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Mary L. Heen
University of Richmond, mheen@richmond.edu

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Congress, Public Values, and the Financing of Private Choice

MARY L. HEEN*

This Article examines the financing dimension of private choice, with a focus on Congress's taxing and spending decision-making processes. The Article begins with an overview of the financing and performance dimensions of privatization decisions, followed by an analysis of how taxation relates to both dimensions. Private choice can be financed individually, that is, paid for by an individual's own resources, facilitated by general tax reduction. Alternatively, private choice can be financed collectively by using tax revenues (or borrowed funds) to pay for privately provided goods and services. The tendency in political debate to conflate those two forms of financing, as well as the failure to distinguish between financing and performance, obscures important decisions about private choice and the government's role in managing or monitoring collectively financed activities.

Congress coordinates its taxing and spending decisions through the budget process, collectively determining what will be financed and performed through government and what will be left to private choice. The courts generally defer to the taxing and spending decisions made by Congress. Nevertheless, in the process of developing this highly deferential approach, the U.S. Supreme Court historically has drawn distinctions between taxes and other means of paying for or regulating the production of goods and services. Although it can be quite difficult to distinguish "taxes" or "revenue raising" from "user fees," "prices," or "penalties," they are not constitutionally interchangeable. When the Court has interpreted express limitations on Congress's taxing power, it has drawn distinctions similar to those drawn in the privatization literature between individual and collective financing. These doctrinal distinctions reflect the democratic values inherent in Congress's taxing and spending powers.

Next, drawing from tax scholarship on tax expenditures, the Article develops the argument that general tax reduction and targeted tax incentives differ in their approach to financing. Targeted tax incentives subsidize certain legislatively favored activities and, therefore, comport with the pattern of privatization typically followed in the United States of retaining collective financing but delegating performance to the private sector (as in government contracting or voucher programs). Collective financing keeps resources under some type of government

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control, with collectively defined goals achieved through the use of either public or private producers.

The Article concludes with a discussion of accountability issues with regard to both financing and performance. Administrative lawyers and scholars are engaged in studying new ways in which regulation, contracts, and contract monitoring may respond to the accountability problems created by increased "contracting out" or privatizing of government services. A parallel effort to study ways in which increased monitoring of tax incentives can be achieved needs to be undertaken. Tax incentives generally do not involve negotiated relationships between government and private contractors, but typically involve tax reporting to the Internal Revenue Service and oversight jurisdiction by the tax-writing committees. The delivery of subsidies through the tax system can mask governmental funding levels and allocations and obscure accountability for outcomes being funded. The use of tax incentives as an alternative to discretionary spending by the government serves privatization goals through their use of market incentives and private choice. How to achieve greater political accountability for both the financing and performance of tax incentives remains a central challenge. The Article ends with suggestions for incremental ways to achieve such increased monitoring through budgetary and oversight reforms.

I. INTRODUCTION

Congress defines and accomplishes public purposes through the exercise of its taxing and spending powers.[1] Differences over taxing and spending levels, which are negotiated primarily through the legislative process,[2] often reflect underlying disagreements about the role and scope of government.[3] The political dynamics involve raw budgetary conflicts, contested ideas about the value of collective versus private choice,[4] and deep differences in views about governmental competencies and

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[1] U.S. CONST. art. I, § 8, cl. 1 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States . . . .").

[2] The negotiation process involves key players from both the executive and legislative branches, including the President and congressional leadership, and depending upon political factors, it may involve an executive/legislative "summit" meeting and agreement to resolve budgetary and tax issues. *See* discussion *infra* Part IV.A.2.

[3] LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 6 (2002).

> Disagreements over the legitimate scope of government benefit and constraint, and over the way that scope is affected by individual rights, are likely to underlie differences over taxation, even when they are not made explicit. These are disagreements about the extent and limits of our collective authority over one another through our common institutions.

Id.

[4] *See, e.g.*, Mark H. Moore, *Introduction* to Symposium, *Public Values in an Era of*

functions. These differences also underlie current political debates falling under the general rubric of "privatization."[5]

The term "privatization" has been used to include a broad array of political and policy initiatives.[6] Structurally, the choice between public and private[7] involves the two basic dimensions of financing and performance.[8] As noted by a scholar of privatization initiatives, the financing dimension concerns the choice between individual and collective financing: "Should we pay for some good or service individually, out of our own resources, or should we pay for it collectively with funds raised through one form or another of taxation?"[9] The performance dimension involves the choice between governmental and nongovernmental production of goods and delivery of services: "Should the good be produced or the service delivered by a governmental organization or by a nongovernmental organization?"[10] In the United States, privatization has generally followed a pattern of "retaining

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Privatization, 116 HARV. L. REV. 1212, 1213 (2003).

[5] *See* Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1237–41 (2003). Although the United States has a long history of partnerships between the public and private sectors, recent privatization efforts differ from past patterns, according to Minow, in at least four important ways: 1) the use of direct financing and joint ventures rather than reliance on public policies to facilitate private enterprises; 2) the reversal of twentieth century trends toward expansion of the social safety net; 3) the use of market-style language and concepts in the provision of social services combined with the assumption that competition and individual choice are better, or more effective, than collective democratic governance; and 4) the increased partnering with religious organizations themselves, and not just their separate nonprofit social service agencies, to provide social services. *Id.* at 1240–41.

[6] Privatization proposals originate from multi-faceted political efforts to make the public sector more efficient, constrain its growth, or to downsize it. "Privatization" can refer to the divestiture of government-owned-and-operated property, "contracting out" or outsourcing of publicly provided goods and services, creation of public/private partnerships, or the removal of certain constraints on private choice. *See, e.g.*, Ronald A. Cass, *Privatization: Politics, Law, and Theory*, 71 MARQ. L. REV. 449, 456–62 (1988) (discussing the forms taken by privatization proposals, including divestiture, leasing and "contracting out," improving service choices through deregulation, vouchers, or increasing direct dollar choices through user fees or by increasing the amount of money in private hands through tax reduction).

[7] For discussion of the difficulties in using the terms "public" and "private," see, *e.g.*, MARTHA MINOW, PARTNERS, NOT RIVALS: PRIVATIZATION AND THE PUBLIC GOOD 29–35 (2002); Morton J. Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423, 1424 (1982) (observing that taxation began to be understood as part of public law only with the development of theories of sovereignty in the seventeenth century, and that "[t]he emergence of the market as a central legitimating institution brought the public/private distinction into the core of legal discourse during the nineteenth century"); Symposium, *The Public/Private Distinction*, 130 U. PA. L. REV. 1289 (1982). *See also* Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 551 (2000) [hereinafter Freeman, *Private Role*].

[8] JOHN D. DONAHUE, THE PRIVATIZATION DECISION: PUBLIC ENDS, PRIVATE MEANS 7 (1989).

[9] *Id.*

[10] *Id.*

collective financing but delegating delivery to the private sector."[11]

This Article examines the financing dimension of private choice with a focus on Congress's taxing and spending decision-making processes. Increased private performance can be paid for by individual resources, facilitated by general tax reduction.[12] Alternatively, private choice can be financed collectively by using tax revenues (or borrowed funds) to pay for privately provided goods and services or by using targeted tax incentives to stimulate private substitutes for public programs.[13] Although it can be difficult to distinguish between "taxes" and "prices," or even between "taxing" and "spending," individual and collective financing are not interchangeable. As argued in greater detail below, conflating them can obscure important political decisions about private choice and the government's role in managing or monitoring collectively financed activities.[14]

Although the U.S. Constitution places few limitations on privatization,[15] it serves as a "blueprint" to create an open political process for decision making about governmental functions.[16] In political and economic discourse about privatization, the line between the public and private sectors is sometimes drawn by reference to "ownership,"[17] and sometimes by other criteria such as the nature of the goods or

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[11] *Id.* at 215. In the United States, aside from a limited number of asset sales, privatization has more generally meant "enlisting private energies to improve the performance of tasks that would remain in some sense public." *Id.* at 7. *See also* ELLIOTT D. SCLAR, YOU DON'T ALWAYS GET WHAT YOU PAY FOR: THE ECONOMICS OF PRIVATIZATION 6 (2000) (noting that "[p]rivatization American style is essentially old-fashioned public contracting writ very large").

[12] PRESIDENT'S COMM'N ON PRIVATIZATION, PRIVATIZATION: TOWARD MORE EFFECTIVE GOVERNMENT 229 (1988) [hereinafter PRIVATIZATION] ("[T]he two most important forms of privatization in the United States have been deregulation and tax reduction.").

[13] Stuart Butler, *Privatization for Public Purposes*, *in* PRIVATIZATION AND ITS ALTERNATIVES 18, 20 (William T. Gormley, Jr. ed., 1987) ("The most complete form of privatization is the . . . shifting of a function entirely out of government . . . . The second most complete form of privatization is a combination of deregulation and tax incentives."). *See* discussion *infra* Part II.

[14] *See* discussion *infra* Part IV.

[15] *See* Clayton P. Gillette & Paul B. Stephan III, *Constitutional Limitations on Privatization*, 46 AM. J. COMP. L. 481, 482 (Supp. 1998) (suggesting that the constitutional clause "that most clearly stands in the way of privatization [is] the guarantee of a republican form of government," but noting that the Guarantee Clause has not been held judicially enforceable). Although Professors Gillette and Stephan find little constitutional authority dealing directly with the privatization process, they examine three areas where decisions to privatize encounter limitations that in some sense might be termed "constitutional," focusing on "whether constitutional rules that normally would apply only to governmental actors might apply to privatized activities," "federal administrative law governing decisions by the federal government to contract out its functions," and state constitutional provisions affecting privatization. *Id.* at 482–83.

[16] *Id.* at 482; *see also* Cass, *supra* note 6, at 497–502.

[17] In countries other than the United States, the term generally refers to "selling government-owned-and-operated businesses to private enterprise." Cass, *supra* note 6, at 450; *see, e.g.*, DIETER BÖS, PRIVATIZATION: A THEORETICAL TREATMENT 1–2 (1991) (discussing privatization in

services being provided, the receipt of public funds, or the public function of an activity.[18]

Through its role as a representative decision-making body, Congress collectively defines "public" goals, purposes, and functions. Redrawn lines between what is understood as public and private could have a significant impact on upcoming public policy debates, including continuing discussions about taxes,[19] school choice,[20] welfare policy and charitable choice,[21] the budget deficit,[22] and the future of the social security system.[23] Resolution of these major policy issues or, alternatively, the

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Western European economies).

[18] *See generally* ALBERT O. HIRSCHMAN, SHIFTING INVOLVEMENTS: PRIVATE INTEREST AND PUBLIC ACTION 6–7, 121 (1982) (distinguishing between public action in the political realm—involvement of the citizen in civic and community affairs—and attending to one's private interests through the pursuit of increased material welfare for oneself and one's family).

[19] *See, e.g.*, Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752; Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

[20] *See* No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425, 1776–873 (providing assistance to enhance public school choice); Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38, 58 (2001) (expanding Coverdell education savings accounts, I.R.C. § 530, to include qualified expenses of elementary and secondary students at public, private, or religious schools). *See also* Zelman v. Simmons-Harris, 536 U.S. 639, 652 (2002) (upholding under an Establishment Clause challenge Cleveland's school voucher program, which "provide[d] assistance directly to a broad class of citizens who, in turn, direct[ed] government aid to religious schools wholly as a result of their own genuine and independent private choice").

