THE FISCAL CLIFF AS REELECTION STRATEGY: RETHINKING THE TEMPORARY TAXATION DEBATE

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ABSTRACT

Recent scholarship contends that temporary tax provisions are socially costly because they increase rent-seeking activity and create uncertain investment environments. This Article challenges that view and shows that, while temporary tax provisions may increase rent-seeking activity, such activity is not always socially costly; and while temporary tax provisions may create uncertain investment environments, such environments are not always unfavorable for private investors. The real problem with temporary tax provisions, simply put, is that legislators use them to win reelection and externalize a number of costs in the process.

Once this fundamental point is grasped, the normative conclusions that follow sharply differ from those offered by prevailing scholarship. Some scholars, for example, have recently recommended that all tax legislation should default to permanent status in order to decrease rent-seeking and

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investment uncertainty. Yet other scholars have recommended that all tax legislation should default to temporary status for the same reasons. Given that legislators use temporary tax provisions to win reelection, however, both recommendations miss the mark. Not only are the social costs of rent-seeking and investment uncertainty unclear, recommendations of self-enforced congressional default rules will not adequately constrain lawmakers from strategically seeking reelection. This Article recommends therefore that temporary tax provisions should, at the constitutional level, require immediate offset.

I. INTRODUCTION

While temporary fiscal policies are at least as old as the American Constitution,[1] the frequency and intensity of their strategic use in the United States has sensationally increased within the past fifteen years. At the beginning of 2000, more than 100 American tax provisions were scheduled to expire, including some of the largest tax cuts in history.[2] Only a decade prior, less than two dozen relatively inconsequential provisions were scheduled to expire.[3] The increase from 1990 to 2000 continued into the following decade: during fiscal year 2011, 251 tax provisions were scheduled to expire.[4] As a result, there has been a steady output of legal scholarship on temporary taxation, which, in the main, observes that temporary provisions in the tax code promote irresponsible fiscal imbalances for three reasons. First, temporary provisions ease the passage of spending increases and tax cuts.[5] Because

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1 Article I § 8 provides that "[t]he Congress shall have Power [t]o lay and collect Taxes, Duties, Imposts and Excises, . . . [in order] [t]o raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years." U.S. CONST. art. I, § 8.

2 Rebecca M. Kysar, *Lasting Legislation*, 159 U. PA. L. REV. 1007, 1010 (2011).

3 *Id.*

4 *Id.* at 1010 n.6; *see also* STAFF OF J. COMM. ON TAXATION, LEGISLATIVE BACKGROUND OF EXPIRING FEDERAL TAX PROVISIONS 2011-2022 (JCX-6-12) (Jan. 27, 2012) (providing background on over 140 provisions already scheduled to expire before 2022); George K. Yin, *Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint*, 84 N.Y.U. L. REV. 174, 189–90 (2009) (describing the dramatic increase in temporary tax legislation under the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901, 115 Stat. 38, 150, and the Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752).

5 *Cf.* Jacob E. Gersen, *Temporary Legislation*, 74 U. CHI. L. REV. 247, 264 (2007) (noting that temporary legislation typically passes more easily than permanent legislation because permanent legislation allocates enactment costs up front at the moment the legislation is passed, while temporary legislation allocates enactment costs at the moment the legislation is passed in addition to those moments when the legislation is extended).

temporary tax provisions last for relatively shorter times if not extended, they more easily satisfy current budget rules and are less opposed by opposition legislators and citizens.[6] They therefore are more likely to become law. Second, most of the scholarship recognizes that temporary tax legislation easily circumvents budgetary rules that require offsetting, i.e., concomitant increases in taxation or reductions in outstanding spending, that are, in theory, supposed to render new spending increases or tax cuts budget neutral.[7] Because offset rules are easily circumvented, temporary timing rules facilitate passage of spending increases or tax cuts that increase the deficit. This process will be explained in the following section. Third, temporary tax legislation is subject to inertia.[8] Future legislatures are routinely forced to extend temporary changes or lose political power.[9] Failure to extend a popular spending program or tax cut can be politically costly; thus, the expected budgetary cost of a temporary change is actually much greater than the initial budgetary cost used for its accounting.[10]

Opponents of temporary taxation provide examples of temporary enactments, which were extended at each expiration, and argue that the inertia of a temporary enactment typically propels it to de facto permanent status.[11] If legislatures were required to account for the expected costs of a temporary

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6 *See* Elizabeth Garrett, Comment, *Accounting for the Federal Budget and its Reform*, 41 HARV. J. ON LEGIS. 187, 195 (2004) (explaining that if temporary tax provisions were made permanent, their potentially negative impacts would be much greater).

7 *See, e.g.*, Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501, 526 (1998) ("Several . . . means of [evading revenue offset rules] exist . . . ."); Kysar, *supra* note 2, at 1023 ("Not surprisingly, waivers and violations of [budgetary offset] rules are common.").

8 Kysar, *supra* note 2, at 1031 n.93 (noting that the political pressures for temporary spending and tax cuts are great, and that the endowment effect often leads to inertia and entrenchment of provisions once they are passed). The endowment effect generally describes the possibility that people feel more strongly about keeping something rather than receiving something new. *See* Manoj Viswanathan, Note, *Sunset Provisions in the Tax Code: A Critical Evaluation and Prescriptions for the Future*, 82 N.Y.U. L. REV. 656, 672 (2007) ("A tax cut that was originally perceived as a windfall becomes an entitlement."). For an overview of the endowment effect, see Christine Jolls, Cass R. Sunstein & Richard H. Thaler, *A Behavioral Approach to Law and Economics*, *in* BEHAVIORAL LAW AND ECONOMICS 13, 18–19 (Cass R. Sunstein ed., 2000).

9 Professor Garrett explains that "the vast majority of popular provisions expire in election years, thereby reducing the chance that members of Congress will be willing, even by inaction, to raise taxes on voters." Garrett, *supra* note 6, at 195.

10 *Id.* at 196 (noting that temporary tax legislation "mask[s] the long-term cost[s]" from both budgetary and political perspectives).

11 *See* Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335, 359–60 (2006) (documenting the continued extensions of the R&D tax credit and various tax cuts).

enactment, its estimated total cost would be much greater.[12] This is because the potential costs of each extension would necessarily be included in that estimate. When considering those costs, it would be far less likely that a temporary change to the tax code would acquire the political support for its passage and fail to become law as a result.[13] Thus, for opponents, the only meaningful difference between temporary and permanent taxation is that temporary taxation passes more easily through the legislature because of its perceived shorter duration and superficial satisfaction of budgetary rules. The common circumstance, however, is routine extension and actual circumvention of budgetary rules.[14] For these reasons, i.e., ease of passage, budget rule circumvention, and legislative inertia, opponents of temporary taxation argue that its use generally promotes irresponsible fiscal imbalances.

On the other hand, there are a small number of scholars who make the opposite argument.[15] They observe that a permanent spending increase or tax cut hides its full budgetary cost because it only accounts for annual changes against the baseline budget for the length of the budget window, currently set at ten years.[16] In contrast, a temporary spending increase or tax cut requires reenactment every few years, and therefore typically fits within the budget window for its entire life.[17] Because each reenactment fits within the budget window, a temporary change to the tax code continually subjects itself to budgetary approval under Congressional offsetting rules.[18] Unlike temporary

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12 Expected costs are probabilistic costs. For example, if the cost of extending a tax cut is $500 million, and there is a 50% probability of extension, then its expected cost is $250 million. For a brief overview of expected value theory, see ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 49–50 (4th ed. 2004).

13 *See* Garrett, *supra* note 6, at 195–96.

14 *Id.* at 196 (noting that tax extensions are "almost always extended [and] sometimes retroactively").

15 *See, e.g.*, Yin, *supra* note 4, at 174 (arguing that temporary-effect legislation promotes fiscal responsibility).

16 *See* Yin, *supra* note 4, at 193 (noting that legislation whose effect extends beyond the end of the budget period, such as permanent legislation, systematically understates its actual cost). The baseline is a term used to denote the amount of government revenues that would occur *without* the proposed tax legislation in effect. The cost of a proposal is the difference between the baseline, and the estimated amount of revenues that would occur *with* the legislation in effect. *Id*. at 185. Critically, the total cost of a proposed spending increase or tax cut is only computed over the life of the budget window period (typically set at five or ten years by congressional resolution). Thus any costs that accrue beyond the budget window period are not computed in the total cost of a proposal. *Id.* at 188–92.

17 *Id.* at 198 tbl.2 (providing examples of temporary tax legislation that fits within the budget window).

18 *Id.* at 208 ("[W]hen policy choices are continued, an extension of temporary-effect legislation requires congressional action that reveals the cost of continuation. . . ."). Part II.A, *infra*, further explains the mechanics of congressional offsetting.

changes, permanent changes require enactment only once, and therefore avoid accounting for those costs which extend beyond the ten-year budget window. Temporary changes to the tax code should then be favored, according to this line of reasoning in the scholarship, in order to promote fiscal balances.[19]

As already mentioned, most of the scholarship contends that temporary changes do not continually require budgetary approval under Congressional offsetting rules however.[20] Because American budgetary law is controlled by the legislature itself, budgetary rules are weakly binding and easily circumvented.[21] Critics of temporary taxation have documented how weaknesses have led to shifting baselines, exceptions to offset requirements, and a general flouting of budgetary rules since their introduction.[22] These critics assert that any purported benefit which results from ensuring that each temporary enactment continually subjects itself to budgetary rules is therefore meaningless.[23]

The unmet challenge for opponents of temporary taxation has been to suggest a workable constraint that either prohibits the use of temporary tax legislation for avoiding budget restrictions, or that at least forces the legislature

[19] Yin, *supra* note 4, at 193 (explaining that the official cost of legislation calculated over the life of the budget window is equal to its actual cost, and lawmakers who support legislation whose effects only fall within the budget window "must therefore internalize the full budgetary consequences of their choice").

[20] Kysar, *supra* note 2, at 1035 (concluding that temporary taxation cannot be characterized as a tool for enhancing fiscal responsibility because of numerous exceptions to revenue offset rules such as a PAYGO and CUTGO); Kysar, *supra* note 11, at 384 (noting that "the threat of offset requirements has never been unmanageable [for Congress because] Congress has often found a way to avoid triggering sequestration under PAYGO"). Professor Garrett further explains that interest groups can avoid the high costs of offset requirements through several "means of evasion" such as "[t]iming gimmicks that manipulate the limited budget window" and influencing the executive branch to implement spending programs through regulations. On timing gimmicks, see *infra* Part II.A. On influencing the executive branch to increase spending, see Garrett, *supra* note 6, at 530–36.

