is a policy case for using public dollars to subsidize private research. Studies have largely found that the tax credit passes the cost-benefit test (Linden and Tyson 2012), meaning that each dollar of forgone revenue creates more than a dollar in increased R&D spending. Further, as of 2008, the United States only ranked 24th in terms of tax incentives given for R&D among OECD countries (OECD 2008).

However, the current structure of the R&D credit has numerous flaws, including a lack of help for small firms and start-ups; administrative complexity, especially in determining a company's existing rate of R&D spending for which the credit does not apply (the IRS routinely spends years auditing returns to determine this point); and lack of data collection sufficient to determine the credit's efficiency at incentivizing R&D spending beyond what would have taken place in the credit's absence.

There are many recommendations on how best to address these deficiencies, including making some of the credit refundable for start-ups, redesigning some of the credit to explicitly subsidize researchers' jobs, and simplifying other complex rules.[5] However, the most likely change to the R&D credit is an unwelcome one: The IRS is considering allowing firms to claim the credit for the costs of developing prototypes that the companies ultimately sell. The biggest flaw in this proposal is that the change would be applied *retroactively*, meaning large companies such as Boeing would be able to claim new tax savings dating back to 2007 (Yang 2014). Rewarding past behavior is the definition of providing tax benefits that do not (indeed, logically cannot) spur a desired behavior. Instead, this retroactive credit would simply be a windfall to business.

Renewable electricity production tax credit

The renewable electricity production tax credit (PTC) was extended for one year by the deal to resolve the "fiscal cliff" at the beginning of 2013. This renewal expanded the PTC "by allowing wind turbines (and other such facilities) to qualify so long as their construction began during 2013, whereas before the turbines had to be up and running by the

end of the year" (Citizens for Tax Justice 2013a). As wind has accounted for 36 percent of all new electricity generation installed in the United States over the past five years (Philips 2014), the expanded PTC could be viewed as a successful incentive that led to societally beneficial behavioral changes. However, this tax benefit operates within a web of overlapping energy production incentives that often work at cross purposes; currently, the PTC is one of 42 different tax breaks to aid certain energy technologies, 25 of which regularly expire (Plumer 2013). Moreover, this complexity leads some clean energy technologies to be favored over others, especially over those that are newly emerging. In December, Senate Finance Committee Chair Max Baucus unveiled a plan that would replace these 42 provisions with two broad credits to encourage clean energy production (Baucus 2013), making the tax code more technology-agnostic.

The policy goal of fostering an increase in renewable energy production is clearly worthy. Firms that produce non-renewable energy that emits greenhouse gases (GHGs) currently benefit from a large implicit subsidy of not having to pay for the unpriced externality they impose on the economy (the externality being, of course, furthering harmful global climate change). But there are much more direct and efficient ways to level the playing field between renewable and non-renewable energies. The most obvious one is simply pricing GHG emissions—with either a GHG tax or a system of tradable permits that would provide a cap on overall emissions. These solutions would be simpler and completely technology-neutral, and would also see resources flow into the budget instead of out of it.

Active financing exception

In contrast, the policy merits of the active financing exception are nowhere near as ambiguous, in that they simply do not exist. The provision states that financial services firms and manufacturers can defer U.S. taxes on overseas income from specific types of financial transactions (Eggen 2010). Backers of the provision, which was originally put into law in 1997 after President Clinton's line-item veto of the provision was ruled unconstitutional, say it allows them to compete freely with multinationals based in other countries with lower corporate tax rates. It is a "top lobbying priority for companies such as GE and JP Morgan" (Plumer 2014). Detractors say the provision makes "it easy for U.S. multinational companies to move income to offshore tax havens and avoid paying U.S. tax" (Citizens for Tax Justice 2012). This is simply a corporate tax giveaway that should be ended.

Deduction of state and local sales taxes

The fourth-largest tax extender is the provision allowing individual taxpayers to deduct the payment of state and local sales taxes from their federal income taxes. The policy case for this extender is that those living in states without a broad-based income tax[6] lose out on being able to deduct their state income taxes from their federal return (a provision which is itself highly regressive), and thus should enjoy a benefit similar to that enjoyed by their fellow taxpayers on the other side of the state line. However, in practice, because sales taxes are already highly regressive, the deduction makes them more so because federal income tax filers on the lower end of the income distribution do not itemize and hence cannot claim the benefit. Further, the provision (like all tax deductions) is worth more the higher a filer's marginal tax rate, and this skews the benefits to high-income taxpayers. This is why filers with incomes over $200,000 represent less than 7 percent of those claiming this deduction, but 26 percent of the deduction's dollar value (Citizens for Tax Justice 2013a).