[21] *See, e.g.*, John J. DiIulio, Jr., *Government by Proxy: A Faithful Overview*, 116 HARV. L. REV. 1271, 1278–82 (2003); *see* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, THE PRESIDENT'S MANAGEMENT AGENDA: FISCAL YEAR 2002, at 35–38 (2001), *available at* http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf [hereinafter THE PRESIDENT'S MANAGEMENT AGENDA] (discussing community and faith-based initiatives to supplement existing charitable choice legislation); Exec. Order No. 13,199, 66 Fed. Reg. 8499 (Jan. 29, 2001) (establishing White House Office of Faith-Based and Community Initiatives); Exec. Order No. 13,198, 66 Fed. Reg. 8497 (Jan. 29, 2001) (setting forth agency responsibilities with respect to Faith-Based and Community Initiatives). *See generally* 42 U.S.C. § 604(a) (2000) (permitting states to provide welfare-related services through contracts with charitable, religious, and private organizations).

[22] *See, e.g.*, DANIEL SHAVIRO, DO DEFICITS MATTER? 65–150 (1997) (reviewing the debate in economic literature about deficits); s*ee also* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: FISCAL YEAR 2005: OVERVIEW OF THE PRESIDENT'S 2005 BUDGET 10 (2004), *available at* http://www.whitehouse.gov/omb/budget/fy2005/budget/pdf/budget/overview.pdf (projecting a $521 billion deficit for fiscal year 2004).

[23] *See* PRESIDENT'S COMM'N TO STRENGTHEN SOC. SECURITY, STRENGTHENING SOCIAL SECURITY AND CREATING PERSONAL WEALTH FOR ALL AMERICANS 11–13 (2001), *available at* http://www.commtostrengthensocsec.gov/reports/Final_report.pdf (presenting three plans for reforming social security and proposing individual accounts financed by diverting funds from

failure to resolve them over the next several years will have important implications for how the government and the private sector address the country's economic and social problems in the future.

As in the past, the terms and structure of those debates will be defined in part by the resolution of more obscure tax and budget process choices. Congress coordinates its taxing and spending decisions through the budget process. It is through this process "that the Nation chooses what areas it wishes to leave to private choice and what services it wants to provide through government."[24] Although often technically complex in nature, decisions about tax and budgetary processes hold high stakes for the transparency of our democratic decision-making processes over the next few years. In politics, when and how the debate gets framed often determines the outcome.

President George W. Bush, like President Ronald Reagan nearly twenty-five years ago, proposed and encouraged a broad range of privatization initiatives, and in this respect he continued and expanded the Reagan legacy. The Bush Administration[25] also adopted certain modifications in the presentation of tax revenue information in the budget, in ways similar to those proposed and partially adopted during the Reagan Administration.[26] As suggested below, the two developments, one representing core governmental philosophy and the other representing technical changes in the budget presentation, were not unconnected as a matter of political strategy. These changes have significant implications for debates about key public policy issues.

The debates also raise more fundamental questions for our democratic polity. Do public values represent something other than the aggregation of individual preferences? What role should public deliberation play in shaping preferences? How can public purposes best be achieved? In considering the complex public/private relationships typical of privatization initiatives, lawmakers forge legislative responses to these questions in varied contexts and, in the process, confront new questions of political legitimacy and accountability.

The most complete form of privatization, in which both financing and performance are transferred to private actors, also implies a shift from collective, public decision making to more individualized, private decision making.[27]

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social security trust funds).

[24] PRESIDENT'S COMM'N ON BUDGET CONCEPTS, REPORT OF THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS 11 (1967) (submitted to President Johnson by Commission Chairman David M. Kennedy and fifteen commission members, including Charles Schultze and Carl Shoup).

[25] Unless otherwise specified, references to the "Bush Administration" throughout the Article are to the presidential administration of President George W. Bush, beginning in 2001, and not to the administration of his father, President George Herbert Walker Bush, who was elected President in 1988 after serving as Vice President during both terms of Ronald Reagan's presidency.

[26] *See* discussion *infra* Part III.A.

[27] Moore, *supra* note 4, at 1215 (observing that "we might see privatization most importantly as the individualization of judgments about value that formerly were made collectively").

Privatization initiatives thus shift the locus of decision making. Privatization of both financing and performance necessarily results in a smaller sphere of government action.

By contrast, collective financing keeps resources under some type of government control, with collectively defined goals achieved through the use of government-monitored contractors or other private producers. Although collective financing of private performance does not necessarily shrink the size of government, private performers may (or may not) provide the goods or services more efficiently or effectively than government employees. Collective and individual financing accordingly accomplish privatization goals in very different ways, with dramatically different consequences for both public administration and democratic decision making.

My discussion proceeds as follows. The next Part begins with a brief overview of the financing and performance dimensions of privatization decisions, followed by an analysis of how taxation relates to both financing and performance. The level of taxation is an important political choice, which the constitutional framework leaves primarily to the political branches. The courts generally defer to congressional action in this area. Nevertheless, in the process of developing this highly deferential approach, courts have drawn distinctions between taxes and other means of paying for or regulating the production of goods and services. These distinctions illustrate and emphasize the important democratic values inherent in the taxing and spending powers. These values are reflected in the decision-making procedures established by the Constitution for collectively financed activities.

Part III, which draws from and builds on tax scholarship relating to "tax expenditures,"[28] sets forth the argument that general tax reduction and targeted tax incentives, both ways of advancing privatization goals, differ in approaches to financing. General tax reduction results in more individual financing of goods and services. Targeted tax incentives, on the other hand, subsidize certain legislatively favored activities and, therefore, comport with the pattern of privatization typically followed in the United States of retaining collective financing but delegating performance to the private sector. Across-the-board tax reduction and targeted tax incentives advance different privatization goals with very different political consequences.

The argument that targeted tax incentives are more like spending programs than tax cuts is somewhat counterintuitive, and has been controversial in both academic and political quarters.[29] Regardless of whether that argument is accepted as a matter of theory, however, the characterization of tax provisions as revenue raisers or revenue losers provides useful information to legislators because taxing and spending decisions tend to be made incrementally and by reference to a current budgetary or revenue baseline. The rest of Part III discusses some political and

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[28] *See* discussion *infra* Part III.B.

[29] *See* discussion *infra* Part III.B.

theoretical issues at stake in defining the revenue baseline.

Part IV examines accountability issues. Administrative lawyers and scholars are engaged in studying new ways in which regulation, contracts, and contract monitoring may respond to the accountability problems created by increased "contracting out" or privatizing of government services.[30] A parallel effort to study ways in which increased monitoring of tax incentives can be achieved needs to be undertaken. Tax incentives generally do not involve negotiated relationships between government and private contractors, but typically involve tax reporting to the Internal Revenue Service and oversight jurisdiction by the tax-writing committees. The delivery of subsidies through the tax system can mask governmental funding levels and allocations as well as obscure accountability for outcomes being funded. The use of tax incentives as an alternative to discretionary spending by government serves privatization goals through their use of market incentives and private choice. How to achieve greater political accountability for both the financing and performance of tax incentives remains a central challenge. Part IV ends with suggestions for ways to achieve such increased monitoring.

The political debate about privatization focuses public attention on the roles played by government and by private enterprise in achieving societal goals, but at the same time may conceal more direct arguments about the proper goals for society.[31] Discussion about government versus private performance, that is, about "ownership," "outsourcing," "management," and "competition" can mask important disagreements about public values. These disagreements underlie the politics of taxation[32] and under our constitutional framework are resolved in large part by Congress through the exercise of its taxing and spending powers.

II. DEFINING PUBLIC VALUES: CONGRESSIONAL TAXING AND SPENDING POWERS

In interpreting express limitations on the taxing power, the U.S. Supreme Court has distinguished between "taxes," or "revenue raising," and other methods of financing or regulating activities.[33] Those distinctions, developed in varied constitutional contexts, capture certain important differences between collectively and individually financed activities and embody the democratic values inherent in the taxing and spending powers. Similar distinctions animate the financing and performance dimensions of privatization decisions.

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30 *See, e.g.*, Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. 1285, 1289 (2003); Freeman, *Private Role*, *supra* note 7, at 549, 574–92.

31 Cass, *supra* note 6, at 452.

32 *See* MURPHY & NAGEL, *supra* note 3, at 8–10 (arguing that "[j]ustice or injustice in taxation . . . mean[s] justice or injustice in the system of property rights and entitlements that result from a particular tax regime").

33 *See* discussion *infra* Part II.B.

A. *The Public/Private Dimensions of Financing and Performance*

Privatization decisions contain dual dimensions of financing and performance. They involve choices between individual versus collective financing (primarily through taxation), and governmental versus private production of goods or delivery of services. The financing dimension is independent of the performance dimension,[34] creating four possible combinations of public/private choice: 1) collective financing and governmental performance; 2) collective financing and private performance; 3) individual financing and governmental performance; and 4) individual financing and private performance.[35]

In the first pair of these combinations, collective financing and governmental performance, the government raises revenues through taxes and produces the goods or delivers the services through a government agency. Privatization proponents often have this combination in mind when they urge reform. For example, tax dollars used by the government to provide public schools or social welfare services would fit this pattern.

In the second pair, collective financing and private performance, the government raises revenue, but then contracts with the private sector to deliver the goods or services. Tax dollars used to pay private contractors to build roads, prisons, or supply

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[34] A similar distinction between financing and production was made by Richard Musgrave in discussing the use of fiscal instruments to secure adjustments in the allocation of resources. *See* RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 3–27 (1959) (explaining the allocation, distribution, and stabilization functions of public budgets). Musgrave distinguished between "provision for public wants" and "production." He explained what he meant by the government "providing" for the satisfaction of public wants as follows:

> We mean, simply, that the goods and services needed to satisfy public wants must be paid for out of general revenue. The goods and services must be supplied free of direct charge to the user; at the same time, they need *not* be produced under the direct management or supervision of the government.

Id. at 15. He thus distinguished between goods "produced by the government and sold on the market" and goods "produced privately but purchased by the government and distributed free of direct charge." *Id*. In the first case, "there is no provision for public wants, while all production is under public management," and in the second case, "there is no public production, but all resources are devoted to provision for public wants." *Id*.

[35] DONAHUE, *supra* note 8, at 7–8. As Donahue points out, the distinction between public and private is "a good deal messier" than the categories suggest. *Id.* at 8. Comparisons must be qualified by the variety of possible organizational forms, ambiguous distinctions between taxes and prices, and political processes involved in choices about what to pay for collectively. *Id.* at 8–9.

For a similar explication of the financing and performance dimensions of public versus private choice, see Lester M. Salamon, *The New Governance and the Tools of Public Action: An Introduction*, *in* THE TOOLS OF GOVERNMENT: A GUIDE TO THE NEW GOVERNANCE 27 (Lester M. Salamon ed., 2002). I disagree, however, with Salamon's categorization of special tax advantages as an example of private finance and private delivery. *See Id.* at 28. For development of the view that they combine collective financing with private delivery, see discussion *infra* Part III.B.

government offices with computers and paper fit within this pattern. So do school voucher programs, in which tax dollars are used to finance the purchase by individuals of educational services provided by private schools.

In the third pair, individual financing combined with governmental performance, the government charges individuals a "user fee" for the goods or services provided. Thus, the financing is private but the performance remains tied in some way to government. The government may charge an individual or business a cost-based fee, for example, for postal services, access to camp grounds at national parks, or use of certain government-provided harbor services or maritime facilities.