[21] Professor Kysar explains that "[b]ecause [congressional offset rules] lack external enforcement mechanisms," that is, the rules are adopted by Congress itself, circumvention of those rules is often achieved. Kysar, *supra* note 2, at 1023; *cf.* Garrett, *supra* note 7, at 546 (explaining that Congress has institutionalized offset rules in order to destabilize tax lawmaking).

[22] *See, e.g.*, Kysar, *supra* note 2, at 1034 (detailing how many of the EGTRRA and JGTRRA tax cuts were made permanent, how the costs of extending alternative-minimum-tax relief were made permanent, and how the temporary estate tax exemption was reenacted at 2009 levels); *see also* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES *passim* (1982) (arguing that legislation generally leads to higher levels of entrenchment and provides less flexibility to legal rules than judge-made law).

[23] Kysar, *supra* note 2, at 1007–08 ("[The theory that temporary tax legislation promotes fiscal responsibility] is flawed. Many factors—shifting baselines, exceptions to the revenue offset or 'pay as you go' rules, . . . —thwart the theoretical fiscal restraint of temporary legislation.").

to observe the initially legislated duration of a temporary change through the foreclosure of extensions. The difficulty of that challenge is high. The American constitution treats extensions of temporary tax bills like any other legislative enactment.[24] Passage through the legislature and approval by the executive are sufficient for codification.[25] Nor have opponents attempted to craft a coherent legal challenge to those initial enactments of temporary taxation that are purposefully intended to flout budget law. These limitations have led opponents to suggest that the legislature should face a rebuttable default rule that requires all tax legislation to be passed permanently.[26] Proponents have suggested a rebuttable default rule that requires all tax legislation to be passed temporarily.[27]

In a detailed critique of Professor Kysar's article, *Lasting Legislation*, Professor Epstein emphasizes the inability of default timing rules to constrain lawmakers from seeking to extract rent[28] in exchange for tax legislation.[29] He

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[24] *See* U.S. CONST. art. I, § 7.

[25] Gersen, *supra* note 5, at 247 ("[T]emporary legislation merely sets a date on which an agency, regulation, or statutory scheme will terminate unless affirmative action satisfying the constitutional requirements of bicameralism and presentment is taken by the legislature.").

[26] Kysar, *supra* note 2, at 1008 ("Accordingly, this Article recommends a policy presumption . . . in favor of legislation that does not expire by its own terms . . . . This presumption should be stronger in the context of provisions made temporary due to budgetary constraints . . . .").

[27] Yin, *supra* note 4, at 193–94 ("[A]t least from the standpoint of promoting political accountability and fiscal restraint, legislation whose effect extends beyond the end of the budget period, such as permanent legislation, generally should be disfavored, whereas legislation whose effect ends no later than the end of the budget period, such as temporary-effect legislation, generally should be favored." (footnote omitted)).

[28] Rent is a political science and public choice concept that refers to the benefits an interest group receives when a particular piece of legislation is in effect. For example, a manufacturer of safety goggles is said to receive "rent" from legislation that requires workers to wear its safety goggles. Thus the manufacturer seeks rent when it petitions the legislature to pass a safety goggle requirement. Public choice theory normatively contends that rent-seeking is a wasteful activity because those who take part in it could otherwise participate in an activity that more directly bears on the economic well-being of society. *See* NICHOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM POSNER TO POST-MODERNISM 96–97 (1997). Legislators are said to "extract" rent from interest groups when they receive side payments for a particular piece of legislation that provides rent to an interest group. Thus, the legislator extracts rent from an interest group when she receives a campaign contribution in exchange for passing a safety goggle requirement that benefits an interest group with rent. *See* FRED S. MCCHESNEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION 2–3 (1997).

[29] Richard A. Epstein, Commenter, 13th Annual Faculty Conference of the Federalist Society, Young Scholars Paper Presentations (Jan. 7, 2011), *available at* http://www.fed-soc.org/publications/pubid.2082/pub_detail.asp. Professor Epstein uses the term "timing rule" to denote the default rule of expiration for a particular piece of tax legislation. *Id.* If the tax legislation contains a provision that provides for automatic expiration, then that piece of tax

asserts that any second-tier rule related to the organization of the administrative state (in this instance, a default rule that favors permanent tax legislation) cannot confine what the legislature can do as a substantive matter (in this instance, to use their discretion to rebut and continue to pass temporary tax legislation).[30] Within the context of the modern administrative state, argues Epstein, the legislature has too many degrees of freedom available to circumvent the substantive purpose of a procedural rule.[31] Permanent default rules will not suffice because they are not strong enough to prevent interest groups from successfully bargaining with the legislature for temporary tax legislation and its extension; temporary default rules will not suffice because they are not strong enough to prevent interest groups from successfully bargaining with the legislature for exemptions.[32]

As already suggested, most of the scholarship on temporary tax legislation takes a strong, and often strident, normative stance against temporary spending increases and tax cuts.[33] The tone reflects a general understanding that temporary changes to the tax code fail to lead to increased fiscal responsibility because of routine extensions.[34] Worse, the relatively shorter duration of those changes makes it politically easier for the legislature to pass spending increases and tax cuts in their first instance, which may contribute to structural increases in long-term deficit levels.[35] On the other hand, proponents point out that each of the initial temporary changes and extensions must adhere to budget rules—weakly binding or not.[36] Yet the literature has only given cursory attention as to why the extensions are

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legislation is said to be governed by a temporary timing rule. *Id.* If the legislation contains no provision that provides for automatic expiration, then that piece of tax legislation is said to be governed by a permanent timing rule. *Id.* For more background, see Jacob E. Gersen & Eric A. Posner, *Timing Rules and Legal Institutions*, 121 HARV. L. REV. 543 (2007).

30 Epstein, *supra* note 29.

31 *Id.*

32 *Id.*

33 *See supra* notes 21–23 and accompanying text.

34 Kysar, *supra* note 2, at 1034–35; *cf.* Yin, *supra* note 4, at 199–202 (noting that because the temporary research and development tax credit has continued more or less uninterrupted in one- or two-year increments since 1981, fiscal responsibility has been enhanced).

35 *See* Gersen, *supra* note 5, at 262 (explaining that because temporary legislation produces a finite stream of benefits by default, and permanent legislation produces an infinite stream of benefits by default, that temporary legislation is less costly for legislatures to pass given that the two pieces of legislation do not vary substantively, i.e., they only vary with respect to whether they automatically expire by default or not).

36 *See* Yin, *supra* note 4, at 188–90 (noting that budget window limits apply to "any form of new legislation").

routine.[37] Nor has it examined whether the inertia of temporary tax legislation outweighs its questionably weak obligation to incremental cost-accounting. In other words, does the increased ease of passage and extension of temporary tax law relative to permanent tax law outweigh the advantage of confining most temporary changes to tax law within the budget window. Professor Epstein's critique asserts that incremental cost-accounting with an offset requirement (or any other procedural budget constraint) will not adequately check bargaining between the legislature and interest groups, which he implies is socially costly.[38] Thus, the constraining benefits of temporary taxation are illusory.[39]

This Article considers the problem nonetheless for three reasons. First, Professor Epstein's assumption that bargaining between the legislature and interest groups is always socially costly is contestable.[40] Second, procedural normative recommendations that flow from an analysis of how exactly contemporary legislatures are using temporary tax legislation can be worthwhile, even if those recommendations take the form of second-tier procedural frameworks like default rules. As Professor Garrett has observed, "[p]rocedural frameworks . . . give [legislators] the opportunity to deliberate and . . . increase the chance that voters will be able to hold their representatives accountable."[41] While legislators may not take that opportunity and continue to allow their legislative decisionmaking to be dominated by the acquisition of personal benefits that accrue from bargaining with interest groups, knowledge of ideal solutions can exert pressure on their decisionmaking through other channels such as voter accountability or non-pecuniary legislator utility.[42] Lastly, procedural normative recommendations can have meaningful effects if implemented at the constitutional level. Indeed, there is a growing trend to

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37 Professor Garrett emphasizes that while Congress has no legal commitment to extend, it does have a political commitment;

> Congress is likely to deliver on [its political] commitment for several reasons: because of the past experience with [tax extensions], which were almost always extended sometimes retroactively; because of the support they received when they were passed; and because of the structure of the expirations [that is, the way they are grouped with other temporary tax provisions].

Garrett, *supra* note 6, at 196. Professor Kysar notes that the endowment effect helps explain why temporary tax cuts are more easily extended than created anew. Kysar, *supra* note 2, at 1031 n.93; *see also* Viswanathan, *supra* note 8, at 672 ("[I]n the minds of taxpayers [repeal of a temporary tax cut] becomes a tax increase rather than a return to the status quo.").

38 Epstein, *supra* note 29.

39 *Id.*

40 *See infra* Part II.B.1.

41 *See* Garrett, *supra* note 7, at 567–68.

42 *Id.*

address fiscal policy constitutionally. Within the past decade, Austria,[43] Germany,[44] Switzerland,[45] and Spain[46] have amended their constitutions with fiscal rules. In the United States, constitutional law scholars have begun to acknowledge that the general intellectual constraints placed upon amendment are largely misplaced, and that amendment should be seriously considered irrespective of the structural difficulties posed by Article V.[47] For these reasons, this Article develops a thorough analysis of the social costs and benefits of temporary taxation. It particularly focuses on how temporary tax provisions impact rent-seeking, private investment, and legislators' reelection strategy. The analysis concludes that the impact of temporary tax provisions on the social costs and benefits of rent-seeking and private investment is ambiguous.[48] However, because legislators use temporary tax legislation as a reelection strategy and thereby externalize the costs of debt service onto the public,

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43 Austria changed its constitution in 2007 in order to transform the "traditional budget principles of being economical, thrifty and useful" to four new principles: outcome orientation, efficiency, transparency, and true and fair view of federal finances. The fourth principle, true and fair view, led to a change in cash to accrual accounting. *See* Gerhard Steger, *Austria's Budget Reform: How to Create Consensus for a Decisive Change of Fiscal Rules*, 2010/1 OECD J. ON BUDGETING 1, 7 (2010).

44 Germany changed its constitution in 2009 to "prohibit[] the federal government from running a deficit of more than 0.35 per cent of gross domestic product by 2016." This reform is known as the "debt brake" or *Schuldenbremse* and is modeled after the Swiss law of the same name. *See* Daniel Schäfer & Ben Hall, *Berlin Calls for Eurozone Budget Laws*, FIN. TIMES May 16, 2010), *available at* http:///www.ft.com/cms/s/0/5ff35db4-6117-11df-9bf0-00144feab49a.html; *see also* Elke Baumann & Christian Kastrop, *A New Budget Rule for Germany*, *in* BANCA D'ITALIA PUBLIC FINANCE WORKSHOP, FISCAL POLICY: CURRENT ISSUES AND CHALLENGES 595, 600–03 (2007) (discussing the early challenges of redesigning constitutional budget rules for Germany that took place within the past decade).