Further, if this provision makes it easier for states to resist enacting a state income tax and to rely more heavily on sales taxes (or makes it easier to switch from income taxes to sales taxes as key revenue sources), this also is distributionally regressive. If the policy goal is to aid state and local governments with their budgets, direct grants (say, by taking on a

larger share of total Medicaid spending) would be a much more transparent, effective, and progressive way to meet this goal.

Other tax extenders

Among the other provisions in the extender package are a $50 million annual break to racetrack builders and a $240 million support for the rum industry in Puerto Rico and the Virgin Islands. The list also shines an unflattering light on some permanent tax provisions that are just as objectionable. For example, among the extenders is a provision that increases the amount of pre-tax dollars employers can put toward commuting via public transit each month, from $130 to $240 (Gleckman 2013). The increase is to match the permanent benefit given to employees for parking if they drive to work. A coherent argument can be made for subsidizing public transit ridership (though the benefit is probably not a strong enough incentive to get many people to switch modes of transportation), but there is simply no public policy benefit to incentivizing commuters to take their own cars to work.

On the other hand, there are other extenders that aim at sensible policy goals, such as allowing teachers to deduct $250 worth of school supplies that they buy with their own money for their classrooms, or not taxing money that "underwater" homeowners "earn" when their mortgage lender reduces their mortgage (this provision would cost $1.3 billion to extend). But these provisions could be transformed to achieve their goals more efficiently. The deduction for teachers, for example, is regressive, benefiting those in a higher tax bracket. There is not much sense, for example, in making the deduction more generous for teachers who are married to a high earner and filing in a higher tax bracket than it is for single teachers. Moreover, if the federal government wants to subsidize the purchase of school supplies, it could simply give money to schools for that purpose, or pay teachers more. And though the Mortgage Forgiveness Debt Relief Act of 2007 continues to help underwater homeowners—almost 100,000 of whom benefited from this provision in 2011 (Dewan 2014)—Congress should at least review proposed policy changes[7] (such as lowering the ceiling on the amount of debt forgiveness that is untaxed) or consider a direct subsidy program before extending it again.

Extending all the provisions simultaneously does nothing to help differentiate the tax incentives that are worthwhile from those that are not—which is the stated purpose of short-term tax provisions in the first place. Indeed, temporary tax policies only make sense if they truly are akin to a scientific study—policymakers should determine if a provision passes reasonable comparisons of costs and benefits (including distributional costs and benefits) and is worth the reduction in revenues, and then, and only then, decide to extend the policy for future years. If this kind of inquiry is absent from a provision, there is no point in its having been instituted temporarily.

Discretionary spending is at historic lows, yet discretionary tax breaks continue

In the name of deficit reduction, Congress has reduced discretionary spending to historic lows, relative to the size of the economy. In and of itself, this is irrational. Public investment—which the nonpartisan Congressional Budget Office (CBO) says is spending that, for the most part, "contributes to the economy on an ongoing basis by improving the private sector's ability to invent, produce, and distribute goods and services" (CBO 2013b)—makes up nearly half of federal non-defense discretionary spending. These spending cuts have resulted in steep contractions in economic activity and job growth in recent years, severely hampering a full recovery from the Great Recession.

The slashing of discretionary spending is especially irrational given that this type of spending is not projected to put upward pressure on deficits over the long term. In fact, with non-defense discretionary federal spending growing at a slower rate than the economy over the next decade,[8] this category of spending is not increasing debt at all, relative to GDP.

Given this great (and yet misguided) political momentum to reduce budget deficits by slashing spending, a $50 billion annual increase in discretionary spending would be unimaginable. Yet there seems to be an ample congressional caucus willing to pass $50 billion worth of subsidies through the tax code. When it comes to first-round deficit impacts, it seems to not matter that there is simply no difference between a traditional spending program and spending through the tax code.

Another apt comparison can be made when considering how various tax expenditures equate to spending on federal programs. Tax expenditures that are a permanent part of the tax code (such as the mortgage interest tax deduction or the exclusion of employer-provided health care benefits) are akin to mandatory spending (such as Medicare, Social Security, and so on) in that they are a fixture of the federal budget.[9] On the other hand are the "temporary" tax provisions. These extenders are similar to discretionary spending programs; each is expected to be evaluated every year or two, and yet, in both instances, Congress has shown a preference to lump together scores of unrelated provisions to pass omnibus bills as a matter of course.