Finally, the last pair, which combines individual financing with private sector delivery, "covers the large share of the economy in which the government role is limited to enforcing contracts and otherwise regulating, monitoring, and certifying private exchange."[36] This pattern would include private market transactions, such as the purchase of a haircut, a personal automobile, or a share of stock.

1. *General Tax Reduction: Individual Financing of Private Performance*

At the most fundamental level, privatization poses questions about the appropriate level of taxation needed or desired to fund the public sector.[37] Privatization proponents typically advocate tax reduction as a means to achieve a reduction in the size of government, combining individual financing with private production of goods and services.

For example, in the 1980s President Reagan created a commission to study the appropriate division of responsibilities between the federal government and the private sector. The Report of the President's Commission on Privatization described privatization as "part of a fundamental political and economic rethinking" about the role of government in the modern welfare state.[38] According to the Commission, tax reform in the 1980s accomplished "major reductions and simplifications" in federal taxation, which were intended to diminish "government influence over private sector activity."[39]

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[36] DONAHUE, *supra* note 8, at 7.

[37] *See, e.g.*, MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 1 (Rev. 4th ed. 2002) ("Taxation is the process by which a government transfers resources (almost always money) from the private to the public sector."); s*ee also, e.g.*, MURPHY & NAGEL, *supra* note 3, at 76 ("Taxation . . . determines how much of a society's resources will come under the control of government, for expenditure in accordance with some collective decision procedure, and how much will be left in the discretionary control of private individuals, as their personal property."); MUSGRAVE, *supra* note 34, at 5–24 (describing the objectives of budget policy as including allocation, distribution, and stabilization functions).

[38] PRIVATIZATION, *supra* note 12, at xii.

[39] *Id.* at 229. The Commission described the role of tax reduction as follows:

> The United States has also been a leader in the effort to reduce the intrusiveness of

Twenty years later, the Bush Administration's initial approach to taxation echoed the Reagan Administration's tax-rate-reduction approach.[40] General tax reduction serves privatization goals by decreasing government revenues and increasing the amount of money in private hands, thereby reducing the role played by government. George W. Bush made that link explicit when he campaigned in support of major tax relief: "[T]he surplus is not the government's money—the surplus is the people's money, and we ought to trust them with their own money."[41] After the 2000 election, President Bush made a major tax cut a legislative priority, and accomplished it in substantial part during the first six months of his administration.[42]

Although individual financing combined with private performance results in the most complete form of privatization by shifting both the financing and performance of a function to the private sector, it also raises serious concerns about distributive fairness.[43] Complete privatization would allow individual preferences to be asserted through the marketplace, but only as permitted by the individual's income and wealth.

Redistributive policies can be implemented by providing the least well-off with government-provided food, shelter, education, and health care, by providing them with minimum levels of income[44] or wealth[45] to make their own choices about what

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> taxation in the private economy. By the 1980s tax rates in many nations had reached the point of inhibiting private initiative, and taxes were exerting a pervasive influence on the behavior of private corporations and individuals. The major reductions and simplifications in federal taxation that occurred in the 1980s were intended to diminish this form of government influence over private sector activity.

Id.

[40] *See, e.g.*, C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 210 (2004).

[41] Dana Milbank, *Bush Signs Tax Bill Into Law: Lawmakers Spar Over Whether to Pare or Extend $1.35 Trillion Cut*, WASH. POST, June 8, 2001, at A1 (describing the tax cut as fulfilling his "signature campaign promise" and describing many of the President's words at the signing ceremony as "the same he used on the campaign trail to sell his plan"); *see also* David Firestone & Alison Mitchell, *In Hot Debate, Bush and McCain Collide over Campaign's Tactics*, N.Y. TIMES, Feb. 16, 2000, at A1 (quoting Candidate Bush as saying "either you trust the people or you trust government" and describing his tax cut as giving people their money back).

[42] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

[43] *See, e.g.*, SCLAR, *supra* note 11, at 4 ("Ideology that places market concerns ahead of those of equity and access animates the larger political discourse in which privatization is advocated."); Paul Starr, *The Case for Skepticism*, *in* PRIVATIZATION AND ITS ALTERNATIVES 25, 27–29 (William T. Gormley, Jr. ed., 1991) [hereinafter Starr, *Case for Skepticism*].

[44] *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 161–76 (1963).

[45] *See* BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY 4–5 (1999) (presenting and defending a proposal of providing each citizen, upon reaching adulthood, a one-time grant of $80,000 financed by an annual 2% wealth tax); ROBERT HAVEMAN, STARTING EVEN: AN EQUAL OPPORTUNITY PROGRAM TO COMBAT THE NATION'S NEW POVERTY 168–71, 272 (1988)

they need or want, or through private charity. Arguably either governmental or private performance can achieve the desired level of societal redistribution.

Accordingly, the reasons for or against government performance are not necessarily reasons for or against redistribution.[46] The reasons for or against redistribution, however, often underlie arguments for or against collective financing.[47] Decisions about taxation involve in part a collective determination about how much inequality in the distribution of income and wealth will be tolerated.[48] Fairness in collection of the tax relates to each individual's ability to pay a share of governmental cost of publicly provided goods and services. The overall redistributive role of the public budget[49] is an important political choice, which our constitutional framework leaves primarily to the political branches.[50] The reasons for and against governmental performance instead tend to center on efficiency and accountability concerns.

(developing the idea, proposed in 1968 by Nobel Prize Winner Professor James Tobin, of an "endowment" account or a "universal capital" account that would be assigned to all youths upon graduation from high school, which could be used to support certain human capital investments of their choice).

[46] *See* MURPHY & NAGEL, *supra* note 3, at 76–77 (arguing that reasons for and against putting resources under government rather than private control are not necessarily reasons for or against redistributing resources among groups or individuals and distinguishing between the "public-private division" and "distribution").

[47] *See, e.g.*, Patricia E. Dilley, *Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization*, 41 B.C. L. REV. 975, 983 (2000) (arguing that "what is frequently portrayed as a numbers problem to which a 'correct' answer can be found is in fact an ideological and political argument about wealth building versus direct income support and . . . of public entitlement as opposed to private property rights"); Lisa Philipps, *Taxing the Market Citizen: Fiscal Policy and Inequality in an Age of Privatization*, 63 LAW & CONTEMP. PROBS. 111, 113–18 (2000) (arguing that recent tax reforms in Canada signal a shift away from the redistributive ideals of social citizenship toward a more individualistic model of market citizenship).

[48] *See generally* Moore, *supra* note 4, at 1215–17 (describing Milton Friedman's proposal as "a particularly radical form of privatization, untainted by the problem of an 'unfair' distribution of income" by in effect publicly financing a collectively determined minimum level of income and wealth for everyone).

[49] *See* MUSGRAVE, *supra* note 34, at 18 (suggesting that adjustments in the distribution of income and wealth secured through the tax and transfer system, if implemented properly, tend to involve the least interference in the efficient functioning of the economy).

[50] Although the U.S. Constitution links the power to tax with the power to spend for the "general welfare" the courts have largely deferred to the political process for determination of the public purposes appropriate for congressional action. *See, e.g.*, United States v. Butler, 297 U.S. 1, 65–68 (1936) (observing that "Congress is expressly empowered to lay taxes to provide for the general welfare," and adopting an expansive view of the scope of the spending power); South Dakota v. Dole, 483 U.S. 203, 207 (1987) (citing *Butler* and noting that "[i]n considering whether a particular expenditure is intended to serve general public purposes, courts should defer substantially to the judgment of Congress"); s*ee also* discussion *infra* Part II.B.

2. *Tax Incentives and Private Performance*

Privatization initiatives are part of a broader public law shift from centrally managed government programs to decentralized and market-based models.[51] Under these models, federally funded programs are managed by state or local government officials, by quasi-governmental bodies, or are contracted out to private firms or nonprofit organizations.[52] The paradigm here would be competitive "contracting out" by the government of collectively financed goods or services.

In the tax context, the term "privatization" can suggest an array of specific management-related initiatives, such as "contracting out" tax-administration services to private entities,[53] or the use of tax-exempt nonprofit or "faith-based" organizations to provide welfare-related services formerly provided by government personnel.[54]

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[51] *See, e.g.*, B. GUY PETERS, THE FUTURE OF GOVERNING: FOUR EMERGING MODELS 2, 21 (1996).

[52] *See, e.g.*, Symposium, *New Forms of Governance: Ceding Public Powers to Private Actors*, 49 U.C.L.A. L. REV. 1687–824 (2002); Paul R. Verkuil, *Reverse Yardstick Competition: A New Deal for the Nineties*, 45 FLA. L. REV. 1, 5, 7–8, 11–12 (1993); *see also* A. Michael Froomkin, *Reinventing the Government Corporation*, 1995 U. ILL. L. REV. 543, 546 (1995); Nancy J. Knauer, *Reinventing Government: The Promise of Institutional Choice and Government Created Charitable Organizations*, 41 N.Y.L. SCH. L. REV. 945, 952–53 (1997).

[53] Such proposed initiatives include pilot programs for private tax collection, outsourcing of tax return processing, and using private contractors for electronic return filing. *See, e.g.*, GENERAL ACCOUNTING OFFICE, TAX DEBT COLLECTION: IRS IS ADDRESSING CRITICAL SUCCESS FACTORS FOR CONTRACTING OUT BUT WILL NEED TO STUDY THE BEST USE OF RESOURCES 2–4 (2004), *available at* http://www.gao.gov/new.items/d04492.pdf (discussing FY2005 budget proposal to use private collection agencies to help collect tax debts); George Guttman, *News Analysis: How the IRS May Test the Use of Private Collectors*, 69 TAX NOTES 1435, 1435 (1995) (describing a $13 million allocation in the 1996 IRS appropriation for a pilot program using private law firms and debt collection agencies to collect outstanding tax debts); *see also, e.g.*, George Guttman, *News Analysis: Where is IRS Modernization Heading?*, 86 TAX NOTES 1191, 1193 (2000) (reporting that much of the processing of returns that had planned to be outsourced by the IRS to the private sector is instead being done by electronic return originators); James J. McGovern, *The Tax Exempt and Government Entities Division—The Pathfinder*, 86 TAX NOTES 219, 229 (2000) (reporting on the outsourcing of employee plans return processing). *See generally* Maureen B. Cavanaugh, *Private Tax Collectors: A Roman, Christian, and Jewish Perspective*, 104 TAX NOTES 963, 968 (2004) (concluding from historical experiments with private tax collection that the government should provide adequate safeguards and ongoing supervision).

[54] Martha Minow, *Choice or Commonality: Welfare and Schooling After the End of Welfare As We Knew It*, 49 DUKE L.J. 493, 528–42 (1999) (discussing the charitable choice provisions in welfare reform legislation); *see also* Michele Estrin Gilman, *"Charitable Choice" and the Accountability Challenge: Reconciling the Need for Regulation with the First Amendment Religion Clauses*, 55 VAND. L. REV. 799, 801, 806–07 (2002); Steven K. Green, Book Review, *The Ambiguity of Neutrality*, 86 CORNELL L. REV. 692 (2001) (reviewing CHARLES GLENN, THE AMBIGUOUS EMBRACE: GOVERNMENT AND FAITH-BASED SCHOOLS AND SOCIAL AGENCIES (2000)); Martha Minow, *Partners, Not Rivals?: Redrawing the Lines Between Public and Private, Non-Profit and Profit, and Secular and Religious*, 80 B.U. L. REV. 1061, 1077 (2000) (reporting

Privatization can also be fostered more generally, however, through other more substantive tax provisions, including various types of tax incentives. Targeted tax incentives encourage private businesses or individuals to engage in certain socially or economically favored activities.[55] This type of "privatization" also involves a redrawing of lines between the public and private sectors, making public goals private interests by modifying market incentives.[56]

Tax incentives operate by reducing the prices of favored goods or services, relying on the market to determine how much production and consumption of the desired output actually occurs.[57] Thus, they provide an alternative to public programs managed by government bureaucrats by encouraging private individuals and businesses to act in their own economic self-interest. Although they rely on market responses, they alter existing market incentives through tax reduction for certain types of activities. In the context of tax incentives, line-drawing issues between public and private also relate to the distinction between taxes and prices, a distinction quite ambiguous in practice.[58]

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that "41 percent of charitable organizations providing human services receive government grants," citing a study published in 1993).