45 Switzerland amended its constitution in 2001 to provide for a debt brake, which requires that the federal government maintain a balanced budget over "the medium term, i.e. over an economic cycle . . . [s]urpluses have to be managed in boom periods so as to compensate for deficits in subsequent recessions." SWISS FEDERAL FINANCE ADMINISTRATION AND FDF COMMUNICATIONS, THE DEBT BRAKE — A SUCCESS STORY 2 (2012); *see also* Daniel J. Mitchell, *How the Swiss 'Debt Brake' Tamed Government*, WALL ST. J. (Apr. 25, 2012), *available at* http://online.wsj.com/article/SB10001424052702303459004577361622927199902.html (noting that the debt brake does not balance the budget in the traditional sense, but instead balances "trendline revenue").

46 Spain introduced a constitutional debt limit in 2011 that will come into effect in 2020. Additionally, Spain constitutionally mandated that debt payments be given priority over every other type of new expenditure. José M. Abad & Javier Hernández Galante, *Spanish Constitutional Reform: What is Seen and Not Seen*, CENTRE FOR EUROPEAN POL'Y STUD. POL'Y BRIEF, no. 253, Sept. 2011, at 1, *available at* http://www.ceps.eu/book/spain%E2%80%99s-constitutional-reform-what-seen-and-not-seen.

47 *See* ADRIAN VERMEULE, LAW AND THE LIMITS OF REASON 165–68 (2009).

48 *See infra* Parts II.B.1–2.

temporary tax legislation is systematically problematic.[49] This Article, therefore, recommends a constitutional amendment which stipulates that temporary tax cuts or spending increases *and their offsets* take immediate effect.[50]

II. WELFARE ANALYSIS OF TEMPORARY TAX LEGISLATION

An analysis of the social costs and benefits of taxation is part of the generalized public finance problem of optimal public spending.[51] Solutions to this problem necessarily involve normative questions of how governments should allocate resources intertemporally since borrowing and spending occur over time. It is generally agreed that current generations should, to some extent, limit paying for frontloaded benefits with backloaded costs,[52] but governments have struggled to find the right method to control public spending and budget deficits. Non-constitutional experiments in Europe and the United States have included annual deficit limits, debt-GDP targets, compulsory balanced budgets, target discretionary spending limits, and the current American approach of placing limits on incremental changes to the deficit.[53] Each of the rules embodied in these experiments have either been bypassed or directly violated,

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49 *See infra* Part II.B.3.

50 *See infra* Part III.

51 *See* Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 388 (1954) (developing an economic model that describes government expenditure on collective consumption goods and asserting that optimal collective consumption cannot be attained through decentralized market mechanics, which gives rise to the need for public spending).

52 *See, e.g.*, Louis Kaplow, *Discounting Dollars, Discounting Lives: Intergenerational Distributive Justice and Efficiency* 6–10 (Harvard Cent. for Law, Econ., & Bus., Discussion Paper No. 550, 2006), *available at* http://ssrn.com/abstract=921436 (arguing that any limitation to fiscal policies of the current generation should be based on economic conceptions of efficiency between current and future generations); *see also* Daniel Shaviro, *The Long-term U.S. Fiscal Gap: Is the Main Problem Generational Inequity?*, 77 GEO. WASH. L. REV. 1298 (2009) (arguing that the chief harm of fiscal policies that increase the deficit is not intergenerational fairness, but rather economic efficiency).

53 *See, e.g.*, Budget Enforcement Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388–573 (codified as amended in scattered sections of 2 U.S.C.) (specifying targets for annual discretionary spending and replacing annual deficit targets with limits on incremental changes in the deficit by means of a budget window); Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings Act), Pub. L. No. 99-177, 99 Stat. 1038 (codified as amended at 2 U.S.C. §§ 900–922 (2012)) (setting deficit targets toward balancing the budget); Resolution of the Amsterdam European Council on the Stability and Growth Pact, 1997 O.J. (C 236) (specifying annual deficit limits and debt-GDP targets).

however, and most of the supporting law has either been hollowed out or repealed.[54]

The primary objective of budget rules is to decrease the shifting of future burdens that are created today to future generations.[55] As such, the rules attempt to pressure those in control to minimize preemptive borrowing and spending.[56] One reason why legislators borrow and spend preemptively is to foreclose competing legislators from capturing resources.[57] Professor Auerbach develops a model where two groups, *D* and *R*, differ in preferences over public spending.[58] For example, *D* prefers "big" government with high taxes and high direct spending. *R* prefers "small" government with equally high values of gross taxation, which are reduced by tax expenditures that limit the tax burdens of select classes of constituents. While each group cares fully about its heirs, each nonetheless feels compelled to shortchange them because any resources that could be left to them might first be captured by the competing group.[59] The analysis below also supposes that two groups, *D* and *R*, differ in preferences over public spending.[60] However, it shifts the emphasis away from preemptively capturing tangible resources that take the form of spending increases and tax cuts, and toward capturing political resources which control whether an opponent pays a political cost during an election.[61] Like Professor Auerbach's model, the analysis here supposes that each group cares fully about its heirs, but each feels the need to remain in power through using temporary preemptive borrowing and spending. Temporary tax policy shifts the political costs of applying fiscal discipline onto future political opponents.[62] When the temporary policy expires, legislators pay a political cost if they exercise fiscal

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54 *See* Alan J. Auerbach, *Budget Windows, Sunsets, and Fiscal Control*, 90 J. PUB. ECON. 87, 87–88 (2006) (noting that the European Union's attempts at deficit limits and debt-GDP targets experienced a number of violations leaving the status of its budget law in limbo and that the United States has continually either amended or repealed attempts at reining in its spending); *see also* Schäfer & Hall, *supra* note 44 (reporting on the concern of the German government that other E.U. members continue to exercise unsustainable fiscal policies).

55 Auerbach, *supra* note 54, at 88 ("budget rules . . . aim to reduce the shifting of fiscal burdens to future generations").

56 *Cf. id.* at 89 (explaining that an optimal use of the budget window efficiently allocates resources between current and future time periods); *see also* Kaplow, *supra* note 52, at 6 (arguing that conceptions of intergenerational fairness should align with economic conceptions of intergenerational efficiency).

57 Auerbach, *supra* note 54, at 89.

58 *Id.* at 89–94.

59 *Id.* at 89.

60 *See infra* Part II.B.3.

61 *See infra* Part II.B.3.

62 *Cf.* Garrett, *supra* note 6, at 195 (observing that "the vast majority" of temporary tax provisions expire during election years).

discipline and reject an extension.[63] By rejecting to extend a deficit-increasing temporary policy, legislators lose votes from supporters of those policies. At the same time, legislators lose votes from opponents if they choose to extend.[64] Because current period legislators understand that their political opponents will pay political costs through rejection or extension, current period legislators choose to preemptively borrow and spend, especially when future control of the legislature is more likely to be at stake.[65]

On the other hand, if legislators choose to preemptively borrow and spend in order to favor one group, they may need to redistribute public resources away from another group through tax increases or reductions in public spending.[66] Thus, any political support gained from favoring one group may be counterbalanced by political opposition gained from disfavoring another group. Under current budget rules of the 112th American Congress, the House may not increase spending or cut taxes unless it reduces current public spending.[67] This offset requirement is known as CUTGO, short for cut-as-you-go. Previously, in the 110th Congress, new spending or tax cut legislation could be offset through a reduction in spending or an increase in taxes.[68] This rule was known as PAYGO, short for pay-as-you-go. Under either set of rules, however, offset requirements may be sufficiently weakened so that spending can be increased or taxes can be cut without offsetting reductions in spending or increases in taxes.[69] Before introducing the cost-benefit analysis, the following section explains how CUTGO or PAYGO offset requirements are sometimes avoided.

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63 *Id.* (observing that expiration during election years "thereby reduc[es] the chance that members of Congress will be willing, *even by inaction*, to raise taxes on voters" (emphasis added)).

64 Legislators can lose votes by extending tax policies that some voters oppose. *See* Ajay K. Mehrotra, *The Price of Conflict: War, Taxes, and the Politics of Fiscal Citizenship*, 108 MICH. L. REV. 1053, 1076 (2010) (reviewing STEVEN A. BANK, KIRK J. STARK & JOSEPH J. THORNDIKE, WAR AND TAXES (2008) (noting the existence of political party allegiance to tax policies, in particular tax cuts)).

65 *See infra* Part II.B.3.

66 This is the rationale behind using offset rules with a budget window in order to maintain acceptable deficit levels. *See* Yin, *supra* note 4, at 188–94.

67 H.R. Res. 5, 112th Cong. § 2(d) (2011).

68 H.R. Res. 6, 110th Cong. § 405 (2007). The Senate continues to use this form of the rule, which it adopted in May, 2007. *See* S. Con. Res. 21, 110th Cong. § 201 (2007); Kysar, *supra* note 2, at 1018 n.39.

69 Kysar, *supra* note 2, at 1021–26.

A. Offset Requirements

There are two categories of Congressional offset requirements: actual revenue offsets within the budget window, and a general limit on significant deficit increases that accumulate beyond the budget window.[70] The general limit, known as the Byrd Rule, is applied with discretion by the Senate.[71] While the actual revenue offset rule purports to be mandatory, it too is applied with discretion by the House of Representatives. As mentioned above, the CUTGO rule requires that the cost of new spending or tax cut legislation be offset through a spending reduction.[72] Otherwise, the House may not consider the legislation. The cost of the legislation is measured by calculating the difference in government revenues or outlays with and without the proposed legislation in effect.[73] The latter is known as the baseline. Critically, the cost calculation is only made over the length of the budget window.[74] Any costs that occur beyond the budget window are unaccounted for, and therefore do not require offsets.[75] If the budget window costs are positive, then the House cannot consider the legislation.

However, this rule can be enforced only if a legislator affirmatively raises a point of order.[76] Moreover, with approval from a simple majority, the House Rules Committee can adopt ad hoc rules that waive any points of order when considering budgetary legislation.[77] In short, the budget window offset

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[70] *See supra* notes 67–68 and accompanying text.

