

Matt Yglesias

Today at 10:01 am

[The Perverse Distributional Consequences Of Tax Breaks Are a Feature To Some On The Right](#)

Progressives have developed “tax expenditures” as a term to communicate with the public about the proliferation of loopholes in the tax code. A certain strain of libertarian has decided to [object to this verbiage](#) in pursuit of the goal of minimizing federal revenue. Since the ultimate level of revenue is [determined by the level of spending](#) rather than by the structure of the tax code, I don’t think this will achieve anything for them. But the point either way is that if your concern for “small government” is about the idea that public policy is distorting the operation of the market economy rather than tax-fetishism, then tax loopholes are distorting in exactly the same way as direct spending would be. A large direct government expenditure on housing would shunt an artificially large share of social resources into the housing sector, and a giant tax break for housing has the same impact.

The main difference, as CAP’s Seth Hanlon explains, is that doing it with a tax break [gives most of the benefits to rich people](#):

Consider the mortgage interest deduction, which is by far the largest government housing program. Its estimated cost of \$98.6 billion in the upcoming fiscal year is more than twice as much as the discretionary budget for the Department of Housing and Urban Development. **If a family in the 15 percent tax bracket**

claims the deduction (assuming it itemizes its expenses, which is unlikely), the government essentially matches 15 cents for every dollar in mortgage interest paid. Families in the highest 35 percent tax bracket get the largest benefit: 35 cents for every dollar in mortgage interest.

Of course, **taxpayers in higher tax brackets tend to have bigger homes and bigger mortgages, and therefore more deductible interest.** And so wealthy taxpayers with larger homes get the greatest benefit from the deduction:

Household income	< \$40,000	\$40,000–\$75,000	\$75,000–\$125,000	\$125,000–\$250,000	\$250,000+
Average tax savings from the mortgage interest deduction	\$91	\$523	\$1,264	\$2,703	\$5,459

Now of course in principle that government *could* frame a program of direct expenditures on housing such that the richer people and people with fancier houses get more help than people with average incomes and average houses. But in practice that would never happen, since it would be insane. Doing it through the tax code gives you all the pernicious (or perhaps you think it's beneficial) economic distortions, and also structures the benefit in an upside down way. So, again, if your worry about big government is that you think smaller government will promote human well-being then you ought to be very worried about tax loopholes, whether or not you want to call them "tax expenditures."

That said, we have seen an upsurge in rightwingers expressing a different concern. Representative Paul Ryan is a fan of Ayn Rand and Harvard economist and former Bush Council of Economic Advisers Chairman Greg Mankiw has explained that progressive taxation is immoral even though it promotes higher levels of human welfare. Under the circumstances, you might think the economic distortion of tax loopholes isn't a big deal and their upside down nature is a feature rather than a bug. After all, according to this view improving the welfare of humanity as a

whole is small potatoes compared to undoing status quo policy's unconscionably immoral treatment of rich people.

10

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1

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John_Yossarian Today 10:14 AM

"Representative Paul Ryan is a fan of Ayn Rand and Harvard economist and former Bush Council of Economic Advisers Chairman Greg Mankiw has explained that progressive taxation is immoral even though it promotes higher levels of human welfare."

Nice post, Matt. Let's work on sentence structure going forward.

Like

Reply

monarda Today 10:19 AM

It's immoral not to help rich people steal.

2 people liked this.

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Reply

beowulf Today 10:28 AM

That's a good point, tax expenditures have the same fiscal impact as direct spending with the added feature of distorting private investment decisions (for good or ill).

Arthur Laffer's 13 / 13 flat tax plan (the 13% income tax, 13% VAT Jerry Brown endorsed in his 1992 presidential campaign) is not the worse idea in the world. For one thing, Laffer deals with the mortgage interest deduction in an interesting way. Despite removing just about every other tax break, he keeps mortgage deduction in place but gives the same deduction to renters, thus removing the tax incentive for people to buy instead of rent without pissing off every homeowner in America.

The other thing Laffer does, much to his credit, is to add unrealized capital gains to the tax base. Even after adjusting capital gains rate for inflation (which isn't really necessary), it would raise a LOT of money, and since wealth is even more stratified than income, even a flat tax on accrued gains would be inherently progressive.

<http://books.google.com/books?...>

Of course, once a Laffer flat tax were in place, it'd be very easy (technically, if not politically) to add income and consumption surtaxes on the very wealthy (say, an additional 13 / 13 on income or consumption over \$1 million), but keep that on the downlow. :o)

Like

Reply

beowulf Today 10:42 AM

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Boy this is an easier call than even Geithner versus Galbraith:

And Jesus sat over against the treasury, and beheld how the people cast money into the treasury: and many that were rich cast in much.

And there came a certain poor widow, and she threw in two mites, which make a farthing.

And he called unto him his disciples, and saith unto them, Verily I say unto you, That this poor widow hath cast more in, than all they which have cast into the treasury:

For all they did cast in of their abundance; but she of her want did cast in all that she had, even all her living.

(Mark 12:41-44)

<http://www.newyorker.com/archi...>

Like Reply

amiller92 Today 10:52 AM

It's much easier to declare all taxation to be theft (with the helpful corollary assumption that property rights exists independently of the legal system that enforces them) and therefore view anything that reduces taxes paid as a good thing.

It also makes for better campaign slogans.

Like Reply

Rootboy 17 minutes ago [in reply to amiller92](#)

Right. "Letting people keep more of their money" is good, "giving people money" is bad, even if the consequences are exactly the same. It's just semantics borne out of a hatred for government revenue.

Like Reply

Sonic Charmer 47 minutes ago

Isn't what's really going on here is that the nominal progressivity of the income tax portion of tax ends up getting undone, one way or another, using loopholes and 'credits' that primarily end up accruing to higher-income taxpayers?

If you don't like the loopholes/credits, doesn't this argue for a 'grand bargain'? Flat(ter) income tax in exchange for no-loopholes (including, the mortgage-interest deduction). I'd be on board. Would you Matthew?

Like Reply

CapitalistRoader 16 minutes ago

The linked Cato article had a great video of Jon Stewart's comments on Obama's deficit speech (...my plan will require us to come together and make up the additional savings with more spending cuts and *more spending reductions in the tax code.*). Here's Stewart's take, transcribed by Cato:

What? "Spending reductions in the tax code"? The tax code isn't where we spend, it's where we collect. And tha—ohhhhh. I guess what you said is tax code — code for raising taxes. You managed to talk about a tax hike as a spending reduction. [Laughter.] Can we afford that and the royalty checks you're going to have to send to George Orwell? That is the weirdest way — just say tax hike.

True doublespeak. BTW, Cato is all for eliminating the mortgage deduction:

<http://www.cato-at-liberty.org...>

Like Reply

Thomasy 11 minutes ago

Reading this one might come to the mistaken conclusion that the Ryan plan doesn't eliminate these tax expenditures, or that Matt would support a plan that does. (Matt favors eliminating the tax expenditures only to the extent that it represents a marginal tax increase.)

Like Reply

[Paul Rossa](#) 6 minutes ago

What is the average tax savings of the deduction for interest paid on a mortgage on rental property? Explain why we should subsidize buying a home to rent and not a home to occupy.

Why are bloggers ignoring a simple fact that most taxpayers know: businesses and corporations deduct most of what they spend, while the individual taxpayer deducts very little. The notion of "tax expenditures" has been warped from what common sense would dictate.

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Real-time updating is **enabled**. ([Pause](#))

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