[55] *See, e.g.*, Butler, *supra* note 13, at 17. Butler argues that deregulation and tax incentives achieve privatization goals for the following reasons:

> The most general argument for deregulation applies in this instance—improving efficiency and economic benefits through competition. The case for tax incentives as an added boost is that by encouraging individuals to behave in a way that meets a particular public objective, such as providing incentives for private medical coverage and private pension programs, these services can be provided more efficiently than through publicly provided systems.

Id. at 20–21.

[56] *See, e.g.*, CHARLES L. SCHULTZE, THE PUBLIC USE OF PRIVATE INTEREST 5–6 (1977) (arguing for "collective influence over individual and business behavior" by "modifying the incentives of the private market" so that "public goals become private interests," rather than "removing a set of decisions from the decentralized and incentive-oriented private market and transferring them to the command-and-control techniques of government bureaucracy").

[57] *See* Eric J. Toder, *Tax Cuts or Spending—Does It Make a Difference?*, 53 NAT'L TAX J. 361, 362, 366–67 (2000). Their use expands the role of the tax system beyond its traditional revenue-raising function. *See* discussion *infra* Part III.C.

[58] DONAHUE, *supra* note 8, at 9. Donahue explains the distinction as follows:

> If a payment is attached to something essential . . . then the payment may be called a fee or price though it remains, in essence, a tax. Similarly, a tax that can easily be avoided by a change in behavior—like building a home or factory on one side or the other of a jurisdictional boundary—looks very much like a price.

Id. He then observes that "[t]rading on the ambiguous distinctions between prices and taxes can be politically expeditious" but that "it should not obscure the central issue: Should the item in question be paid for individually or collectively?" *Id.*

A premise of Musgrave's allocation function of public budgets is that "satisfaction of social wants must be related to individual evaluations of benefits received." *See* MUSGRAVE, *supra* note

After its first major tax rate cut, the Bush Administration, like administrations before it, increasingly turned to the tax code as a means of implementing specific domestic policy initiatives.[59] As observed by a commentator on proposals in President Bush's fiscal year 2003 budget submission: "The limos from the Education Department and Energy Department found their way to the Treasury building, and their passengers—with the full backing of the White House—were insisting that Treasury officials help them write 'tax laws.'"[60] As in administrations past, the Bush Administration used the tax code "to implement a broad range of policies that really have nothing to do with collecting revenue."[61]

Privatization proponents tend to favor tax incentives as a more effective alternative to other types of government programs. They use the existing tax system to stimulate private activity, a mechanism which permits the market to respond to individual preferences.[62] Proponents tend to view the market as representing an aggregation of individual preferences and thus an effective and cost-efficient way of achieving goals. Under this view, public purposes would be well served by programs that permit the market to operate with as little government control as possible.

Critics of privatization point out that increased private choice results in less participation in democratic political decision making[63] and diminished political

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34, at 20. Under the allocation function, taxes and expenditures serve as a tax-purchase mechanism for providing public wants, as distinguished from the function of taxes and transfers in the distribution branch. The distribution branch determines and secures the "proper" distribution of income and wealth. The proper state of distribution is defined in terms of income earned minus taxes or plus the transfers the distribution branch imposes. Taxes collected by the allocation branch are disregarded by the distribution branch, and treated like personal expenditures made in relation to the taxpayer's own evaluation of the social wants being satisfied. *Id.* at 20–21.

[59] See OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES: FISCAL YEAR 2004, at 66 (2003), *available at* http://www.whitehouse.gov/omb/budget/fy2004/pdf/spec.pdf [hereinafter BUDGET, FY 2004] (proposing tax incentives for charitable giving, strengthening education, investing in health care, protecting the environment, increasing energy production, and promoting energy conservation).

[60] Martin A. Sullivan, *Tax Expenditures for Republicans*, 94 TAX NOTES 1571, 1571–72 (2002).

[61] *Id.* at 1572.

[62] However, tax incentives do not necessarily reduce overall public spending. *See, e.g.*, Lester M. Salamon, *The Changing Tools of Government Action: An Overview*, *in* BEYOND PRIVATIZATION: THE TOOLS OF GOVERNMENT ACTION 3, 4–11 (Lester M. Salamon ed., 1989) [hereinafter Salamon, *The Changing Tools*]; Paul Starr, *The Limits of Privatization*, *in* PROSPECTS FOR PRIVATIZATION 124, 125 (Steve H. Hanke ed., 1987) [hereinafter Starr, *The Limits of Privatization*] (explaining that many proposals for program termination contemplate the use of tax incentives to stimulate private substitutes for public services and thus may not reduce public spending); *see also* Paul R. McDaniel, *Tax Expenditures as Tools of Government Action*, *in* BEYOND PRIVATIZATION: THE TOOLS OF GOVERNMENT ACTION 167, 170–71, 184–90 (Lester M. Salamon ed., 1989).

[63] *E.g.*, AMY GUTMANN, DEMOCRATIC EDUCATION 1–18 (1987) (discussing a democratic

transparency and accountability.[64] Politics offer a process for preference formation through the protection of voting rights and procedures for political deliberation, including open proceedings and constitutional protections for public discussion and criticism.[65] Private firms have fewer obligations to provide access to information about their operations or the reasons for their decisions.

The critics tend to view public values as representing something other than the aggregation of individual preferences. They point out that the exercise of individual choice in the marketplace is quite different from collective choice exercised through political participation in the democratic process.[66] The marketplace records individual preferences through purchasing power.[67] Its increased use for collectively financed activities, critics argue, may result in a loss of political participation and deliberation as well as the loss of those choices made possible through government action.[68]

It thus matters politically whether targeted tax deductions or tax credits are viewed as equivalent to collectively financed but privately provided goods or services (that is, as subsidies), or instead as equivalent to general tax reduction, making more individual resources available for private choice (that is, as tax cuts).[69] Before turning to that discussion, however, first a consideration of the areas in which courts have enforced limits on Congress's taxing and spending powers. The limitations, to the extent they have been enforced by the courts, illustrate the democratic values inhering in the taxing and spending powers, which are reflected in the decision-making procedures established by the Constitution for collectively financed activities. In defining such limitations, the courts have distinguished between individual financing of goods and services through "user" fees and collective financing through taxation.

B. *Constitutional Limitations on the Taxing and Spending Powers*

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theory of education). In discussing publicly financed voucher plans to increase parental choice of schools, Gutmann argues that "[m]inimally constrained voucher plans . . . avoid the controversial issue of how schools should educate citizens only at the cost of denying our collective interests in democratic education" and that the "most defensible" "[m]aximally constrained voucher plans . . . appear to avoid the issue only by shifting our controversies over democratic education from a mixture of local, state, and national politics to a more purely centralized politics." *Id.* at 68–69.

[64] *E.g.*, Starr, *The Case for Skepticism*, *supra* note 43, at 27–29; Starr, *The Limits of Privatization*, *supra* note 62, at 131–36.

[65] Starr, *The Limits of Privatization*, *supra* note 62, at 132.

[66] *See* MICHAEL J. SANDEL, DEMOCRACY'S DISCONTENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY 128–36, 141, 166–67 (1996).

[67] *See, e.g.*, MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT 14–18 (1980).

[68] Starr, *The Limits of Privatization*, *supra* note 62, at 132.

[69] *See* discussion *infra* Part III.

Although the Constitution links the taxing power with the power to spend for the "general welfare," the courts have largely deferred to the political process for determination of the public purposes appropriate for congressional action. In interpreting express constitutional limits on the taxing power, however, the U.S. Supreme Court has analyzed the taxing power in relation to its financing function. Differences between collective and individual financing underlie certain distinctions important in constitutional analysis. The cases suggest that the express constitutional limitations on the taxing power are enforced when Congress is engaged in general "revenue raising" as opposed to collecting fees in exchange for goods or services. That is, an imposition may be a "tax" when funds are collected from private parties for a "public" purpose. In addition, the Court has drawn historically significant distinctions between "taxes" and "penalties" for regulatory violations.

1. *The Taxing Power*

The U.S. Constitution vests in Congress the power to tax, placing certain express limitations on its exercise.[70] These limitations include the uniformity requirement imposed on indirect taxes,[71] the prohibition against the taxation of exports,[72] and the

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[70] U.S. CONST. art. I, § 8. *See* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 841–43 (3d ed. 2000); Boris I. Bittker, *Constitutional Limits on the Taxing Power of the Federal Government*, 41 TAX LAW. 3, 3–12 (1987) [hereinafter Bittker, *Constitutional Limits*]. Bittker quotes Chief Justice Chase's summary of the "very extensive" federal power to tax as follows:

> It is given in the Constitution, with only one exception and only two qualifications. Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.

Id. at 4 (quoting The License Tax Cases, 72 U.S. (5 Wall.) 462, 471 (1866)).

[71] U.S. CONST. art. I, § 8, cl. 1 ("all Duties, Imposts and Excises shall be uniform throughout the United States").

The Supreme Court has interpreted the uniformity requirement to mean "geographic" uniformity rather than uniformity as applied to individuals. Knowlton v. Moore, 178 U.S. 41, 106–09 (1900) (holding the federal inheritance tax constitutional, even though it increased rates progressively as the size of the legacy increased, because it taxed the subject of the tax at the same rate throughout the United States). Even so, the Court has permitted Congress "to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems." The Regional Rail Reorganization Act Cases, 419 U.S. 102, 159 (1974). *See* United States v. Ptasynski, 462 U.S. 74, 85 (1983) (holding constitutional an exemption of certain Alaskan oil from the Windfall Profit Tax Act of 1980 by concluding that Congress had acted on the basis of "neutral factors" relating to the ecology, environment, and remoteness of the favored area).

[72] U.S. CONST. art. I, § 9, cl. 5 ("No Tax or Duty shall be laid on Articles exported from any State."). *See, e.g.*, United States v. United States Shoe Corp., 523 U.S. 360, 367–70 (1998) (striking down an *ad valorem* harbor maintenance tax as applied to goods loaded at U.S. ports for export as not reflecting a fair approximation of services, benefits, and facilities provided to exporters, and

apportionment requirement imposed on direct taxes.[73] In addition, all bills for "raising revenue" must originate in the House of Representatives.[74]

The taxing power is also limited by the cross-cutting limitations of the Bill of Rights,[75] which can apply to any exercise of congressional power. Nevertheless, as pointed out by Professor Boris Bittker, the Supreme Court has generally accorded Congress a presumption of validity in the exercise of its taxing power:

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thus, not a permissible user fee); United States v. Int'l Bus. Mach. Corp., 517 U.S. 843, 854–56 (1996) (holding that a tax on policies insuring exports is functionally the same as a tax on exports); Pace v. Burgess, 92 U.S. 372, 375–76 (1875) (upholding a tobacco stamp requirement as a user fee rather than a prohibited export tax). For a recent discussion of these cases, see Erik M. Jensen, *The Export Clause*, 6 FLA. TAX REV. 1, 16–42 (2003).

