COMMITTEE ON FINANCE
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Opening Statement of Senator Max Baucus (D-Mont.)
Regarding the Effectiveness of Tax Incentives
As prepared for delivery

Albert Einstein once said: "Make everything as simple as possible, but not simpler."

There is a limit to how simple certain things can be. But today's tax code can certainly be simplified. And the complexity of the code has significant consequences.

At our last hearing we looked at unintended consequences of the complications in our tax code.

Our witnesses laid out undesirable distortions that may prevent growth and job creation. For example, we discussed how the tax bias towards debt in the tax code may have contributed to the financial crisis.

But some of the tax code's complexity is a result of incentives inserted in the code. That intentional complexity is what we are discussing today.

Today we will ask our expert witnesses how to measure the effectiveness of a tax incentive, including our current incentives.

And we will ask how to best structure incentives so people respond as we intended.

We will ask how we get the most bang for the buck. Or, in the words of Dr. Einstein, how do we keep it simple, but not too simple?

Today, we have all sorts of incentives in the code. Many incentives are meant to encourage or discourage certain behavior.

The research and development credit is meant to encourage innovation and create jobs.

The higher education incentives are meant to help students pay for college.

The retirement savings incentives are meant to encourage saving for those later years.

In 2010, we used 109 billion dollars for more than a dozen different incentives to help Americans save for retirement. We used 91 billion dollars to promote homeownership through the mortgage interest deduction.

All in all, incentives in the income tax code cost more than one trillion dollars each year. That's about the same as the total amount raised by the income tax code.

Studies show that the way tax incentives are presented and structured affects the way individuals respond to them.

Take retirement savings tax incentives, for example. Studies have found that taxpayers save more of their money for retirement when they receive a contribution that matches their own rather than receiving a tax refund at the end of the year.

Tax incentives are also more effective when they are offered immediately.

Programs like "Cash for Clunkers" show that on-the-spot incentives are more effective than a tax credit individuals receive when they file their tax returns.

More people purchased energy-efficient cars more quickly through that program because the money was in their hand right away.

Today we will ask our witnesses what makes a well-designed tax incentive.

Do taxpayers respond less to complex incentives? What about the response to temporary tax incentives? There are certainly many complex and overlapping tax incentives.

For example, there are more than 15 provisions to assist with the rising costs of higher education. The sheer number of options, and choosing between them, often overwhelms taxpayers.

Does this complexity discourage young people from enrolling in college?

There are also a huge number of temporary tax incentives. And the prevalence of these temporary provisions has risen dramatically over the past decade.

There are now 141 temporary provisions that expire nearly every year. These temporary tax incentives hinder taxpayers' ability to plan. As a result, they may only benefit those people who would have acted anyway.

Ultimately, the desirability of any tax incentive will depend on whether we want to encourage the activity in the first place.

If Congress is going to encourage certain activities through the tax code, we need to know how to most effectively achieve the intended policy goals.

We need to know how to structure tax incentives that are simple enough to generate a response, but not so simple that they are not well targeted.

I look forward to the discussion today from these experts.

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