The budgetary cost of putting tax extenders on autopilot is simply enormous. For example, the average annual cost of extending expired and expiring tax breaks over the next 10 years (about $52 billion) is twice the cost of extending federal emergency unemployment benefits for one year (Mishel and Shierholz 2013). Another comparison: The cost of the previous two-year extension of a tax extender package was roughly equal to the 10-year federal price tag of President Obama's "Preschool for All" plan, wherein the federal government would support grants to states for the implementation of high-quality preschool programs (CTJ 2013a; U.S. Department of Education 2013). These two spending programs would be far more effective than the tax extenders at both spurring a full economic recovery from the Great Recession and spurring future productivity growth.

Indeed, the savings from jettisoning the tax extenders that are poorly targeted and/or inefficient could finance a large reduction in the cuts to discretionary spending projected over the next decade. These discretionary spending cuts are much more damaging to macroeconomic stabilization and job growth than would be a cancellation of these extenders. Further, the benefits of these tax extenders are distributed far more regressively than benefits from a comparable amount of discretionary spending.

Lastly, because the political realities of Congress make individual provisions within the tax extender package difficult to jettison, history has taught us that the number of temporary provisions in the code tends to increase (JCT n.d.). In 1998, there were 42 such provisions; currently there are 79. Hence, the annual amount of tax revenue put out of reach because the extenders are on autopilot grows over time.

The regular extension cycle does a poor job of incentivizing behavior: A case study of the R&D tax credit

Tax incentives are called that for a reason—they exist to incentivize some kind of behavior that our political system has determined is for the public good. For example, the employer-provided health care exclusion incentivizes employers and employees to offer and receive health insurance through the workplace, and this serves the useful policy goal of constructing insurable risk pools.

Though the provisions within the tax extender package are often renewed, there is routinely uncertainty as to whether they will in fact be extended. If economic actors are unsure whether a tax provision will be in place in future years, it is impossible for them to commit to the kind of long-term investment that the tax provisions were established to provide in the first place.

The research and experimentation (or R&D) tax credit, for instance, has been extended 14 times since 1981 (Plumer 2014). It was even allowed to lapse for a year in the 1990s. As the U.S. Department of the Treasury (2011) notes, "The overall effectiveness of the current credit may be negatively affected by the fact that it has been perceived as temporary, which makes it difficult for firms to factor in its effect on long-term research projects and research projects with long lead times." The same problem can be seen in several of the other provisions within the tax extender package.

Moreover, if the tax extenders are put in place retroactively—as was the case in 2012 (when they were passed by Congress only in January of the following year) and may again happen this year—it is likely the provisions' recipients acted as if the incentives would not be passed. In this case, there is no behavioral change whatsoever due to the tax provisions. Indeed, the restoration of a tax break implemented retroactively is simply a windfall—free money from the U.S. government.

Of the last seven tax extender packages to become law, each included some provisions that were extended retroactively; that is, they were extended only after they had expired.[10] Let us again look at the R&D tax credit as an example. In each of the last seven extensions of the credit, it was extended retroactively, leaving long periods in which the credit was not in effect, as shown in **Table 1**.

As part of each of the tax extender bills in Table 1, the R&D tax credit was not in effect for portions of 1998, 1999, 2004, 2006, 2008, 2010, and all of 2012. As the White House and the U.S. Department of the Treasury (2012) note, "Keeping this tax incentive under constant threat of expiration means that businesses planning for long-term research projects have to account for the risk that the credit will not be available, blunting its effectiveness as an incentive." During periods when the credit has temporarily lapsed, it is difficult to discern behavioral changes by firms that regularly receive the credit (this difficulty is likely due to a combination of long-range planning and an assumption that the credit will indeed be extended). Nevertheless, the uncertainty does have a cost. Indeed, some of the cost may come from a dampening of the incentive effect.

As the Congressional Research Service (CRS) explains, "Many R&D projects have planning horizons that extend beyond a year or two. If business managers cannot count on receiving the credit over the expected life of an R&D project, they are unlikely to take it into account when setting the size of annual R&D budgets. Under these circumstances, the credit would exert little or no influence over R&D investment decisions, defeating its purpose" (Guenther

TABLE 1

Tax extender packages passed since 1998

Law number	Date law passed	Date law expired	Retroactive to	Period law not in effect
P.L. 105–277	10/21/1998	6/30/1999	7/1/1998	7/1/98–10/20/98
P.L. 106–170	12/17/1999	6/30/2004	7/1/1999	7/1/99–12/16/99
P.L. 108–311	10/4/2004	12/31/2005	7/1/2004	7/1/04–10/3/04
P.L. 109–432	12/20/2006	12/31/2007	1/1/2006	1/1/06–12/19/06
P.L. 110–343	10/3/2008	12/31/2009	1/1/2008	1/1/08–10/2/08
P.L. 111–312	12/17/2010	12/31/2011	1/1/2010	1/1/10–12/16/10
P.L. 112–240	1/2/2013	12/31/2013	1/1/2012	1/1/12–1/1/13