[73] U.S. CONST. art. I, § 9, cl. 4 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census"); *id.* § 2, cl. 3 ("direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers").

In *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 637 (1895), the Court held that an income tax is a direct tax (insofar as the source of income is property) and therefore invalid unless apportioned. In so holding, the Court reversed course from an earlier determination that the income tax adopted during the Civil War was an indirect excise tax. *See* Springer v. United States, 102 U.S. 586, 602 (1880); *see also* Hylton v. United States, 3 U.S. (1 Dall.) 171, 173–84 (1796) (upholding federal tax on carriages as indirect tax not subject to apportionment requirement). The distinction between direct and indirect taxes and the pre- and post-Civil War history leading to the enactment of the Sixteenth Amendment is discussed in Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1 (1999) and Calvin Johnson, *Apportionment of Direct Taxes: The Foul-Up at the Core of the Constitution*, 7 WM. & MARY BILL RTS. J. 1, 3–5, 46–71, 73–82 (1999).

The Sixteenth Amendment, ratified in 1913, provides that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend XVI.

[74] U.S. CONST. art. I, § 7, cl. 1 ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.").

See, e.g., United States v. Munoz-Flores, 495 U.S. 385, 389–97 (1990) (rejecting the government's argument that an Origination Clause challenge presented a nonjusticiable political question). *See generally* Adrian Vermeule, *The Constitutional Law of Congressional Procedure*, 71 U. CHI. L. REV. 361, 422–27 (2004) (suggesting that the origination privilege may evolve as a norm governing the behavior of bicameral legislatures "in which the lower house specializes in information in return for the distributive advantage of having the first move").

[75] With regard to the Fifth Amendment privilege against self-incrimination, for example, the Court has recognized that a taxpayer may assert the privilege in a tax return, but the privilege does not entitle a taxpayer to refuse to file any tax return at all. *See generally* United States v. Sullivan, 274 U.S. 259, 263–64 (1927) (upholding the conviction of a bootlegger for willfully failing to file an income tax return, but suggesting that the taxpayer may claim the privilege with respect to specific items). However, an otherwise valid tax may not impose a reporting or registration requirement that would violate the taxpayer's Fifth Amendment privilege against self-incrimination. *See* Marchetti v. United States, 390 U.S. 39, 60–61 (1968) (reversing a conviction for violating a federal excise tax registration requirement imposed on those who engaged in the business of accepting wagers, a criminal act in defendant's state, where the information was required by statute to be shared with law enforcement officials).

> [E]ven in the heyday of the judicial use of the due process clause to oversee legislation regulating private business, the Supreme Court virtually deprived it of any jurisdiction over the federal taxing power, stating in *Brushaber v. Union Pacific Railroad* that "the Constitution does not conflict with itself by conferring upon the one hand a taxing power and taking the same power away on the other by the limitations of the due process clause."[76]

Although the Court recognized a residual judicial function to intervene in extreme cases if a "tax[] provision 'was so arbitrary . . . [as to constitute] confiscation of property,'" a presumption of validity was accorded congressional action.[77]

Shortly after *Brushaber*, however, the Court decided a series of cases that judicially distinguished valid revenue measures from invalid regulatory measures. In the Child Labor Tax Case[78] and others decided during the first few decades of the last century,[79] the Court held that a valid taxing provision "must be naturally and reasonably adapted to the collection of the tax and not solely to the achievement of some other purpose plainly within state power."[80] A tax is a regulatory measure, and thus invalid if not authorized by some independent source of congressional regulatory power,[81] if it is triggered by violation of a series of specified conditions enacted along with the tax.[82] Although a tax could have an "incidental" regulatory effect, a tax is unconstitutional "in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment."[83]

In the Child Labor Tax Case, the Court concluded that the excise tax imposed upon an employer's noncompliance with federal regulations on the use of child labor

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[76] Bittker, *Constitutional Limits*, *supra* note 70, at 11 (quoting Brushaber v. Union Pac. R.R., 240 U.S. 1, 24 (1916)).

[77] *Id.* (quoting *Brushaber*, 240 U.S. at 24).

[78] Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922) [hereinafter Child Labor Tax Case].

[79] *E.g.*, Hill v. Wallace, 259 U.S. 44, 66 (1922) (invalidating a tax imposed upon noncompliance with federal regulation of grain boards of trade, which was imposed almost entirely to compel compliance with regulations unrelated to the collection of the tax); *see also* Carter v. Carter Coal Co., 298 U.S. 238, 289 (1936) (invalidating a "tax" as a "penalty" and thus beyond the taxing power and exceeding the commerce power); United States v. Constantine, 296 U.S. 287, 295–97 (1935) (holding a special federal excise tax on liquor dealers operating in violation of state or local laws to be an invalid "penalty" because it exacted an exorbitant amount of money compared to that assessed against law-abiding dealers, took effect only after a state or local law had been violated, and usurped the states' police powers).

[80] Child Labor Tax Case, 259 U.S. at 43 (citing United States v. Doremus, 249 U.S. 86 (1919)).

[81] *See* Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533, 549 (1869) (upholding a federal tax on banknotes issued by state banks since Congress had an independent source of power to regulate currency under Article I, § 8).

[82] TRIBE, *supra* note 70, at 844.

[83] Child Labor Tax Case, 259 U.S. at 38.

was invalid,[84] since the Commerce Clause at that time was not thought to permit federal regulation of child labor.[85] When the Court later took a more expansive view of congressional Commerce Clause powers,[86] the doctrinal distinction between a tax as a valid revenue measure and as an invalid regulatory device no longer served as a meaningful limitation on federal regulatory authority.[87]

After the New Deal Court's post-1937 expansion of national legislative powers,[88] the Court never again invalidated a federal tax as an effort to impose

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[84] The federal statute at issue provided as follows:

> That every person (other than a bona fide boys' or girls' canning club recognized by the Agricultural Department of a State and of the United States) operating (a) any mine or quarry situated in the United States in which children under the age of sixteen years have been employed or permitted to work during any portion of the taxable year; or (b) any mill, cannery, workshop, factory, or manufacturing establishment situated in the United States in which children under the age of fourteen years have been employed or permitted to work, or children between the ages of fourteen and sixteen have been employed or permitted to work more than eight hours in any day or more than six days in any week, or after the hour of seven o'clock post meridian, or before the hour of six o'clock ante meridian, during any portion of the taxable year, shall pay for each taxable year, in addition to all other taxes imposed by law, an excise tax equivalent to 10 per centum of the entire net profits received or accrued for such year from the sale or disposition of the product of such mine, quarry, mill, cannery, workshop, factory, or manufacturing establishment.

Id. at 34–35.

[85] *See* Hammer v. Dagenhart, 247 U.S. 251, 276–77 (1918).

[86] Prior to 1937, the Court had upheld, under the Commerce Clause, congressional regulation of interests affected with a public interest located in a current of interstate commerce, such as the stockyard in *Stafford v. Wallace*, 258 U.S. 495 (1922). Similarly, the Court upheld regulation of the grain board of trade, in *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 31–33 (1923), under a revised law tailored to respond to the Court's objections to Congress's unsuccessful earlier attempt to use its taxing power to regulate the same commodities exchange in *Hill v. Wallace*, 259 U.S. 44 (1922). *See, e.g.*, Robert Post, *Federalism in the Taft Court Era: Can it be "Revived"?*, 51 DUKE L.J. 1513, 1558–76 (2002) (discussing doctrinal developments in the Court's pre-New Deal era and explaining the special difficulties posed for the Court by the Child Labor Tax Case).

[87] The considerations employed by the Court in distinguishing between revenue measures and prohibitory regulatory measures have been relied upon, in part, in federal or state tax cases dealing with Fifth Amendment limitations. TRIBE, *supra* note 70, at 845 n.16 (discussing double jeopardy and self-incrimination cases). *See* Dep't of Revenue of Montana v. Kurth Ranch, 511 U.S. 767, 779–83 (1994) (holding that a state tax on marijuana imposed on those who had been criminally prosecuted for marijuana possession constituted a punishment for double jeopardy purposes).

[88] For a description of the fault lines in the Court's jurisprudence created by the virtual demise of economic due process, see Robert G. McCloskey, *Economic Due Process and the Supreme Court: An Exhumation and Reburial*, 1962 SUP. CT. REV. 34, 36–45. McCloskey argued that an explicit decision "to discard substantive due process root-and-branch would have compelled the Justices . . . to examine the basis of their abnegation." *Id.* at 40. The preservation of old rhetoric left "a large gap in the rationale that underlies the structure of modern constitutional law." *Id.* In the end, he observed, "we are left with a judicial policy which rejects supervision over economic matters and asserts supervision over 'personal rights'; and with a rationale, so far as the written

regulatory standards outside the scope of other enumerated powers.[89] Because any such taxes would have been upheld as a necessary and proper exercise of the Commerce Clause, the relationship between the taxing power and other legislative powers received no serious discussion or reconsideration by the Court in subsequent years.[90]

To summarize, the congressional taxing power is extensive, and the judiciary largely accords Congress a presumption of validity in the exercise of the power. In defining the limits of the power, the courts in the early part of the last century distinguished revenue measures from regulatory taxes. Taxes were upheld as valid revenue measures rather than prohibited regulatory taxes if they were unconditional taxes, achieving their regulatory effects through their rate structure,[91] or if their regulatory provisions bore a "reasonable relation" to their enforcement as a revenue measure.[92] When this doctrinal distinction became less salient after the Court's view of the commerce power expanded, the Court also generally tended to treat tax provisions producing revenue as constituting a valid "revenue" measure.[93]

The courts have offered limited additional guidance with regard to the meaning of the term "revenue" in other constitutional contexts, distinguishing between revenue measures and special assessments or user fees. In interpreting the

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opinions go, that might support withdrawal from both fields but does not adequately justify the discrimination between them." *Id.* at 45. As in the substantive due process area, the Court has never fully repudiated the vocabulary it used to distinguish between "taxes" and regulatory "penalties."

[89] TRIBE, *supra* note 70, at 845. *See, e.g.*, Sonzinsky v. United States, 300 U.S. 506, 513–14 (1937) (upholding a federal license tax on firearms dealers and observing that it is beyond the competency of the courts to "[i]nquir[e] into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it . . . ."). *See also, e.g.*, Mulford v. Smith, 307 U.S. 38, 47–51 (1939) (upholding the imposition of penalties under the Agricultural Adjustment Act of 1938); Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 393 (1940) ("The power of taxation, granted to Congress by the Constitution, may be utilized as a sanction for the exercise of another power which is granted it.").

[90] The Court's recent more restrictive view of congressional Commerce Clause powers, beginning with *United States v. Lopez*, 514 U.S. 549 (1995), could revitalize the distinction between valid revenue measures and prohibited regulatory taxes. *See* TRIBE, *supra* note 70, at 846 & n.19, *cf.* Post, *supra* note 86, at 1639 (placing pre-New Deal federalism in historical context and observing that "[t]he Taft Court's suspicion of federal legislation was grounded simultaneously in a commitment to economic rights deemed essential to 'the orderly pursuit of happiness by free men' and in a brooding mistrust of Congress's capacity authentically to register a national democratic will, especially when compared to the Court's own legitimate role as a common law conservator of public values").