[71] It is applied with discretion because it requires a member of the Senate to raise a point of order if the proposed legislation will substantially increase the deficit beyond the budget window. If no senator raises a point of order, however, the proposed legislation may be considered irrespective of its long-term budgetary impact. *See* 2 U.S.C. § 644(e) (2012). Professor Kysar explains that the Byrd Rule was intended "to guard against senators adding unrelated provisions to the reconciliation bill." Kysar, *supra* note 2, at 1020. On the reconciliation process generally, see the Congressional Budget Act of 1974, Pub. L. No. 93-344, § 310(c), 88 Stat. 297, 315–16 (codified as amended at 2 U.S.C. § 641 (2012)); Elizabeth Garrett, *Rethinking the Structures of Decisionmaking in the Federal Budget Process*, 35 HARV. J. ON LEGIS. 387 (1998).

[72] H.R. Res. 5, 112th Cong. § 2(d) (2011).

[73] Professor Yin refers to this cost as the "official cost." Yin, *supra* note 4, at 188.

[74] *Id.* at 193 ("[T]he official cost incorporates only the budget consequences falling within the budget window period . . . .").

[75] This fact drives Professor Yin's normative argument that temporary legislation should be preferred over permanent legislation, since permanent legislation systematically produces costs beyond the budget window, which therefore "play[] no formal role in the legislative process." *Id.* at 204. Nonetheless Professor Yin concedes that "[i]f the cost of continuation [of permanent legislation] is large enough, it affects the overall budgetary situation of the country and may therefore influence legislative decisions." *Id.*

[76] Kysar, *supra* note 2, at 1018.

[77] *Id.*

requirement can be overcome by a majority of controlling legislators. In addition, an affirmative vote by two-thirds of the House can suspend all House Rules, including those that govern points of order.[78]

Professor Kysar explains a further way that offset requirements can be sufficiently weakened. Usually, the baseline estimate assumes that permanent laws will continue forever and that temporary laws will expire as scheduled.[79] For example, if a temporary tax cut of 1 lowered the baseline to $X - 1$, and was scheduled to expire next year, the baseline for the following year would be X. Recently, however, both the Bush and Obama Presidential Budgets proposed that temporary tax cuts be treated as permanent, despite their adoption as temporary.[80] This means that a permanent extension of the tax cut would be scored with zero costs because it is included in the calculation of the baseline.

Table 1 demonstrates how a shifting baseline can eliminate offset requirements mandated by Congressional rules such as CUTGO.

Table 1: Avoiding an Offset with a Shifting Baseline

	Years 1-5	Years 5-10	Years 11-20
Baseline (Unshifted)	x-1	x	x
Baseline Treatment	T	T	T
Required Offset to Continue Tax	-	1	1
Baseline (Shifted)	x-1	x-1	x-1
Baseline Treatment	T	P	P
Required Offset to Continue Tax	-	0	0

In the upper half of the table, a temporary five-year tax cut with a value of 1 is passed. The baseline accordingly is reduced by 1, and offset rules require the legislature to increase the budget revenues (through a decrease in spending) by 1 in order to pass the tax cut. When the tax cut expires in year five

78 *Id.* ("The point of order may be waived according to the procedural rules of each house of Congress, usually by simple majority of the Rules Committee in the House or by three-fifths of all members in the Senate." (footnote omitted)).

79 Yin, *supra* note 4, at 186.

80 *See* Kysar, *supra* note 2, at 1028–30; *see also* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2009, at 222 (2008), *available at* http://www.gpoaccess.gov/usbudget/fy09/pdf/spec.pdf; OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PROSPECTIVES: BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2011, at 170 n.5 (2010), *available at* http://www.gpo.gov/fdsys/pkg/BUDGET-2011-PER/pdf/BUDGET-2011-PER.pdf; OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, MAJOR SAVINGS AND REFORMS IN THE PRESIDENT'S 2008 BUDGET 203 (2007), *available at* http://www.gpoaccess.gov/usbudget/fy08/pdf/savings.pdf.

or year eleven, a further offset of 1 will be required if Congress wishes to extend the tax. This is because the baseline treatment of the tax throughout its life is temporary.

Consider instead the lower half of the table. A temporary five-year tax cut with a value of 1 is passed. The baseline accordingly is reduced by 1, and offset rules require the legislature to increase budget revenues by 1 in order to pass the tax cut. However, in year five Congress treats that tax cut as permanent simply because it adopts the President's proposed budget. Because the tax cut is treated as permanent, it no longer requires an increase in budget revenues for its extension. The required offset to continue the tax therefore is 0.

Moreover, once the baseline is shifted, any extension that lasts for less than the length of the budget window would be calculated as an increase in revenues.[81] Thus, if the five-year tax cut were extended for only one more year, the savings across the remaining nine years of the budget window could be used to increase spending or cut taxes somewhere else in the budget.

Table 2: Shifting the Baseline for an Increase in Revenues

	Years 1-5	Years 6	Years 7-16
Baseline (Unshifted)	x-1	x-1	x
Treatment	T	T	T
Revenues	-1 x 5	-1 x 1	0 x 9
Total Gain/Loss to the Baseline	-5	-1	0
Baseline (Shifted)	x-1	X	x
Treatment	T	P	P
Revenues	-1 x 5	1 x 1	1 x 9
Total Gain/Loss to the Baseline	-5	1	9

The upper half of Table 2 shows how revenues are calculated for a temporary tax cut, scored at 1 per year, when the baseline remains unshifted. Revenues are reduced by 5 over years one through five, and offset rules require the legislature to increase revenues by 5. At year six, the tax cut is extended for one year. Because the tax cut is treated as temporary, its extension is scored as reducing revenues by 1 for year six. At year seven, the tax cut is no longer extended, and the baseline for years seven through sixteen remains unaffected.

Now consider the lower half the table. Like the unshifted baseline scenario, the tax cut for the first five years is scored at 1 per year. Revenues are accordingly reduced by 5, and offset rules require the legislature to increase revenues by 5 in order to pass the tax cut. At year six however, baseline

81 Kysar, *supra* note 2, at 1029.

calculations treat the temporary tax cut as permanent. Failing to extend the tax cut in year six therefore leads to an increase in revenues of 1. Failing to extend the tax cut over the remainder of a ten-year budget window leads to an increase in revenues of 9.

In sum, offset requirements can be avoided through refusal to raise a point of order, ad hoc rules adopted by the House Rules Committee, a suspension of House rules, and shifting baselines.[82] Thus, the following analysis allows legislators to pass new spending or tax cuts by sufficiently weakening offset requirements in addition to reducing current spending (CUTGO and PAYGO) or increasing taxes (PAYGO only).

B. Costs and Benefits

This section develops a cost-benefit model of temporary taxation. Recent tax scholarship has argued that temporary provisions should be used in the tax code on a limited basis because they increase rent-seeking activity and create uncertainty for private investors. The analysis below shows that the costs of rent-seeking and investment uncertainty are ambiguous, and that the clear problem with temporary taxation is that legislators use it to win reelection at the expense of passing on the costs of debt servicing to the public.

It is helpful to introduce some notation. Given baseline spending and taxing levels, a current majority, by passing a new spending increase or tax cut, can create a public benefit G_1 for the length of the budget window.[83] Suppose this benefit lasts for the length of the budget window with certainty, and will not be extended. The benefit is accompanied by a cost, which can be paid in several ways. First, the benefit can be paid through a redistribution of benefits and costs throughout the length of the budget window.[84] Consider two groups, *D* and *R*. One group receives the benefits of a new spending increase or tax cut; the other group pays the costs of that increase or cut through an increase in their taxes (PAYGO) or a decrease in outstanding government spending that benefits them (PAYGO or CUTGO).[85] Because the public benefit G_1 only lasts for the length of the budget window, the costs (C_1) only last for the length of the budget window also. Because this newly created public benefit is a redistribution between two groups that lasts for a finite period of time with

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[82] *See supra* notes 76–81 and accompanying text.

[83] Like Professor Auerbach's model, we assume that the public benefit provides utility to either group *D* or group *R* indicated by the relevant subscript. Auerbach, *supra* note 54, at 90.

[84] Thus the resource allocation between the two groups *D* and *R* is not intertemporal, or more precisely, between two different budget windows.

[85] *See supra* notes 67–68 and accompanying text.

certainty, the joint-welfare[86] impact (W) of this new spending increase or tax cut may be represented by $W = G_{1D} - C_{1R} = 0$.

Now suppose the current majority can circumvent existing budget rules and create a public benefit for the length of the budget window without paying any budget window period costs. As explained above, this can be accomplished through refusal to raise a point of order, ad hoc rules adopted by the House Rules Committee, a suspension of House rules, or shifting the baseline.[87] Assume again that the public benefit lasts for the length of the budget window with certainty. Yet because offset requirements are circumvented, the costs of this public benefit are instead incurred in a time period beyond the budget window. Under this form of temporary tax law, the realization of benefits is immediate, though the realization of costs is delayed: $W = G_{1D} - T_{2R} = -S_W$.

Unlike the first scenario, the cost of the public benefit for group *D* creates a net joint-welfare loss $-S_W$. This loss represents the cost of servicing debt beyond the budget window that was created by the spending increase or tax cut G_{1D}.[88] Because the current majority chooses to finance G_1 with an offsetting spending cut or tax increase in period 2, the current majority must borrow or increase the money base to create G_1 in period 1.[89] As a result, society as a whole must pay financing or inflation costs for G_1 in addition to group *R*'s period-two outlay.

1. The Normative Neutrality of Rent Extraction

Now suppose that the public benefit is not confined to the budget window with certainty. It can either expire as it does in the two scenarios sketched above, or it can be extended. Professor Kysar notes that the possibility of extension leads to higher levels of interaction between legislators and interest groups when compared with permanent tax legislation.[90] Because the

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86 Joint-welfare refers to the summed costs and benefits for all groups. In addition to group *D* and group *R*, any residual members of society at-large, i.e., the public, are included. Thus, joint-welfare refers to the summed costs and benefits for every member of society. On joint-welfare generally, see MERCURO & MEDEMA, *supra* note 28, at 37–45.

87 *See supra* Part II.A.

88 *See* RUDIGER DORNBUSCH & STANLEY FISCHER, MACROECONOMICS 551 (6th ed. 1994) (explaining that the government's budget constraint, i.e., its deficit, can be financed either by selling government bonds or by increasing the money base typically through open market operations).

