



# Audit the Tax Code

## Doing What Works for Tax Expenditures

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# Introduction and summary

The government funds programs in two ways. First, there's straightforward direct spending—money comes in and the government directly spends it or distributes it to others to spend. Then there are tax expenditures. These expenditures are used to accomplish the same goals as direct spending—they provide incentives for desired behavior, support needed services, and assist certain individuals, groups, or companies. But, unlike direct spending, tax expenditures transfer money by lowering an individual or company's taxes.

The home Weatherization Assistance Program, or WAP, can serve as an illustration of how these two funding methods can achieve the same ends. The WAP helps low-income families make their homes more energy efficient, which reduces family energy bills. It does this by directly paying the workers who provide these weatherization services. But as an alternative to directly providing services, the government could encourage individuals to weatherize their own homes by reimbursing them for the cost of weatherization. This reimbursement could be delivered as a check or through a tax benefit that reduces an individual's taxes.

In all three cases—the direct service, the check, or the tax benefit—the government pays the same amount for people to weatherize their homes. The same amount of money leaves the government and the same amount of money arrives in private pockets. Yet policymakers and politicians treat the costs incurred in the first two instances as spending, but not the tax expenditure. Many tax expenditures consequently are not evaluated for effectiveness or regularly scrutinized in the budget process.

This uneven treatment should change. Tax expenditures are spending programs implemented through the tax code. These spending programs deliver subsidies to individuals and companies through special tax credits, deductions, exclusions, exemptions, and preferential rates, and they cover a wide range of activities. They help people save for retirement, buy a home, or pay for college; provide incentives for companies to invest in green energy technologies or build nuclear power plants; subsidize corporations that drill for oil or purchase real estate; and much more.

The cost of tax expenditure programs has skyrocketed over the last two decades. Last year, spending through tax expenditures totaled over \$1 trillion—significantly more than all nondefense discretionary spending. This year, tax expenditures will make up nearly 25 percent of total government spending.

A major reason for this growth is that it is generally easier to win votes for tax expenditures than direct spending because they are seen as tax cuts. As a result, members of Congress often pursue their priorities through tax expenditures even if direct spending would be more effective at less cost.

But spending programs delivered through tax expenditures should be subject to the same level of scrutiny as direct spending programs. We should make sure tax expenditures are efficiently delivering desired results. Tax expenditures that don't work or are misguided should be scrapped—just the same as ineffective spending programs.

In order to scrutinize tax expenditures:

- Policymakers must first treat tax expenditures as a form of spending.
- The government should measure and evaluate tax expenditures.
- Tax expenditures should be integrated into the budget process.
- Transparency and accountability of tax expenditure spending should be enhanced.

This paper will review each of these steps in more detail.

The Center for American Progress's Doing What Works project is focused on maximizing the value and results of every government dollar spent. But official annual budgets currently do not itemize spending through tax expenditures, which presents a skewed picture of total government spending. This lack of scrutiny is fiscally irresponsible and leads to significant waste.

To be sure, direct spending programs do not always receive the scrutiny they deserve either. Our project seeks to strengthen performance assessment, the budget process, and public transparency so that we make smarter spending decisions. But we are advancing these reforms for all spending, including direct spending and tax expenditures.

In the case of tax expenditures this is not a matter of reforming the current system, as it is for direct spending. It is a challenge to the system itself—something much more difficult. There are jurisdictional issues among congressional committees that would have to be overcome. The Treasury Department, which has resisted measuring tax expenditures, would have to get on board. And congressional tax and appropriations committees, as well as the White House Office of Management and Budget, would have to figure out how to incorporate tax expenditures into the budget process.

This paper is not intended to address these difficult issues and other implementation questions. Instead, what follows provides the Doing What Works philosophy on tax expenditures and previews work we plan to undertake over the coming year to develop specific solutions.

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