[91] *See* McCray v. United States, 195 U.S. 27, 50–64 (1904) (upholding as a revenue measure a tax of ten cents per pound on yellow oleomargarine even though the corresponding tax on white oleomargarine was one fourth of a cent per pound).

[92] United States v. Doremus, 249 U.S. 86, 94–95 (1919) (upholding registration requirement bearing some reasonable relation to its enforcement as a tax measure even if it may have been motivated in part by its regulatory effects); *see* TRIBE, *supra* note 70, at 844.

[93] TRIBE, *supra* note 70, at 846 n.19.

Origination Clause, which requires that all bills for "raising revenue" originate in the House of Representatives,[94] the Supreme Court has included revenues intended for the general support of government but not special assessments designed to fund specific programs from fines or fees.[95] For purposes of interpreting the Export Clause, the Supreme Court has similarly distinguished between prohibited taxes on exports and permissible "user fees" tied to specific benefits, services, or facilities.[96]

2. *Spending Power: The Scope of the General Welfare Clause*

The spending power is textually linked with the taxing power in Article I, Section 8 of the Constitution: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States . . . ."[97] Thus, Article I couples the taxing power with the power to spend for the "general welfare."[98] In interpreting the

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[94] In this context, the term "raising revenue" has been interpreted by lower federal courts as broadly encompassing provisions "relating to" revenue. Taxpayers challenged a large federal tax increase enacted in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 324. The legislation began as a House bill cutting taxes, but was replaced by a Senate amendment increasing taxes. Taxpayers argued that TEFRA violated the Origination Clause because the revenue-raising provisions originated in the Senate, not in the House. The federal appellate courts rejected such challenges, generally holding that the term "raising revenue" refers to all legislation relating to taxes regardless of its revenue effect, and that the bill passed by the House, and later amended by the Senate and agreed to by the House, was a bill to "raise revenue" within the meaning of the Origination Clause. Armstrong v. United States, 759 F.2d 1378, 1381 (9th Cir. 1985); Wardell v. United States, 757 F.2d 203, 205 (8th Cir. 1985) (per curiam); Heitman v. United States, 753 F.2d 33, 35 (6th Cir. 1984) (per curiam); *see also* Texas Ass'n of Concerned Taxpayers, Inc. v. United States, 772 F.2d 163, 166 (5th Cir. 1985) (holding the question to be nonjusticiable), 476 U.S. 1151 (1986); Rowe v. United States, 583 F. Supp. 1516, 1519 (D. Del. 1984), *aff'd mem.*, 749 F.2d 27 (3d Cir. 1984) (reaching the merits and rejecting the Origination Clause challenge).

As explained by the Ninth Circuit in *Armstrong,* the revenue effect of legislation is difficult to predict, and may depend on whether one looks to the long-term or short-run effects. 759 F.2d at 1381. *See* Bittker, *Constitutional Limits*, *supra* note 70, at 5–6. *See also* Flint v. Stone Tracy Co., 220 U.S. 107, 143 (1911).

[95] *See, e.g.*, United States v. Munoz-Flores, 495 U.S. 385, 388 (1990) (holding that a statute that creates a particular governmental program to compensate crime victims and that raises revenue through "special assessments" to support that program, as opposed to a statute that raises revenue to support government generally, is not a "Bil[l] for raising Revenue" within the meaning of the Origination Clause).

[96] *See supra* note 72.

[97] U.S. CONST. art. I, § 8, cl. 1.

[98] For discussion of the possible significance of the absence of the comma after the word "Debts," see TRIBE, *supra* note 70, at 834, 834 n.2. *See also* ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES & POLICIES § 3.4, at 268 (2d ed. 2002) (discussing the broad authority of Congress to tax and spend for the general welfare); RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE & PROCEDURE § 5.7, at 523 (3d ed.

General Welfare Clause, the Supreme Court historically has deferred to Congress.

The Supreme Court in *United States v. Butler*,[99] decided in 1936, interpreted the above-quoted language as empowering Congress to "lay taxes to provide for the general welfare" and viewed the spending power as congruent with the power to tax:

> The Congress is expressly empowered to lay taxes to provide for the general welfare. Funds in the Treasury as a result of taxation may be expended only through appropriation. (Article I, § 9, cl. 7). They can never accomplish the objects for which they were collected unless the power to appropriate is as broad as the power to tax. The necessary implication from the terms of the grant is that the public funds may be appropriated "to provide for the general welfare of the United States."[100]

The Court in *Butler* then discussed the debate between Madison[101] and Hamilton[102] with regard to the scope of the spending power, and expressly adopted Hamilton's more expansive views:

> Madison asserted it amounted to no more than a reference to the other powers enumerated in the subsequent clauses of the same section . . . . [I]n this view the phrase is merely tautology, for taxation and appropriation are or may be necessary incidents of the exercise of any of the enumerated legislative powers. Hamilton, on the other hand, maintained the clause confers a power separate and distinct form those later enumerated, is not restricted in meaning by the grant of them, and Congress consequently has a substantive power to tax and to appropriate, limited only by the requirement that it shall be exercised to provide for the general welfare of the United States. . . . Mr. Justice Story, in his Commentaries, espouses the Hamiltonian position. . . . [We] conclude that the reading advocated by Mr. Justice Story is the correct one. While, therefore, the power to tax is not unlimited, its confines are set in the clause which confers it, and not in those of § 8 which bestow and define the legislative powers of the Congress. It results that the power of Congress to authorize expenditure of public moneys for public purposes is not limited by the direct grants of legislative power found in the Constitution.[103]

1999 & Supp. 2003) (stating that "[t]he constitutional power to spend is a condition imposed on the power to tax" and "the power to spend is coupled with the power to tax and is cast in terms of the power to tax 'and provide for the common Defense and general Welfare'").

[99] 297 U.S. 1, 53–57, 68–78 (1936) (holding unconstitutional on Tenth Amendment grounds the Agricultural Adjustment Act of 1933, which authorized a tax on agricultural goods in order to fund emergency measures, such as paying some farmers to take their land out of production to stabilize farm product prices).

[100] *Id.* at 65.

[101] *See* THE FEDERALIST NO. 41 (James Madison).

[102] *See* THE FEDERALIST NOS. 30, 34 (Alexander Hamilton).

[103] *Butler*, 297 U.S. at 65–66. In addition, the Court quoted Hamilton for the proposition that "the purpose must be 'general, and not local.'" *Id.* at 67.

The *Butler* Court thus rejected Madison's view that the federal spending power was limited to subjects enumerated elsewhere in Article I, Section 8, and instead adopted Hamilton's position that the spending power was a grant of independent authority.

These general principles were reinforced the following year by the Court in two key cases, which upheld the constitutionality of the federal unemployment compensation system[104] and old age pension program created by the Social Security Act.[105] As Justice Cardozo stated in *Helvering v. Davis*,[106] in which the Court held that the old age pension program did not violate the Tenth Amendment, the discretion to decide whether the objective of a particular program advances the general welfare rather than merely the interest of the directly benefited locality "belongs to Congress, unless the choice is clearly wrong, a display of arbitrary power, not an exercise of judgment."[107] The Court also emphasized that the concept was not "static": "Needs that were narrow or parochial a century ago may be interwoven in our day with the well-being of the Nation."[108] The Court upheld the social security tax on employers, the proceeds of which were intended to provide funds for payments to retired workers, in furtherance of the general welfare.[109]

Fifty years later, in *South Dakota v. Dole*,[110] the Court reaffirmed the expansive scope of the spending power. Objectives not thought to be within the enumerated legislative powers "may nevertheless be attained through the use of the spending power and the conditional grant of federal funds."[111] In *Dole*, the Court upheld a federal highway spending program that withheld five percent of otherwise available federal funds from states that did not adopt a 21-year-old minimum drinking age, and adopted a multi-part test to determine whether federal spending conditions are constitutional.[112]

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[104] Steward Mach. Co. v. Davis, 301 U.S. 548, 589 (1937) (upholding a federal tax imposed on employers to provide unemployment benefits and a credit allowed for similar taxes paid to a state as a legitimate object of federal spending under the "general welfare" clause). Although Congress conditioned the credits upon compliance with regulations, the tax and the credit in combination were held to constitute inducement, not coercion, and as such did not violate the Tenth Amendment. *Id.* at 585–86. The Court held that the credit for state taxes bore a reasonable relationship "to the fiscal need" subserved by the tax in its normal operation, because state unemployment benefits would relieve the burden for direct relief by the national treasury. *Id.* at 591.

[105] Helvering v. Davis, 301 U.S. 619, 640 (1937) (noting also that "[t]he line must still be drawn between one welfare and another, between particular and general").

[106] 301 U.S. 619 (1937).

[107] *Id.* at 640.

[108] *Id.* at 641.

[109] *Id.*

[110] 483 U.S. 203 (1987).

[111] *Id.* at 207.

[112] *Id.* at 207–08, 212.

First, and most relevant to the discussion here, the Court noted that exercise of the spending power must be in pursuit of the "general welfare," citing both *Butler*[113] and *Helvering v. Davis*.[114] Writing for the Court, Chief Justice William Rehnquist observed that "[i]n considering whether a particular expenditure is intended to serve general public purposes, courts should defer substantially to the judgment of Congress."[115] He also noted that the Court has "questioned whether 'general welfare' is a judicially enforceable restriction at all."[116] Next, any conditions Congress imposes must be unambiguous so that each state can make an informed choice.[117] Third, there must be a "nexus" between the area being regulated and the substance of the condition. That is, any conditions "might be illegitimate if they are unrelated 'to the federal interest in particular national projects or programs.'"[118] Finally, a determination must be made as to whether any other constitutional provisions pose "an independent bar to the conditional grant of federal funds."[119]

The Court concluded that the legislation was designed to serve the general welfare as defined by Congress, that it met the clear statement requirement, the condition imposed was directly related to the federal highway spending goal of providing safe interstate travel, and that the Twenty-First Amendment did not bar congressional involvement through the use of the spending power.[120] The Court thus upheld the condition on the federal grant, even though it assumed that Congress could not regulate drinking ages directly because of the explicit reservation of control over alcoholic beverages to the states under the Twenty-First Amendment.

Despite the enforcement by the Rehnquist Court since *Dole* of federalism norms in various forms,[121] the Court has not similarly qualified the scope of Congress's

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[113] 297 U.S. 1, 65 (1936)

[114] 301 U.S. at 640–41.

[115] *Dole*, 483 U.S. at 207.

[116] *Id.* at 207 n.2 (citing Buckley v. Valeo, 424 U.S. 1, 90–91 (1976) (per curiam)). In *Buckley*, the Court upheld the public financing of election campaigns, stating as follows:

> In this case, Congress was legislating for the "general welfare"—to reduce the deleterious influence of large contributions on our political process, to facilitate communication by candidates with the electorate, and to free candidates from the rigors of fundraising. . . . Whether the chosen means appear "bad," "unwise," or "unworkable" to us is irrelevant; Congress has concluded that the means are "necessary and proper" to promote the general welfare, and we thus decline to find this legislation without the grant of power in Article I, § 8.

Buckley, 424 U.S. at 91.

[117] *Dole*, 483 U.S. at 207 (citing Pennhurst State Sch. & Hosp. v. Halderman, 451 U.S. 1, 17 (1981)).

[118] *Id.* (quoting Massachusetts v. United States, 435 U.S. 444, 461 (1978)).

[119] *Id.* at 208.

[120] *Id.* at 210–12.