Source: Guenther (2011)

2011). Further, CRS assesses that it is "conceivable (though hard to prove)" that the ongoing string of temporary credits provides an uneven incentive effect across industries; those with longer planning and development timelines, like pharmaceuticals, may be poorly incentivized by a credit they believe to be temporary, whereas, say, software firms could start and finish an entire project within the timeframe of a two-year extension of the credit (Guenther 2011).

Moreover, a University of Michigan study (Hoopes 2013) found that market analysts tend to adjust their earnings expectations upward for companies that receive the credit after it is extended, meaning the financial markets are uncertain whether the tax credit will be extended. Markets therefore undervalue companies that receive the credit (compared with what would be an accurate valuation if there were certainty the credit would indeed be extended), which costs those companies money. Once the credit is extended, market analysts have been shown to have difficulties in determining accurate valuations in a timely manner. Furthermore, "trading costs rise when markets have difficulty interpreting earnings affected by the expired R&D tax credit" (Hoopes 2013).

Indeed, the experience of the R&D tax credit shows that the effect of continually extended "temporary" tax provisions is neither the short-term behavioral change one would expect from a short-term incentive, nor the consistent utilization of credits that would come with policy certainty. Instead, it has become the worst of both worlds.

Tax extenders make informed fiscal debate more difficult

A final argument for why tax extenders represent misguided public policy is the one most irritating to budget wonks: The expected continual extension of these provisions makes difficult the creation of a single budget baseline that all parties agree on, and this can damage the prospects for having transparent, evidence-based fiscal policy debates. In essence, if we assume the extenders will continue to be routinely renewed, as they have in the past, narrowing just one provision within an extender package will shrink the deficit. If instead we assume that the extenders will expire as the law states they will, each renewal will expand the deficit greatly. In this manner, policymakers can play mathematical and verbal games, pretending to be fiscally hawkish or dovish as it suits their audience.

This situation exists because the standard in scoring tax and spending provisions in Beltway policy debates is a 10-year "budget window," analyzed by CBO. Legislation is often written in such a way as to minimize the projected effect on the deficit over this 10-year window.

For example, in a particularly egregious case, the Bush-era tax cuts were designed to expire in 10 years (Klein 2010a), so as to not add to the deficit after that.[11] Similarly, the major *spending* provisions of the Affordable Care Act—the Medicaid expansion and the individual insurance subsidies—were pushed back to 2014 from 2013 at least in part to ensure that the legislation's costs would not exceed $1 trillion in CBO's 10-year budget window,[12] and was scored by the CBO to be deficit-reducing over both its first and second decades (CBO 2010). The plethora of policies that are routinely extended but not paid for leads to official budget projections that are (officially) acknowledged to be unrealistic. (The most egregious examples of these policies are the more-or-less regular, unpaid-for patches of the Medicare Sustainable Growth Rate[13] and the alternative minimum tax.[14]) For that reason, the Congressional Budget Office has routinely published an "alternative fiscal scenario" (AFS) baseline,[15] which includes policies that are set to expire under current law but widely expected to be extended.

The existence of both an official "current law baseline" as well as an AFS baseline greatly hinders easy assessment of federal policymakers' and lobbyists' claims concerning various policies. For example, measured against the CBO's official budget baseline, which assumes budget-affecting provisions will expire when the current law dictates they will, the "fiscal cliff" deal in 2013 to end the Bush-era tax cuts for high earners but keep them for all others was actually a tax *cut* for all Americans. But measured against the AFS, which assumed the Bush-era tax cuts would continue for all income levels, the law was a tax *increase* for high-income taxpayers.

This situation makes transparent debate about fiscal policy extremely difficult. It allows lawmakers' proposals to be labeled as either fiscally irresponsible or fiscally hawkish depending on which baseline is invoked. The existence of competing baselines also adds to the challenge of educating the public on fiscal issues—a challenge that is especially acute when it comes to tax extenders. If competing politicians can simultaneously label the same policy a tax hike or a tax cut and both be technically correct, the public can be forgiven for not understanding the fiscal consequences of decisions made in Washington.

Conclusion

Unfortunately, there is little chance the tax extenders will each undergo the thorough analysis that is clearly needed in the near future. As previously noted, Sen. Wyden, who recently became chairman of the Senate Finance Committee, has stated he would like his committee to promptly enact a tax extender package.

