Daily Tax Report: State

People look at their reflection with the city skyline during a press preview for the Roof Garden Commission: Dan Graham with Günther Vogt at the the Metropolitan Museum of Art in New York April 28, 2014.

Photographer: Timothy A. Clary/AFP via Getty Images

Tax Expenditure Scrutiny Can End Trillion-Dollar Political Game

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Tax expenditures should be scrutinized as much as direct spending but are often under-reported, if reported at all. Improving estimates and reporting of such outlays would ease budget constraints and help governments better align their core policy objectives, say Flurim Aliu and Agustin Redonda of the Council on Economic Policies and Doug Koplow of Earth Track.

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Though a quarter-century old, the federal child tax credit has been the subject of increased debate in recent years within the United States. Conservatives highlight its large fiscal cost while proponents focus on its effectiveness in fighting child poverty. Both camps rely on a significant amount of data on the cost and impacts of the provision.

Topics

This type of data is missing for many tax breaks in the US and is lacking entirely in many countries. When it comes to evaluating the scope, size, and impact of tax expenditures, policy makers are most often driving blind.

Too often, government spending is understood only as cash payments to specific individuals or groups. However, targeted exemptions or reductions in taxes owed strain public coffers similarly to direct spending, though often with far less visibility.

This type of outlay, referred to as tax expenditures, is used widely, and the resulting loss in revenue flowing into Treasuries (revenue forgone) is surprisingly large. In fiscal 2021, for example, income-related federal tax expenditures in the US amounted to $1.4 trillion in revenue forgone—a figure equal to more than 20% of the $6.8 trillion in federal direct spending during that same period.

Perhaps even more sobering, the lost revenue from tax breaks were equal to roughly 70% of the $2.1 trillion in federal tax revenue collected, or about 6% of GDP. They nearly equaled the $1.6 trillion in total federal discretionary spending that year, a category that includes key government support for defense, food and agriculture, energy and environment, transportation, and education.

The US is not an outlier—2020 tax expenditures amounted to 14.2% of GDP in the Netherlands and 10.4% in Ireland. During the same year, Canada and the UK logged revenue losses comparable to the US at 6.5% and 8.1% of GDP, respectively. Average revenue losses globally approach 4% of yearly GDP.

Similar to direct spending programs, tax expenditures are used to pursue a variety of policy goals, including regional development, attracting foreign direct investment, greening the economy, or mitigating inequality and poverty. And like those spending programs, tax expenditure provisions can be politically influenced or poorly structured such that they end up supporting non-target groups or generating windfall gains to the wealthy.

The big difference across these two areas is in terms of transparency, and that needs to change. Assessing the scale of support, the main beneficiaries, and the effectiveness of a tax break in achieving its stated policy goals are critical to ensure the efficient use of public resources.

The scope and degree of detail of the Canadian Tax Expenditure report provides a useful model. Capturing not just basic information on each provision and why it is classified as a tax break, Canada also links revenue forgone estimates to policy goals and the standard functions of government, recognizing that tax expenditures and direct spending are often interchangeable policy strategies. Further, the Canadian report on federal tax expenditures includes references to specific evaluations of tax breaks. The 2021 report, for example, included a cost-benefit assessment of subsidies to childcare.

Transparency Challenges

agriculture regulation
Gross Domestic Product
federal budget
non-U.S. tax
federal tax
child credit
fossil energy
collection of tax
individual income tax
foreign direct investment

Unfortunately, we are far from achieving even a minimal level of transparency. The Global Tax Expenditures Database is the most comprehensive tally of tax expenditures in the world, gathering all available tax expenditure information published by national governments worldwide since 1990. Yet, among the 218 countries it tracks, more than half—116—are classified as non-reporting against the low bar of having released at least one official tax expenditure report within the last three decades.

Even among the 102 reporting countries, the quality and scope of the information provided varies significantly and is often quite limited. For example, of nearly 23,000 tax expenditure provisions currently captured within the GTED from national-level data, 30% included no estimate for the associated revenue forgone. This is a critical value to assess the magnitude of the tax breaks and prioritize reform. Yet, of the roughly 16,000 provisions that do contain a revenue loss estimate, 60% don't disclose the policy goal that they were implemented to achieve, making evaluations of policy efficacy near impossible.

Under-reporting is a pervasive problem. The latest TE report of the UK, for example, lacks revenue forgone values for more than 30% of its reported tax expenditure provisions. While the report lists six broad reasons for this gap, they are generic, such as lack of data, confidentiality issues, and the rather unhelpful category of "other."

An even bleaker scenario arises with sub-national reporting and disclosure. Initial data reviews of OECD's fossil fuel subsidy database indicate that sub-national tax breaks supporting the production and consumption of fossil fuels are significant in many countries. These sub-national subsidies often are reported sporadically or not at all.

The US is an exception. Most states report on tax expenditures with disclosure that compares favorably even with national tax expenditure reports in many other countries. A detailed inspection, however, shows that important gaps remain. For instance, the lack of transparency and data tracking between federal and state opportunity zone programs renders proper evaluation of the total taxpayer subsidy to construction projects impossible.

Another example is a legislative loophole for mandatory tax expenditure reporting in Texas that enables large exemptions from smaller tax bases to be excluded, even if they result in substantial losses to state taxpayers. The result is that the single largest tax break to natural gas, worth more than $1 billion in 2022, didn't have to be included in the report.

Tax expenditures should be subject to as much scrutiny as direct spending. Indeed, the opacity of tax expenditure beneficiaries creates political pressures to increase the public resources directed in this way because the political costs to both recipients and their political supporters are lower. Improving tax expenditure estimation and reporting would ease budget constraints and allow the design of tax expenditures that better align with the government's core policy objectives.

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