[121] *See, e.g.*, United States v. Morrison, 529 U.S. 598, 607–19, 627 (2000) (Commerce

broad conditional spending power.[122] Although the Court in *Dole* noted that Congress cannot enact spending conditions to induce the states to engage in unconstitutional acts[123] or to coerce states into actions rather than offering them a choice,[124] no clear limiting principle on the spending power has emerged since *Dole*.[125]

Clause and Section 5 of the Fourteenth Amendment); Printz v. United States, 521 U.S. 898, 925–33 (1997) (Tenth Amendment); Seminole Tribe v. Florida, 517 U.S. 44, 54–73 (1996) (Eleventh Amendment); United States v. Lopez, 514 U.S. 549, 552–68 (1995) (Commerce Clause); New York v. United States, 505 U.S. 144, 159–66 (1992) (Tenth Amendment).

[122] *See* New York v. United States, 505 U.S. 144, 173 (1992) (upholding conditional spending provisions as a permissible means of encouraging state action with respect to nuclear waste disposal).

[123] South Dakota v. Dole, 483 U.S. 203, 210–11 (giving as examples grants "conditioned on invidiously discriminatory state action or the inflicton of cruel and unusual punishment"). This restriction is aimed primarily at protecting individual rights, such as rights under the First or Fourteenth Amendments, from being violated and not states' rights. *Compare* United States v. Am. Library Ass'n, 539 U.S. 194, 203–04 (2003) (per Rehnquist, C.J.) (citing *Dole* and upholding the Child Internet Protection Act, which requires libraries to use filter technology to block pornographic images on their computers or lose federal funding, as a valid exercise of the spending power) *with* Legal Serv. Corp. v. Velazquez, 531 U.S. 533, 547–49 (2001) (per Kennedy, J.) (holding that congressional restrictions on the use of federal funds for welfare reform activities by Legal Services Corporation grantees and their clients violates the First Amendment).

[124] The Court acknowledged that financial inducements offered by Congress may be "so coercive as to pass the point at which 'pressure turns into compulsion.'" *Dole*, 483 U.S. at 211 (quoting Steward Mach. Co. v. Davis, 301 U.S. 548, 590 (1937)). However, no post-*Dole* spending condition has been invalidated on that ground.

In the Eleventh Amendment context, Justice Scalia has drawn a distinction between Congress threatening a "sanction" and a "denial of a gift or gratuity" if the state refuses to agree to its condition. *See* Coll. Savs. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 687 (1999) (per Scalia, J., joined by Rehnquist, C.J.) (acknowledging that such a distinction could disappear where the gift withheld is substantial enough, but explaining that "where the constitutionally guaranteed protection of the States' sovereign immunity is involved, the point of coercion is automatically passed—and the voluntariness of waiver destroyed—when what is attached to the refusal to waive is the exclusion of the State from otherwise lawful activity"). Thus, the Court found no voluntary waiver of sovereign immunity when a state merely engaged in commercial activities regulated under a federal law, which provided that states are subject to suit in federal court for false or misleading advertising in connection with those activities. *Id.* (distinguishing such situations from the waiver of immunity that may be found in the state's acceptance of a federal grant).

[125] *See, e.g.*, TRIBE, *supra* note 70, at 839 (observing that "the scope of the spending power would seem to extend to virtually any secular activity"); Jesse H. Choper, *Taming Congress's Power under the Commerce Clause: What Does the Near Future Portend?*, 55 ARK. L. REV. 731, 765 (2003) (explaining that the most direct approach to adopting a limiting principle "would simply be for the Court to employ the doctrine of unconstitutional conditions and rule that Congress cannot use a carrot to accomplish what it is forbidden to do with a stick"). Professor Choper criticizes the suggested distinction made by Justice O'Connor's dissenting opinion in *Dole*, between conditions that only generally relate to the purposes of Congress's grant and conditions that expressly specify

In sum, although the courts have enforced some limits on the taxing and spending powers, they have largely left to the political process the determination of whether federal legislation advances public purposes under the General Welfare Clause. In defining revenue provisions, both Origination Clause and Export Clause cases draw distinctions between individually financed "user fees" and collectively financed "general revenues." On the spending side, Congress has a great deal of latitude in determining whether a particular expenditure serves "public" purposes.

Constitutionally required enactment procedures[126] provide democratic legitimacy for Congress's taxing and spending decisions.[127] These decision-making procedures apply to all legislation, whether Congress is raising or lowering taxes, enacting targeted tax incentives, or appropriating funds.[128] Other democratic values, including transparency and accountability, depend upon the availability of information about and public understanding of those decisions.[129]

III. TRANSPARENCY: TAX AND BUDGET POLITICS

Taxation generally determines the level of collective financing of goods and services, whether produced and delivered by government employees or purchased

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how the money should be spent, arguing that it is "just as malleable as other potentially limiting principles." *Id.* at 766.

[126] U.S. CONST. art. I, § 7, cl. 2 (bicameralism and presentment); *see, e.g.*, Clinton v. City of New York, 524 U.S. 417, 438–40 (1998); Immigration and Naturalization Serv. v. Chadha, 462 U.S. 919, 951 (1983) (observing that the Article I power to enact statutes may only "be exercised in accord with a single, finely wrought and exhaustively considered, procedure").

[127] *See* McCulloch v. Maryland, 17 U.S. 316, 428 (1819) (observing that security against the abuse of the taxing power is found in "the structure of government itself" and that in imposing a tax, the legislature "acts upon its constituents," which provides in general "a sufficient security against erroneous and oppressive taxation").

[128] *See* U.S. CONST. art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time."). *See also* Cincinnati Soap Co. v. United States, 301 U.S. 308, 321–22 (1937) (recognizing the wide discretion of Congress in making general appropriations of amounts to be expended as directed by designated government agencies). For a discussion of congressional budget authority outside of annual "appropriations" acts, including contract authority, borrowing authority, and entitlement authority, see Kate Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 CAL. L. REV. 595, 605–09 (1988) ("Entitlements, such as formula grant programs for individuals and other entities, usually are permanently appropriated and may be funded either from trust fund receipts . . . or general revenues.") (footnote omitted); *see also* Charles Tiefer, *"Budgetized" Health Entitlements and the Fiscal Constitution in Congress's 1995-1996 Budget Battle*, 33 HARV. J. ON LEGIS. 411, 416 (1996).

[129] *E.g.*, JOHN RAWLS, A THEORY OF JUSTICE 133 (1971) (stating that a condition for a concept of right is publicity and explaining that "[t]he point of the publicity condition is to have the parties evaluate conceptions of justice as publicly acknowledged and fully effective moral constitutions of social life").

from the private sector. The use of tax incentives serves privatization goals by providing more market-based private sector production alternatives. However, targeted tax incentives result in revenue losses, which may be offset by higher tax rates generally, higher governmental borrowing costs from increased deficit levels, or by spending cuts.

The characterization of taxing and spending decisions influences public debate. It matters politically whether tax incentives are viewed as equivalent to collectively financed but privately provided goods or services; or instead, as equivalent to general tax reduction. The recent re-examination of the tax expenditure budget by the Bush Administration illustrates the political dynamics at play.[130]

Although much of the tax code is designed to raise revenue or to accomplish specific tax policy objectives, some tax provisions are identified as "tax expenditures" by the Treasury[131] and by Congress.[132] Under tax expenditure analysis, tax expenditures are categorized as subsidies or as spending provisions (in the form of foregone revenue), rather than as income measurement or revenue raising provisions.[133] Tax expenditures may be in the form of exclusions, exemptions, deductions, credits, deferrals, or special tax rates. Many targeted tax incentives currently are identified in the budget process as "tax expenditures" and, thus, are identified conceptually with the use of public resources. Tax expenditures are listed for informational purposes as equivalent to governmental expenditures, listed by reference to federal funding categories.[134]

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[130] *See* discussion *infra* Part III.A.

[131] Treasury published its first tax expenditure analysis in 1968, under the leadership of Harvard Law School Professor Stanley S. Surrey, who served as Assistant Secretary of Treasury for Tax Policy from 1961 to 1969. *See* U.S. DEP'T OF THE TREASURY, ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FOR THE FISCAL YEAR ENDED JUNE 30, 1968, DOC. NO. 3245, 35–36, 322 ex. 29 (1969); *see also* Jonathan Barry Forman, *Origins of the Tax Expenditure Budget*, 30 TAX NOTES 537, 537–38 (1986); Erwin N. Griswold, *A True Public Servant*, 98 HARV. L. REV. 329 (1984) (describing Surrey's academic and public service achievements). Currently, Treasury's tax expenditure budget appears in the ANALYTICAL PERSPECTIVES portion of the President's annual budget submission to Congress. *See* BUDGET, FY 2004, *supra* note 59, at 101.

[132] *See, e.g.*, STAFF OF THE J. COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2004–2008 (JCS-8-03) 1 & n.2 (2003) [hereinafter J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008] (listing prior reports beginning in 1972, and containing current tax expenditure estimates prepared for the House Committee on Ways and Means and the Senate Committee on Finance, and submitted also to the House and Senate Committees on the Budget); STAFF OF THE J. COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2002–2006 (JCA-1-02) 1 & n.2 (2002) [hereinafter J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2002–2006].

[133] *See* Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1156 (discussing how tax expenditures function as government subsidies). For further discussion of the tax expenditure concept, see discussion *infra* Part III.B.

[134] Tax incentives are listed as "expenditures" in annual budget submissions to Congress. *See*

The following subsections describe the objections to the tax expenditure concept raised in the Bush Administration's budget submissions, briefly explain the history of the tax expenditure concept, and provide an analysis of the ownership and tax base issues underlying the Administration's reconsideration of the tax expenditure budget.

A. *Reconsideration in Progress*

The Bush Administration's first budget, submitted to Congress in April 2001, announced a controversial reconsideration of the tax expenditure concept.[135] The budget submission questioned the value of tax expenditure analysis on both ideological and technical grounds.[136] The ideologically based objection highlighted key assumptions underlying the tax expenditure concept: that the government would "otherwise collect additional revenues but for these provisions" and that these revenues constitute a "resource to be spent."[137] Technical objections questioned the income tax baseline used to determine the tax expenditure list. The Bush budget criticized the current income tax baseline for its arbitrariness and its "breadth."[138] Although it was impossible to tell from its first budget submission whether the Bush Administration's reconsideration would lead to the rejection of the tax expenditure concept or to other less drastic changes in budget presentations made in the future, some initial observations by Treasury officials suggested that the changes being

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discussion *infra* Part III.B.

135 *See* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES: FISCAL YEAR 2002, at 61 (2001), *available at* http://www.whitehouse.gov/omb/budget/fy2002/spec.pdf [hereinafter BUDGET, FY 2002]. *See* Julie Roin, *Truth in Government: Beyond the Tax Expenditure Budget*, 54 HASTINGS L.J. 603, 603–04 (2003) (noting that by including the announcement "President Bush sparked a minor firestorm within the Beltway" and that it sounded to many "like an opening salvo in a battle" to eliminate the tax expenditure listings in the budget).

136 The Bush Administration's first budget submission explained the need for reconsideration of the tax expenditure concept as follows:

> The Congressional Budget Act of 1974 (Public Law 93-344) requires that a list of "tax expenditures" be included in the budget. So-called tax expenditures may be defined as provisions of the Federal tax laws with exclusions, exemptions, deductions, credits deferrals, or special tax rates. Underlying the "tax expenditure" concept is the notion that the Federal Government would otherwise collect additional revenues but for these provisions. It assumes an arbitrary tax base is available to the Government in its entirety as a resource to be spent. Because of the breadth of this arbitrary tax base, the Administration believes that the concept of "tax expenditure" is of questionable analytic value. The discussion below is based on materials and formats developed and included in previous budgets. The Administration intends to reconsider this presentation in the future.