89 *Id.*

90 Kysar, *supra* note 2, at 1045 ("We can theorize, then, that lawmakers are more attuned to the needs of interest groups the more they interact with them . . . ."); *see also* Cary Coglianese, Richard Zeckhauser & Edward Parson, *Seeking Truth for Power: Informational Strategy and Regulatory Policymaking*, 89 MINN. L. REV. 277, 336-41 (2004) (arguing that higher levels of informal interaction between legislators and lobbyists can produce information that is beneficial

temporary public benefit will expire, interest groups will lobby legislators to continue that benefit each time the law is about to sunset.[91] Instead, if the public benefit were legislated permanently, interaction between legislators and interest groups would occur only once at the law's enactment.[92] Each time the legislators and interest groups interact following a temporary enactment, legislators are able to extract payments from an interest group in exchange for continuing a beneficial spending increase or tax cut.[93]

Using shorthand,[94] the difference according to Professor Kysar would appear to be:

$$W_\tau = m(\, G_D - C_R \,) = m(-R_D)$$

$$W_\pi = G_D - C_R = 0$$

For m interactions that follow the initial enactment, a total rent of $m(-R_D)$ is extracted. Note that the rent is extracted from the group who receives the public benefit only (in this case group D). For proponents of the rent extraction theory, this creates a compelling normative argument against temporary tax legislation and in favor of permanent tax legislation since the joint-welfare impact of permanent legislation W_π is 0, and the joint-welfare impact of temporary legislation creates a cost.[95] From the explication above, however, it

for the public); Gersen, *supra* note 5, at 271–72 (noting that private interest groups or lobbyists can have better information than legislators for lawmaking, and have increased incentive to reveal that information the more that they interact with legislators); *cf.* Eric Rasmusen, *Lobbying When the Decisionmaker Can Acquire Independent Information*, 77 PUB. CHOICE 899, 910 (1993) (arguing that "[l]obbying raises welfare when the politician's investigation costs are higher").

91 *See* Kysar, *supra* note 2, at 1051–52 (explaining that temporary legislation is a viable threat to the discontinuation of a policy which is beneficial to an interest group, and that interest groups will therefore lobby legislators at each iteration of the policy's extension).

92 *See id.*

93 *See* WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY & ELIZABETH GARRETT, LEGISLATION AND STATUTORY INTERPRETATION 97 (2d ed. 2006) (noting that temporary tax legislation "produces enough uncertainty" for legislators to make credible threats to discontinue that legislation, and that interest groups are therefore willing to make payments to legislators); MCCHESNEY, *supra* note 28, at 3 (same); *see also* Garrett, *supra* note 7, at 545–46 (noting the connection between the general lack of durability of tax legislation and the ability of Congress to extract rent).

94 Joint-welfare W is subscripted with τ and π to indicate joint-welfare from temporary and permanent legislation respectively.

95 Professor Kysar explains that "[s]cholars (including myself) have argued that temporary legislation, through continual threats of expiration, allows congressional members to extract more rents from interest groups than does [permanent] legislation." Kysar, *supra* note 2, at 1051–52. While this may be true, Professor Kysar does not address how extracting rent from interest groups hurts society as a whole. As mentioned above, public choice theory normatively

is clear that rent extraction simply reduces the size of the public benefit at the expense of the beneficiary, and not at the expense of society as a whole. Thus, the social impact of the temporary tax is better understood as $W_\tau = m(G_D - C_R - R_D) = 0$.

It is straightforward that the beneficiary, and not society as a whole, pays the extracted rent. Interest groups make payments in exchange for legislation that benefits them. Any additional benefits that accrue to other groups are *external* to the transaction.[96] Legislators cannot extract rents from other groups by supplying them with legislation because those other groups are not actively demanding legislation. For example, if *D* demands legislation, legislators cannot ask for payments in exchange from *R*. *R* would not agree to make payments precisely because *R* does not demand the legislation.

Worse, a normative theory of rent extraction used against temporary taxation cannot show that the increased potential for rent extraction under temporary legislation may reduce the level of beneficial externalities created by a legislative transaction.[97] Beneficial externalities are benefits that accrue to a group that is not involved in the legislative transaction. For example, an interest group may successfully bargain for an extension of the R&D tax credit. If the individual firms that make up that interest group hire additional researchers as a result of their reduced taxes, the additional researchers, who by assumption must benefit from that employment more than they benefit from their current employment,[98] are said to receive benefits that are external to the legislative transaction. Importantly, the newly employed researchers did not expend any resources to bargain for the R&D tax credit, but they nonetheless benefit from its passage. Opponents of temporary taxation might argue that because *D* would make additional payments for legislation, *D* may demand less legislation that could have socially beneficial effects for *R* like those that accrue to the hypothetical researchers.[99] As a result, rent extraction under a series of

contends that activities surrounding rent-seeking are wasteful because those who take part in them could otherwise participate in a more direct economic function to society. *See supra* note 28. Yet this claim is not made explicit in Professor Kysar's analysis. Moreover, as will be shown, it is particularly contentious within a temporary taxation context.

96 COOTER & ULEN, *supra* note 12, at 44 ("[S]ometimes the benefits of an exchange may spill over onto other parties than those explicitly engaged in the exchange . . . [This] is an example of an *external benefit* . . . .").

97 *See supra* notes 94–96 and accompanying text.

98 Otherwise they would not change jobs.

99 The assumption that *D* and *R* have divergent interests would need to be relaxed. The theory is further complicated by the fact that because the beneficiary *R* is not actively seeking the legislation desired by *D*, a subjective value of the legislation must be imputed to *R* in order to determine *R*'s valuation of the legislation, and *R*'s consequent valuation of the beneficial externality brought on by *D*'s effort. Economics, and more broadly utilitarianism, possesses no broadly agreed upon analytical tools for measuring subjective value. Judge Posner explains that

temporary extensions would not only reduce the welfare of *D*, but also that of *R*.

A reduction in joint-welfare is ambiguous, however. First, it is unlikely that *D* will demand lower levels of legislation. This is because legislators are extracting a portion of the legislative consumer surplus in a negotiation context.[100] The consumer surplus involved in a transaction for legislation is the benefit that exceeds the interest group's willingness to pay.[101] For example, if the interest group is willing to pay $100 million for an extension of the R&D tax credit because it will receive approximately that amount in rent,[102] and expends $1 million in payments to legislators in order to negotiate the extension, then the interest group's consumer surplus is the difference between its willingness to pay and the payment, i.e. $99 million. If legislators are able to extract additional payments, that is, through negotiating payments for extension, then the consumer surplus will shrink as a result. When legislators negotiate additional payments for extensions, the price of legislation is not simply increasing and exerting a downward pressure on demand;[103] legislators are interacting with interest groups and learning what those interest groups are

"there is no reliable technique for measuring a change in the level of satisfaction of one individual relative to a change in the level of satisfaction of another." RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 54 (1981).

[100] *See* Garrett, *supra* note 7, at 544 (characterizing the exchange of legislation as a "deal[]"); Kysar, *supra* note 2, at 1054 (characterizing the exchange of legislation as a "deal[]"); Yin, *supra* note 4, at 240 (describing the interest group theory of bargaining and noting that the legislator creates legislative "product"); Kysar, *supra* note 11, at 394 (characterizing the exchange of legislation as a "contract[]").

[101] Consumer surplus refers to the excess utility a person receives in the course of transacting. For example, say a person paid $10 for a toaster, but would have paid $15 for the same toaster. Her consumer surplus is therefore reflected in the differential between her willingness-to-pay, i.e. $15, and the actual price she paid, i.e. $10. Thus she is said to experience a consumer surplus valued at $5. *See* POSNER, *supra* note 99, at 92–93.

[102] Under standard economic assumptions, an interest group would be willing to pay $100 million for the legislation if that legislation would benefit the interest group with rent equal to $100 million less a penny. *See* COOTER & ULEN, *supra* note 12, at 25–28. Recent advances in behavioral economics, primarily through experimental "ultimatum game" evidence, show that the interest group will very likely need more of the surplus than a penny in order to transact. *See* Jolls et al., *supra* note 8, at 21–23. Nonetheless, the general point that interest groups are still benefiting even under temporary legislation still holds. For an overview of behavioral economics with respect to bargaining, including an explanation of the ultimatum game, see *id.*

[103] This is true because interest groups will demand legislation for values up to the price where the marginal benefit of the legislation equals its marginal cost. Judge Posner provides the example of a greengrocer: "If A sells a tomato to B for $2 . . . we can be sure that the utility to A of $2 is greater than the utility of the tomato to him, and vice versa for B . . . ." POSNER, *supra* note 99, at 88. Likewise, if an interest group trades a payment for a legislative extension, we can be sure that its utility of the extension is greater than its utility of the payment. This concept is known as consensual transacting. *Id.* at 90.

willing to pay for an extension of temporary legislation before setting the price.[104] In order to receive their payments, legislators must make credible threats to discontinue the legislation, but cannot prohibitively price it.[105] Thus, the supply of spending increases and tax cut extensions is unlikely to decrease due to rent extraction. This means that any socially beneficial effects that accrue to *R* from extensions demanded by *D* are unlikely to decrease in any meaningful way.

A theory of rent extraction therefore cannot positively show that temporary taxation unambiguously reduces social welfare; it can only show that a particular group that demands legislation could potentially pay a price closer to its actual willingness to pay. Moreover, under the assumption of consensual transacting,[106] interest groups always receive a net gain at each extension. Otherwise, they will not transact.[107] This means that any additional payment made by interest groups under a series of temporary extensions simply reduces the legislative consumer surplus that might be experienced under a permanent enactment. Under temporary legislation, legislators may capture a greater portion of that surplus; under permanent legislation, the lion's share may go to the interest group.

Aside from the fact that anchoring a theory against temporary taxation in rent-seeking requires normative argument that favors a particular interest group over a controlling group of legislators, it is not entirely clear that the total outlay made by an interest group for multiple extensions would exceed the total outlay for a permanent enactment. Under a permanent timing rule, group *D* receives an infinite stream of benefits.[108] Under a temporary timing rule, group *D* receives a finite stream of benefits.[109] If interest groups are paying for legislation in benefits, then they presumably would pay more for a permanent enactment because it offers a larger stream of benefits.[110] Thus, the total outlay for a temporary enactment and multiple extensions may not exceed the total outlay for a permanent enactment.[111] When this is true, rent extraction through a series of temporary extensions is less appealing to legislators. They can

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104 *See supra* note 90 and accompanying text.

105 Indeed, if legislators prohibitively priced their "product," i.e. legislation, then interest groups would no longer transact. *See* POSNER, *supra* note 99, at 88.

106 *See supra* note 103.

107 *See supra* note 103.

108 Gersen, *supra* note 5, at 262.

109 *Id.*

110 *Id.*

111 *Id.*

receive a larger payment in exchange for permanent passage up front.[112] In either case, a legislative transaction necessarily involves a wealth transfer between legislators and interest groups. Absent a strong normative argument that recognizes that interest groups should receive a larger portion of the legislative consumer surplus, temporary and permanent taxation present an ambiguous comparison of social benefits and costs in terms of rent extraction.