Because lumping the extenders together allows disparate constituencies—teachers, manufacturers, realtors, financiers, etc.—to all advocate for the same bill, splitting it apart would be politically disadvantageous for proponents of any single provision, lawmakers and lobbyists alike. Nonetheless, it is important to point out how the extenders are, both collectively and individually, representative of misguided public policy. The status quo enables provisions with mostly marginal societal benefit to be lumped together, creating legislation that is at once broadly popular yet undiscerning and regressive.

As Rutgers University Professor Rosanne Altshuler said in testimony before the Senate Finance Committee, when it comes to temporary tax provisions, “an expiration date can be seen as a mechanism to force policymakers to consider the cost and benefits of the special tax treatment and possible changes to increase the effectiveness of the policy. This reasoning is compelling in theory, but has been an absolute failure in practice as no real systematic review ever occurs. Instead of subjecting each provision to careful analysis of whether its benefits outweigh its costs, the extenders are traditionally considered and passed in their entirety as a package of unrelated temporary tax benefits” (Senate Finance Committee 2012).

While it is highly unlikely that policymakers will become more deliberate in their review of tax extenders this time around, there is still value in pointing out how and why unthoughtful fiscal policy decisions are harmful. Ideally, no extender legislation would be approved without careful consideration of each provision. Congress should improve and make permanent those that pass muster, and simply shelve those that do not.

About the author

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Endnotes

1. For an example of Summers making this argument, see Summers (2013).

2. This analysis leaves out bonus depreciation, which is widely expected to not be renewed. (Typically, firms can deduct part of the costs of some of their equipment against their taxes, for the loss of value to that equipment for normal wear and tear. “Bonus depreciation” was a temporary measure that allowed firms to deduct a greater portion of the value of some of their equipment.)

3. The Congressional Budget Office (2014b) recently put out a report on the 55 provisions that expired on Jan. 1, 2014, finding that the 10-year (2015–2024) cost of extending these provisions would be $448 billion. This number does not take into account the provisions that expire within the next decade, which accounts for most of the difference between CBO’s number and CBPP’s 10-year (2014–2023) figure.

4. Figures are as calculated by Citizens for Tax Justice (2013a).

5. For more such policy recommendations, see Linden and Tyson (2012) and Citizens for Tax Justice (2013b).

6. For a list of these states, see Institute on Taxation & Economic Policy (2013).

7. Such as those offered by Keightley and Lunder (2013).

8. This is true even when including the recent Murray-Ryan budget deal (Smith 2013).

9. CBO (2014a) makes this point clearly: “Tax expenditures are more similar to the largest benefit programs than to discretionary spending programs: They are not subject to annual appropriations, and any person or entity that meets the legal requirements can receive the benefits.”

10. The last seven, as compiled by the Congressional Research Service, were signed into law on the following dates: Oct. 21, 1998; Dec. 17, 1999; March 9, 2002; Oct. 4, 2004; Dec. 20, 2006; Oct. 3, 2008; Dec. 17, 2010; and Jan. 2, 2013 (Sherlock 2013).

11. The sunset provision of the Bush-era tax cuts also enabled their proponents to pass them via the "reconciliation" process, which requires only 50 Senate votes for approval, rather than the standard 60-vote, filibuster-proof supermajority. (The "Byrd Rule" states that reconciliation rules can be applied if the legislation does not add to the deficit beyond the 10-year budget window.) For more, see Rampell (2010).

12. The Affordable Care Act (ACA) includes spending cuts and revenue increases as well as spending increases; proponents of the legislation nonetheless wanted to ensure that the new spending in the ACA did not total $1 trillion. For more, see Klein (2010b).

13. The Medicare Sustainable Growth Rate (SGR), in law since 1997, "adjusts Medicare physician payment rates so that total spending on physician-related services increases in line with the overall economy. Every year since 2001, the SGR formula has called for an across-the-board reduction in payment rates, because the overall increase in the volume and intensity of physician-related services has exceeded the target SGR. Since 2002, Congress has stepped in with short-term legislation to avert the payment reduction. These 'patches' have failed to keep up with inflation over time and also have resulted in a divergence between the actual level of Medicare physician-related spending and the target in the SGR formula, so that the budgetary cost of permanently fixing the SGR runs into hundreds of billions of dollars" (McClellan, Patel, and Sanghavi 2014).

14. The alternative minimum tax was finally indexed to inflation in 2013 (Kadlec 2013).

15. For CBO's projections of the baseline budget deficit made in May 2013, see Congressional Budget Office (2013a).

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