There is an additional benefit of temporary taxation worth mentioning in the rent extraction context. At each extension, the interest group may exchange information with lawmakers about why continuance of the public benefit is merited.[113] Lawmakers use information in order to create better-informed laws, which can have positive impacts on social welfare.[114] Early signaling models of lobby activity recognize the social value of information transmitted through lobbying.[115] Later research goes further, showing that regulatory capture can enhance welfare since capture may entail closer relationships between interest groups and legislators, thereby promoting higher levels of informal interaction that produces hard-to-get and socially valuable information.[116] Even if we were to accept the normative argument that interest groups should claim a greater portion of the legislative consumer surplus via permanent legislation, that benefit would still need to be balanced against the loss of information that is revealed by the interest group at each interaction in the temporary legislation context.[117]

In sum, the comparison between temporary and permanent taxation with respect to rent extraction cannot unambiguously identify a loss in joint-welfare. Instead, the comparison involves a normative argument over who should receive greater claim to the legislative consumer surplus. Under temporary tax legislation, legislators may capture a greater portion if they successfully extract a series of rents. Under permanent tax legislation, the interest group may capture a greater portion. Still, the total outlay under a series

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112 Professor Kysar acknowledges that "[t]o be sure, it seems reasonable to conclude that interest groups will value temporary legislation less than lasting legislation due to its shorter duration," but nonetheless contends that temporary tax legislation leads to systematically higher levels of rent extraction. Kysar, *supra* note 2, at 1052–53.

113 *See supra* note 90 and accompanying text.

114 *See* Coglianese et al., *supra* note 90, at 281–85 (categorizing the various types of information needed for lawmaking).

115 *See, e.g.*, Susanne Lohmann, *Information, Access, and Contributions: A Signaling Model of Lobbying*, 85 PUB. CHOICE 267, 267 (1995) (noting that "lobbying activities may have an impact on political decisions because of their information content"); Jan Potters & Frans van Winden, *Lobbying and Asymmetric Information*, 74 PUB. CHOICE 269, 286 (1992) (observing that "lobbying messages from an interest group to a policymaker may be informative even if there is a substantial conflict of interest" (emphasis omitted)); Rasmusen, *supra* note 90, at 910.

116 *See* Coglianese et al., *supra* note 90, at 336–41.

117 *See* Gersen, *supra* note 5, at 271–72.

of smaller temporary enactments may be less than the total outlay under a larger permanent enactment. Nonetheless, opponents of temporary taxation have argued that permanent taxation should be favored because it creates less opportunity for rent extraction.[118] They implicitly view rent extraction as costly to society.[119] By contrast, if rent extraction is viewed merely as a wealth transfer between legislators and interest groups, then temporary tax legislation is unambiguously welfare-improving because higher levels of interaction can lead to information production.[120] Temporary tax legislation increases the level of interaction between lawmakers and interest groups, which increases the possibility that beneficial information for lawmaking will be revealed.

2. The Ambiguous Cost of Uncertainty

The legislature's discretion to extend or not extend temporary tax legislation creates an uncertain environment, which can undermine the effectiveness of intended tax incentives, particularly those aimed at the promotion of long-term investment or the adjustment of behavior that requires significant commitment.[121] While permanent legislation can be repealed or amended, temporary legislation automatically expires without affirmative action by the legislature and, as a result, may create less certain legal environments than those created by permanent legislation.[122] That temporary legislation can create less certain legal environments than permanent legislation is not always true however.

Temporary enactments can signal a long-term legislative commitment when the legislature is continually adjusting legislation to a changing legal environment. Because adjustments to temporary legislation incur less transactions cost[123] than adjustments to permanent legislation, interest groups

118 Kysar, *supra* note 2, at 1051–56.

119 *See* Epstein, *supra* note 29. This view is consistent with public choice theorists in general. *See supra* note 28.

120 *See* Gersen, *supra* note 5, at 271–72.

121 Yin, *supra* note 4, at 244; *see also* Gersen & Posner, *supra* note 29, at 558–61 (noting that the optimal timing of legal intervention depends upon uncertain conditions); Barbara Luppi & Francesco Parisi, *Optimal Timing of Legal Intervention: The Role of Timing Rules*, 122 HARV. L. REV. F. 18, 18–20 (2009) (same). *See generally* Francesco Parisi, Vincy Fon & Nita Ghei, *The Value of Waiting in Lawmaking*, 18 EUR. J.L. & ECON. 131 (2004).

122 *See* Luppi & Parisi, *supra* note 121, at 25–26.

123 Generally, transactions cost are the costs of an exchange. In this case they signify the costs of resources (such as time, research, bargaining capital, etc.) that legislators exchange for adjusting temporary or permanent legislation. For a brief overview of transactions cost, see Cooter & Ulen, *supra* note 12, at 91–94. Enactments of temporary legislation often incur less transactions cost than enactments of permanent legislation because temporary legislation lasts for a shorter duration and is often valued less. More importantly in the tax context, temporary

that expect legislators to adjust statutes know that temporary enactments signal a legislative commitment toward achieving a particular policy objective.

Consider a policy to curb the number of highway deaths through an optimal speed limit, for example. Suppose the legislature has a history of adjusting the speed limit laws according to highway fatality statistics and that interest groups expect the legislature to continue to adjust the law so as to minimize deaths. When the legislature passes a temporary bill setting the limit to 75 miles per hour for one year, it signals that it is likely to adjust the limit again based upon the number of highway deaths at the 75 miles per hour limit.[124] Had the legislature enacted the limit permanently, it would need to expend transactions cost for placement of the adjustment on the legislative agenda in addition to expending the transactions cost for amendment. Through an enactment of a permanent measure, interest groups would know that the commitment to setting an optimal limit has been weakened.[125] This is true because a cost-minimizing legislature would prefer to avoid the cost of agenda placement and amendment if it intended to adjust the law at a later date. Given that adjustment to a permanent enactment is marginally more costly than adjustment to a temporary enactment,[126] cost-minimizing legislatures signal that they are serious about adjusting the law and getting it right only if they enact the law temporarily.[127] Thus, a temporary enactment signals a long-term legislative commitment to an underlying policy (e.g., limiting highway fatalities) and can therefore provide certainty with respect to that policy.

Professor Yin provides two additional scenarios where temporary tax policies provide certainty. First, when the legislature guarantees a tax benefit for investments made on a particular day, i.e. through a "grandfather clause,"

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legislation expires automatically, and therefore does not incur costs involved with placement on the legislative agenda. It thereby automatically becomes a legislative item to extend or let expire. On the theory that less duration often implies less transactions cost, see Gersen, *supra* note 5, at 262. On the theory that temporary legislation is automatically placed on the legislative agenda and thereby incurs less transactions cost, see *infra* Part II.B.3.

[124] *See* Yin, *supra* note 4, at 246 (observing that "[e]xperience can also lend increased certainty to nominally short-term legislation").

[125] This example presents an example of information asymmetry where the legislature knows more about its underlying policy commitment than does the interest group. The type of enactment, i.e. temporary or permanent, serves as a signal that informs the interest group about the legislature's commitment level. For an overview of signaling models in general, see ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 436–60 (1995).

[126] *See supra* note 123.

[127] Of course if the transactions cost of agenda placement and amendment under a permanent timing rule equal the transactions cost of a new enactment under a temporary timing rule, then the signal would have no content. *See* MAS-COLELL ET AL., *supra* note 125, at 436. The point here, however, is that there can exist circumstances where a temporary timing rule can increase certainty with respect to a policy objective under a realistic set of assumptions.

the certainty of receiving that temporary tax benefit can be perfect, irrespective of whether it will expire.[128] Interest groups are guaranteed a tax benefit when they take action on a particular day regardless if the tax benefit expires or extends at a later date.[129] Second, repeated extensions of a tax benefit over a sufficient amount of time can create certainty that the same benefit will be extended again.[130] For example, the research and development tax credit has been extended over twenty times since the 1980s, and interest groups may expect the credit to be extended again as a result.[131] Thus, overall it is unclear that permanent tax policies provide higher levels of certainty than temporary tax policies. Temporary tax policies do not dampen socially desirable actions that require long-term commitments, like investment, in every instance. Other parameters must be considered.

Moreover, the economics literature suggests that higher levels of uncertainty can actually lead to higher levels of socially desirable investment.[132] In general, and outside of the tax context, the literature recognizes that uncertainty can increase or decrease investment levels.[133] If an investment is reversible, that is, if the outlay can be redirected toward a different investment at a later date with no cost, then uncertain and favorable conditions increase investment levels.[134] Investment capital can simply be costlessly redirected toward another use, and there is no potential for loss in the initial investment.[135] In this scenario, investors still realize gains during temporary and favorable conditions even if the investment environment turns out to be unfavorable in the long-term.[136] For example, temporary and favorable conditions in fuel oil consumption may increase investment in petroleum exploration and production to serve the fuel oil market. If fuel oil consumption decreases, the product of exploration and production investment, i.e. petroleum, can simply be redirected to other types of petroleum consumers such as petrochemical producers. The initial investment spurred by favorable conditions in fuel oil consumption experiences no loss as it is costlessly

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128 Yin, *supra* note 4, at 246–47.

129 *Id.* at 247.

130 *Id.* at 246.

131 *Id.*

132 AVINASH K. DIXIT & ROBERT S. PINDYCK, INVESTMENT UNDER UNCERTAINTY *passim* (1994); Andrew B. Abel, *Optimal Investment Under Uncertainty*, 73 AM. ECON. REV. 228 (1983).

133 DIXIT & PINDYCK, *supra* note 132, at 8–9.

134 *See* Abel, *supra* note 132, at 231–32.

135 *See id.*

136 *Id.*

redirected.[137] From a broad perspective, favorable conditions for petroleum consumption in general have never declined, but the point is that the uncertain investment in fuel oil production can be reversed, and any loss in an initial investment in fuel oil can therefore be avoided. Generally this means that even if the environment is uncertain, investment will increase as long as it is reversible.

When investment is irreversible, the investor will balance the expected costs of waiting for a certain environment to arrive against the expected costs of investing in an uncertain environment today.[138] For example, an investment in specialized higher education is irreversible because it cannot be redirected toward a different specialty at a later date. Suppose conditions are uncertain because the value of specialized education can increase or decrease depending upon job market conditions. When job market conditions are favorable but uncertain, investment levels will not necessarily increase because the education cannot be redirected if conditions deteriorate.[139] A potential student will consider the expected costs of waiting for favorable and certain job market conditions, measured, for example, in foregone income while waiting for favorable and certain conditions. If those costs are greater than the expected costs of investing in education in a favorable and uncertain environment, measured perhaps in the cost of holding a potentially worthless education upon matriculation, then the student will make the education investment.[140] A student who estimates the costs of waiting for certainty to be greater than the costs of failing under uncertainty will choose to invest. In general, investors balance the expected costs of waiting for a certain environment to arrive against the expected costs of investing in an uncertain environment today.[141] Thus, investment levels may still increase in uncertain environments even when investment is irreversible, but not always.[142]

Professors Hassett and Metcalf consider investment in an uncertain policy environment for investment tax credits.[143] They find that increases in uncertainty can increase irreversible investment.[144] This is because investment

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137 *Id.*

138 DIXIT & PINDYCK, *supra* note 132, at 8–9. For an overview of expected costs, see *supra* note 12.

139 *See* DIXIT & PINDYCK, *supra* note 132, at 8–9.

140 *See id.*

141 *Id.*

142 *Id.*

143 KEVIN A. HASSETT, TAX POLICY AND INVESTMENT 50–52 (1999); Kevin A. Hassett & Gilbert E. Metcalf, *Investment with Uncertain Tax Policy: Does Random Tax Policy Discourage Investment?*, 109 ECON. J. 372, 372 (1999).

144 Hassett & Metcalf, *supra* note 143, at 388–89 (finding that increasing uncertainty slows investment, yet will increase investment when the value of waiting to invest is low, and the loss

tax credits typically offer benefits beyond the status quo rate of return on an investment.[145] If a credit is not extended, the tax environment does not worsen with respect to the original investment environment. It simply reverts to the status quo.[146] Given that a status quo rate of return is sufficient to spur investment, uncertainty surrounding increases to that rate through tax credits will not decrease investment.[147] On the contrary, uncertainty will spur investment further because an investor will want to use the tax credits today fearing that they will not be available tomorrow.[148]

The same rationale applies to temporary reduction in tax rates.[149] If a reduction fails to be extended, the tax rate does not become unfavorable with respect to the original investment environment, it simply reverts to the status quo tax rate. Given that the status quo tax rate still spurs investment, uncertainty surrounding an extension of the rate reduction will not decrease investment.[150] Investors, fearing that they may lose the favorable rate reduction, will increase investment in order to take advantage of it. Generally, as Professor Yin notes, favorable and uncertain tax policies that revert to the status quo create a "use it or lose it effect" and increase irreversible investment.[151]

In contrast, *unfavorable* and uncertain tax policies that revert to the status quo may decrease irreversible investment if the value of waiting for reversion exceeds any gain that can be made on the investment under the unfavorable tax measures.[152] Temporary elimination of deductions or credits, or temporary increases in tax rates, for example, may decrease irreversible investment if the value of waiting for the more favorable status quo tax environment exceeds any foregone returns under those less favorable

from waiting can be substantial). The authors conclude that "[o]ne must therefore be careful before extrapolating the findings of much of the previous literature on uncertainty and investment to the case of tax policy uncertainty." *Id.* at 374.

145 *See* Yin, *supra* note 4, at 246 (observing that temporary changes to tax depreciation rules or the temporary introduction of investment tax credits often provide more favorable tax environments than the status quo).

146 *Id.*

147 Hassett & Metcalf, *supra* note 143, at 388–89.

148 *Id.*; HASSETT, *supra* note 143, at 51 (noting that "[f]irms will race to buy [whatever provides the tax credit] before the credit is removed").

149 Yin, *supra* note 4, at 246. For example, firms may expand operations that provide immediate cash flows in order to take advantage of a lower tax rate.

150 *Id.*

151 *Id.* (internal quotation marks omitted); *see also* HASSETT, *supra* note 143, at 52 ("[S]ince a firm fears that the credit might be eliminated, it is more likely to invest today while the credit is still effective.").

152 *See* DIXIT & PINDYCK, *supra* note 132, at 8–9.

conditions.[153] Overall, like the general result for irreversible investment during uncertain and favorable conditions described by Professors Hassett and Gilbert, investment levels may still increase in uncertain and unfavorable tax environments even when investment is irreversible, but not always.

In sum, temporary tax policies may or may not introduce uncertainty. Temporary tax policies can signal long-term commitments in policy adjustment contexts, they can provide guaranteed benefits through grandfather clauses, and they can be routinely extended and lead to sufficiently high expectations of certainty.[154] When temporary tax policies do in fact introduce uncertainty, investment may or may not decrease. If investment is reversible without cost, investment will not decrease.[155] If investment is irreversible, investment will not decrease if the uncertain conditions are favorable and revert to the status quo.[156] If investment is irreversible, but uncertain conditions are unfavorable and revert to the status quo, investment will decrease only if the value of waiting for reversion to the status quo exceeds the value of foregone investment under the less favorable conditions.[157] All of this points to a general ambiguity in the social cost of uncertainty introduced by temporary tax measures.

3. The Unambiguous Cost of Reelection Strategy

In the introduction to Part I, it was mentioned that Professor Auerbach develops a model where one group *D* prefers to shortchange its heirs through preemptive borrowing and spending because any economic resources that may be left to them could first be captured by a competing group *R*.[158] While the capture of future group resources may be one plausible explanation for preemptive borrowing and spending, a more immediate and pressing concern for a legislator is reelection.[159] Legislators can increase their chances of reelection by using temporary tax legislation strategically.

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[153] *See id.*

[154] *See supra* notes 123–31 and accompanying text.

[155] *See supra* notes 134–37 and accompanying text.

[156] *See supra* notes 138–51 and accompanying text.

[157] *See supra* notes 152–53 and accompanying text.

[158] *See supra* notes 58–59 and accompanying text.

[159] Professors Medema and Mercuro explain that

> in public choice theory legislators are motivated . . . by endorsing programs and/or voting for laws that maximize their appeal to their constituents or by voting for those programs or laws that are most responsive to active special interest groups (e.g., major financial supporters, those energizing effective publicity, or those providing politically meaningful endorsements) thereby enhancing their prospects for (re)election.

MERCURO & MEDEMA, *supra* note 28, at 92.

When legislators pass temporary tax cuts or spending increases, they guarantee that future legislators must decide to extend or not extend them.[160] At expiration, future legislators pay a political cost if they exercise fiscal discipline and reject extensions.[161] By rejecting an extension of temporary tax cuts or spending increases, legislators lose votes from supporters of those cuts and increases.[162] At the same time, future legislators pay political costs for extending.[163] For example, representatives of group *D* pay political costs for extending the tax cuts of group *R*, or representatives of group *R* pay political costs for extending the spending increases of group *D*. Because current period legislators understand that their rivals will pay political costs through rejection or extension, current period legislators preemptively borrow and spend thereby forcing their rivals to incur political costs.[164]

While the political choice to extend or not extend can create benefits in addition to costs, the creation of those benefits is in the hands of the current legislature who passes (or extends) the temporary tax legislation. Current period legislators will not create expected political opportunities for their rivals, and as a result, most temporary tax legislation used for political jockeying is likely to create net political costs, and not net political benefits, for second period rivals.[165] Figure 2 outlines the game theoretical strategy[166] for a current period legislator.

[160] Gersen, *supra* note 5, at 251 ("Because temporary legislation terminates at the sunset without some affirmative legislative action, continuing a policy originally enacted as temporary legislation requires multiple stages of legislative process in subsequent time periods.").

[161] *Cf.* Garrett, *supra* note 6, at 195 (noting that most temporary tax provisions expire during election years, thereby reducing the chance that legislators are willing to let those provisions expire).

[162] *See id.*

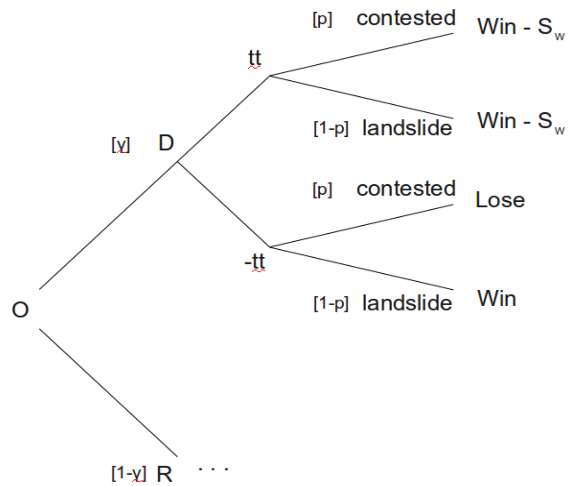
[163] By extending tax policies that their supporters oppose, legislators lose those supporters. *See supra* note 64.

[164] *See infra* notes 167–70 and accompanying text.

[165] This is consistent with the assumption that legislators are motivated by increasing their reelection chances. *See supra* note 159.

[166] "A strategy is a plan for acting that responds to the reactions of others." COOTER & ULEN, LAW AND ECONOMICS 34–35 (3d ed. 2000). Game theory attempts to understand behavior on the basis of those strategies in addition to the parties involved (i.e., the players), and the payoffs associated with each strategy for each player. *Id.* at 38. *See generally* DOUGLAS G. BAIRD, ROBERT H. GERTNER & RANDAL C. PICKER, GAME THEORY AND THE LAW (1994).

Figure 2: Reelection Through Temporary Taxation



Nature moves first and chooses whether the legislator represents group *D* with probability γ or *R* with probability $1 - \gamma$.[167] The legislator then chooses to preemptively borrow and spend temporarily (*tt*), i.e. create or extend temporary tax legislation, or not (*-tt*). With probability p the election is contested. With probability $1 - p$, the election is a landslide. The payoffs are straightforward. Current period legislators always win in a landslide, but if their reelection is contested, their taxing strategy impacts the outcome. If we assume that a contested election hangs upon the votes of the group who is adversely impacted by a rejection to extend tax legislation, then by backward induction,[168] the optimal strategy for current period legislators is to create or extend tax legislation (*tt*). The payoff for this strategy is reelection.

By passing temporary tax legislation today, current period legislators create political costs for their rivals and perhaps for themselves, but rival costs are likely to be greater. Rivals must extend temporary tax legislation that favors the opposing group because the outcome of the election hangs upon the votes

[167] Nature, indicated by O in Figure 2, is a "player" in the theoretic game sense. It is used to abstract away from modeling an entire process. Here, it is used to represent the fact that some legislators are members of group *D* and other legislators are members of group *R* without providing a basis other than probability (which is represented by γ).

[168] Game theory employs backward induction to deduct which strategy the players will choose given the available strategies for selection. Starting from the payoffs, tracing backwards indicates the optimal strategy, i.e. the strategy associated with the largest payoff. *See* COOTER & ULEN, *supra* note 12, at 38–43.

that support extension.[169] Yet if they do so, they lose the support of their own group.[170] Instead, current period legislators also must extend temporary tax legislation that favors their own group.[171] Yet if they do so, they do not lose the support of their own group. For this reason, the political costs of rejecting or extending are likely to be greater for rivals than the political costs of extending for current period legislators.

In a contested election, the difference yields the payoff $Win - S_w$ for current period legislators who choose the strategy *tt*. In addition, if the temporary tax legislation creates a benefit G_{1D} with a delayed cost C_{2R} through the avoidance of offset requirements, then a social cost $-S_w$ for debt service is incurred.[172] As the probability p of a contested election decreases, the legislator is more likely to choose to not preemptively borrow and spend temporarily, given a legislative preference for reducing social cost. In other words, if legislators are socially benevolent and prefer to limit paying for frontloaded benefits with backloaded debt servicing costs, then they will choose to not preemptively borrow and spend temporarily as likelihood of winning in a landslide increases.

By examining temporary tax legislation in relation to reelection incentives, it is easy to see why avoiding spending offset requirements can be so critical to a legislator's strategy. For in a contested election that marginally hangs upon the extension of tax legislation, it is likely that the gain of political support from one group who benefits from extension will counterbalance the loss of political support from another group who must pay for that extension with an offsetting spending decrease (or tax increase). Indeed, the rationale for offset requirements is to render legislative adjustments to prevailing tax policy in some sense budget neutral.[173] If adjustments affect groups who are able to change reelection outcomes, then offset requirements that favor one group over another are not only budget neutral, but politically neutral as well.[174] By avoiding offset requirements, however, political benefits accrue to current period legislators (and financial benefits accrue to favored groups) at the

[169] This is so by assumption. *See supra* note 168 and accompanying text.

[170] *See supra* note 162 and accompanying text.

[171] Again, this is based upon the assumption that the election outcome hangs upon the votes of the group who would be adversely affected by allowing the temporary tax legislation to expire.

[172] *See supra* notes 87–89 and accompanying text.

[173] *See* Auerbach, *supra* note 54, at 88 (noting the primary objective of budget rules is to reduce the shifting of fiscal burdens on future generations).

[174] Professor Garrett notes that legislators have "long used [circumvention of offsets] to send tax benefits to groups that support them without appearing to worsen the fiscal position of the federal government." Garrett, *supra* note 6, at 189. In addition, adhering to offset requirements not only strengthens a fiscal position, it also weakens a political position of the disfavored group who pays the cost of the tax cut or spending increase.

expense of political costs that accrue to second period rivals (and debt servicing costs that accrue to the public). In this way, temporary tax legislation that avoids offset requirements can alter the outcome of a contested reelection; avoidance ensures that political benefits are not canceled out with political costs.

Even if budgetary offset requirements are avoided, extension could nonetheless be politically costly, thereby eliminating any political gains to the legislator. For example, legislators might pay political costs for extension because they are increasing the debt servicing costs of the public,[175] or because they are continuing the favorable tax policies of partisan rivals.[176] When extending in those scenarios, legislators gain support from proponents of extension, but lose support from opponents.[177] Costs associated with rejecting the extension are likely to be greater than costs associated with supporting the extension, however, because temporary tax legislation typically yields concentrated benefits and distributed costs.[178] Benefits concentrate on groups who conduct research and experimentation, produce biodiesel and renewable fuels, maintain railroad tracks, train mine rescue teams, build motorsports entertainment complexes, facilitate child adoptions, educate children at public schools, etc.[179] Instead, the cost of servicing debt,[180] or alternatively, the cost of general partisan dissatisfaction,[181] is widely distributed across the public at large. Revoking concentrated benefits at the expense of creating distributed benefits is generally more politically costly for legislators.[182] Thus, the political cost of failing to extend beneficial temporary taxation is unlikely to be significantly offset by any political benefits due to deficit reduction or widely distributed party satisfaction. As a result, temporary tax legislation that avoids offset requirements is still likely to alter the outcome of a contested reelection.

In sum, current period legislators who pass temporary tax cuts or spending increases guarantee that future legislators must decide to extend or not extend them.[183] If future period legislators do not extend, then they lose

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175 *See supra* notes 87–89 and accompanying text.

176 *See supra* note 64 and accompanying text.

177 *See supra* notes 160–63 and accompanying text.

178 *See* WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY & ELIZABETH GARRETT, CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 812–14 (4th ed. 2007) (defining rent-seeking statutes generally as "distributing benefits to a small group, at the expense of the general public, and without an efficiency justification").

179 *See* STAFF OF J. COMM. ON TAXATION, *supra* note 4.

180 *See supra* notes 87–89 and accompanying text.

181 *See supra* note 64 and accompanying text.

182 *See* ESKRIDGE, JR. ET AL., *supra* note 178, at 814.

183 *See supra* note 160.

support from proponents of extension.[184] If they extend, then they lose support from opponents of extension.[185] By backward induction, current period legislators will pursue temporary tax legislation in order to force their political rivals into difficult positions.[186] As the probability that the election will be contested increases, temporary tax legislation becomes more attractive to current period legislators because their rivals will be forced to extend cuts and increases that are unpopular with their constituencies. At the margins, the rival's decision to either extend or not extend will cost them an election.

When current period legislators pursue this strategy, but are required to offset any tax cuts or spending increases, they too incur political costs.[187] In this way, offset requirements can render temporary tax legislation politically neutral.[188] However, as discussed above,[189] offset requirements can be circumvented, thereby creating net political gains.[190] The social cost of using temporary tax legislation without offsets for reelection is unambiguous. The favored group garners a current period economic benefit, but debt servicing costs accrue at a later period beyond the budget window. This economic cost is borne by all groups, regardless of their preferences over public spending.

III. CONCLUSION

While rent extraction and uncertainty provide unclear normative arguments on the social value of temporary tax legislation, the impact of temporary tax legislation on reelection strategy provides a clear normative argument against its use. To the extent that the scholarship has focused on rent extraction and uncertainty to point to social welfare loss, its normative persuasiveness is misplaced. On the other hand, the use of temporary taxation as a reelection strategy clearly demonstrates social welfare loss.[191] Professor Auerbach reasons that legislators preemptively borrow and spend to capture future economic resources.[192] This may be true, but a more immediate concern for legislators is reelection. The analysis above clarifies how legislators can use preemptive borrowing and spending in order to create political costs for their rivals, which in turn increases the likelihood of their reelection. This practice is

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184 *See supra* note 162 and accompanying text.

185 *See supra* note 163.

186 *See supra* note 168 and accompanying text.

187 *See supra* notes 175–76 and accompanying text.

188 *See supra* notes 175–76 and accompanying text.

189 *See supra* Part II.A.

190 *See supra* text accompanying note 182.

191 *See supra* Part II.B.3.

192 Auerbach, *supra* note 54, at 88.

socially costly because it creates costs that are external to the political process, namely, the social cost of servicing debt.

Optimizing the length of the budget window so as to minimize preemptive borrowing and spending, as recommended by Professor Auerbach,[193] will not eliminate the use of temporary tax legislation as a reelection strategy. As explained above, congressional offset requirements are easily circumvented. Circumvention effectively places costs beyond the purview of any budget window however well-constructed it may be. Thus, any positive impact that an optimal length may have is easily undermined through circumvention devices like ad hoc rules adopted by the House Rules Committee, a suspension of House rules, and shifting baselines.

As Professor Epstein emphasizes, second-tier procedural rules like default presumptions in favor of permanent tax legislation,[194] or congressionally optimized budget windows, cannot meaningfully constrain lawmakers from using temporary tax legislation to seek reelection.[195] Rent-seeking groups simply place too much pressure upon legislators, and it is unrealistic to expect legislators to tie their own hands with a procedural rule that cuts against their reelection.[196] Professor Garrett has suggested that procedural frameworks give legislators the opportunity to deliberate and increase the chance that voters will be able to hold them accountable.[197] However, as mentioned above, most temporary tax legislation involves concentrated benefits that immediately impact the economically favored group, and distributed costs that gradually impact the public who provides the debt service.[198] While procedural frameworks may raise the profile of what Professor Garrett refers to as budget "gimmicks,"[199] it is unlikely that the diffused public will be able to meaningfully pressure legislators through voting.

Thus, it is unlikely that the practice of using temporary tax legislation for reelection can be constrained by legislators themselves. Yet none of the scholarship has discussed judicial or constitutional solutions. This is unsurprising. Certainly, using the tax power for reelection does not satisfy the American constitutional requirement that taxation provide for the general

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193 *Id.* at 100 ("The solution identified here involves the shape of the budget window, rather than restrictions on the policies themselves. Thus, [the solution of an optimal budget window] is more flexible with respect to the economic environment than alternative approaches that would either impose limits on annual budget deficits or simply treat all policies as permanent.").

194 Kysar, *supra* note 2, at 1008.

195 Epstein, *supra* note 29.

196 *Id.*

197 Garrett, *supra* note 7, at 567–68.

198 *See supra* notes 178–80 and accompanying text.

199 Garrett, *supra* note 6, at 189.

welfare,[200] but attempting to uncloak a tax policy as bare reelection strategy could prove impossible for a court. A constitutional solution, while politically difficult, is at least straightforward. An amendment stipulating that all temporary tax legislation adhere to offset requirements would significantly dampen the ability of legislators to use temporary tax legislation for reelection. However, that solution is problematic because the budget window is currently set at ten years. Offsets that occur beyond the legislator's elected term can still create political costs that occur several years after a temporary tax cut or spending increase is passed. Thus, the rule would need to stipulate that the tax cuts or spending increases and their offsets take immediate effect.[201] Under such an amendment, all temporary borrowing and spending offsets immediately, and each temporary tax adjustment is rendered budget neutral as a result. Additionally, constitutional adherence to immediate offset requirements ensures that any political benefit from favoring one group with a temporary tax cut or spending increase is offset by the political cost of disfavoring another group with a temporary tax increase or spending cut. Thus, an amendment that provides for temporary taxation with immediate offset requirements forces legislators to internalize the political costs that they create, and exerts a downward pressure on using temporary tax legislation for reelection.

[200] U.S. CONST. art. 1, § 8, cl. 1.

[201] See Luppi & Parisi, *supra* note 121, at 22–23, for a comparison of legislation that takes effect immediately with legislation that takes effect with delay.