BUDGET, FY 2002, *supra* note 135, at 61.

137 *Id.*

138 *Id.*

considered related to the tax baseline used in tax expenditure analysis.[139]

The Bush Administration's second budget, submitted to Congress in 2002, confirmed those initial indications and provided a more complete description of the ongoing reconsideration of the tax expenditure presentation in the budget.[140] According to the Administration's second budget submission, the re-evaluation and revision efforts by Treasury would focus on three main tax baseline-related issues: 1) a redefinition of the baseline income concept "to be more consistent with a comprehensive income tax base"; 2) consideration of issues involved in estimating "negative" tax expenditures in addition to the current list of positive tax expenditures; and 3) consideration of "estimating tax expenditures relative to a hypothetical consumption tax, as well as to an income tax."[141] The study would consider "possible revisions and improvements in methodology and approach."[142] In addition, the second budget submission stepped back somewhat from the first budget's criticism by acknowledging that "[t]hough imperfect, the tax expenditure budget has expanded our understanding of policy programs operating through the Federal income tax and, more generally, the workings of the Federal income tax."[143]

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[139] *Id.* at 76 (noting that "[a] tax expenditure is an exception to the baseline provisions of the tax structure" and that "[t]he 1974 Congressional Budget Act did not specify the baseline provisions of the tax law"); *see* Heidi Glenn, *Bush Administration Questions Value of Tax Expenditures List*, 91 TAX NOTES 535, 535 (2001) (reporting that the Treasury Department is conducting a periodic review into what should be considered a "normal tax system," and quoting Treasury Assistant Secretary for Tax Policy, Mark A. Weinberger, as observing that our tax system is "really a hybrid tax, a mixture of income and consumption based systems" and "we're going to look at whether the definition has to be modernized as to what is a normal system and what is a deviation from it").

[140] *See* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES: FISCAL YEAR 2003, at 95–97 (2002), *available at* http://www.whitehouse.gov/omb/budget/fy2003/pdf/spec.pdf [hereinafter BUDGET, FY 2003].

[141] *Id.* at 96–97. The concept of "negative tax expenditures" is related to the notion of a tax penalty. For example, a statutory limitation on the deduction of economic losses or other business costs would be inconsistent with an income tax, and thus could be classified as "negative" tax expenditure. *See, e.g.*, I.R.C. § 67 (2004) (providing a 2% floor on miscellaneous itemized deductions).

[142] BUDGET, FY 2003, *supra* note 140, at 96.

[143] *Id.* at 95. The budget submission explains the statutory requirement that the annual federal budget presentation include a list of "tax expenditures" as follows:

> Policymakers and researchers have long recognized that certain income tax code provisions have policy purposes other than simply raising revenue and that it is useful to understand better the nature of these provisions. It is important to know the amounts of revenue associated with them, whether they are achieving desired results, and their consequences for the economy. The answers to these questions are important simply as a source of information, but also so that policymakers and the public can review these features of the income tax regularly to see if change is warranted.

The Administration's next two budgets, submitted in 2003 and 2004, contained the initial results of Treasury's ongoing study of each of the above-mentioned baseline issues, as well as revised estimates of selected tax expenditures.[144] The Treasury review summarized differences between "official" tax expenditures and those based on a comprehensive income tax,[145] included a discussion of negative tax expenditures,[146] and provided an analysis of categories of tax expenditures under a theoretical consumption-based tax.[147] In addition, it explained its new methodology for revised estimates of selected tax expenditures, including lowered estimates for accelerated depreciation.[148]

The last major tax baseline change to the tax expenditure budget was proposed by Treasury early in the Reagan Administration,[149] and was later adopted by that Administration in a somewhat diluted form.[150] The Bush Administration reconsideration echoed some of the concerns expressed about the tax baseline that prompted the modifications adopted over two decades ago.[151] Before turning to a

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Id. at 95.

144 BUDGET, FY 2004, *supra* note 59, at 130–40. The study is reproduced in updated form in the budget submitted to Congress in February 2004. OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, ANALYTICAL PERSPECTIVES: FISCAL YEAR 2005, at 314–25 (2004), *available at* http://www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf [hereinafter BUDGET, FY 2005].

145 The review concludes that "[m]ost large tax expenditures would continue to be tax expenditures were the baseline taken to be comprehensive income, although some would not." BUDGET, FY 2004, *supra* note 59, at 130.

146 The FY 2004 budget documents define negative tax expenditures as "provisions that cause taxpayers to pay too much tax." *Id.* at 133 (providing examples, including the corporate income tax and passive loss rule restrictions on deductions of capital losses).

147 *Id.* at 134–37.

148 The new methodology for estimating the tax expenditure from accelerated depreciation uses replacement cost rather than historic cost and approximates "the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, economic depreciation." *Id.* at 138. Under the new methodology, the new estimates "are smaller" than the old baseline depreciation estimates. *Id*. In addition, the review provides an alternative estimate of the tax expenditure resulting from the tax exemption of the return earned on owner-occupied housing.

149 *See infra* note 151 and accompanying text.

150 *See* Martin A. Sullivan, *Administration Reignites Old Battle Over Tax Expenditures*, 91 TAX NOTES 701, 702 (2001) (describing the attempt by Treasury Under Secretary for Tax and Economic Affairs Norman B. Ture to "completely overhaul" the tax expenditure budget early in the Reagan administration and explaining the resistance to Ture's proposals by the Office of Management and Budget). According to Sullivan, "OMB officials thought it might be politically insensitive for Treasury to be suggesting corporations were overtaxed when generous depreciation allowances and controversial leasing provisions were rapidly shrinking the corporate tax burden" and "OMB recognized that any critique of the tax expenditures budget could backfire on the administration if—as came to pass later in 1982—it sought reductions in tax expenditures to reduce the deficit." *Id*.

151 The Bush Administration's reconsideration of the tax expenditure concept revisits some of

more complete discussion of the implications of the Bush Administration's reconsideration, the next section describes the development of tax expenditure theory and its impact on congressional tax and budgetary decision making. Those familiar with this history might wish to proceed to the following section.

B. *The Tax Expenditure Concept: Some Background*

As explained by the leading tax expenditure theorists, tax expenditures involve "the imputed tax payment that would have been made in the absence of the special tax provision (all else remaining the same) and the simultaneous expenditure of that payment as a direct grant to the person [or business] benefited by the special provision."[152] Tax expenditure theory divides the tax code into two elements: (1) provisions needed to implement the "normal tax structure," and (2) "special preferences."[153]

A central insight of the tax expenditure concept is that financial assistance can be delivered to a particular industry, activity, or class of persons through the tax

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the core objections to the tax expenditure budget raised in 1981 by Norman Ture, Undersecretary of the Treasury for Tax and Economic Affairs. Ture's objections led to the adoption of a modified reference tax baseline by the Reagan administration. His views were not adopted in full, however. The Office of Management and Budget refused to clear his proposed testimony on tax expenditures before the Senate Budget Committee in November 1981, and his appearance before the committee was cancelled. However, a copy of his undelivered testimony later appeared in print. *See Ture's Unreleased Testimony on Tax Expenditures*, 13 TAX NOTES 1535, 1535–39 (Dec. 21, 1981) (arguing for use of a "neutrality" standard, leading to a consumption tax base); *see also* Bruce Bartlett, *The End of Tax Expenditures as We Know Them?*, 92 TAX NOTES 413, 419–21 (July 16, 2001) (arguing in favor of the Bush Administration's reconsideration and suggesting that it may be laying the intellectual groundwork for a tax reform proposal that would shift the tax code toward a consumption base).

[152] STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES 6–7 (1973).

[153] STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 3 (1985) [hereinafter SURREY & MCDANIEL, TAX EXPENDITURES]. Professors Surrey and McDaniels have explained the tax expenditure concept as follows:

> The tax expenditure concept posits that an income tax is composed of two distinct elements. The first element consists of structural provisions necessary to implement a normal income tax, such as the definition of net income, the specification of accounting rules, the determination of the entities subject to tax, the determination of the rate schedule and exemption levels, and the application of the tax to international transactions. These provisions compose the revenue-raising aspects of the tax. The second element consists of the special preferences found in every income tax. These provisions, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favor a particular industry, activity, or class of persons. . . . [T]hese departures from the normative tax structure represent government spending for favored activities or groups, effected through the tax system . . . .

Id.

system. The financial assistance may take the form of permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special tax rates.[154] Tax expenditures are viewed as functionally equivalent to spending programs because they reduce the revenue that would otherwise be collected absent the tax expenditure provision. Beneficiaries of a tax preference are viewed as having received a government grant or appropriation equal to the amount of the tax reduction due to the preference.[155] Thus, in addition to its revenue-raising function, the tax system can be used as a delivery mechanism for government programs. The funding for the programs comes in the form of refunds from, or reductions in, tax otherwise due, rather than from congressional appropriations.[156]

Once a provision is identified as a "tax expenditure," tax expenditure theorists urge policymakers to consider whether financial assistance is warranted and, if so, to determine whether a direct government grant or a tax expenditure would provide a better framework in which to provide government assistance.[157] Fewer tax expenditures in the tax code, some theorists argue, would lead to a more equitable, more efficient, and more administrable tax system and, thus, to better tax policy.[158] The tax reform project of tax expenditure theorists, therefore, initially combined the related goals of achieving a more comprehensive income-measuring tax base with

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[154] *Id.*

[155] Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 706 (1970).

[156] Toder, *supra* note 57, at 363. Although conceptually similar to "spending," tax expenditures do not generally involve a direct outlay of funds, with the exception of certain refundable tax credits such as the earned income tax credit. The foregone revenue from "tax expenditures" need not be "appropriated" by Congress. *See* Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1359 (1988) ("While as a matter of policy Congress may want to treat tax expenditures as equivalent to government spending, the Constitution does not require any such treatment.") (footnote omitted).

[157] *See* SURREY & MCDANIEL, TAX EXPENDITURES, *supra* note 153, at 99–117. Tax expenditures are sometimes viewed as less bureaucratic or more cost effective than developing a new spending program. Often, however, tax expenditures are enacted to supplement existing discretionary spending programs, and as pointed out by tax expenditure theorists, tax expenditures increase the enforcement and administrative burdens of the Treasury and the Internal Revenue Service.

[158] *Id.* at 25–27. The tax reform strategy of eliminating tax expenditures from the tax code may not work well in today's world, as Gene Steuerle has argued:

> We have moved to a world where it is increasingly harder to separate tax and spending issues. . . . Those concerned with coming up with a cleaner, more efficient, and more administrable tax system, therefore, may need to change strategy. The purist cannot claim to be pure by keeping outlay types of issues off of the table. A long-term strategy—admittedly difficult—might be to figure out some way Congress more easily could consider outlay and tax issues simultaneously when a major tax (or outlay) bill is being considered.

Gene Steuerle, *The Merger of Tax & Expenditure Policy in the 2001 Tax Legislation*, 92 TAX NOTES 291, 292 (2001).

the elimination, whenever feasible, of tax expenditures from the tax code.[159]

Tax scholars have extensively debated issues related to defining and measuring "tax expenditures."[160] Much of the controversy about tax expenditure analysis has focused on the difficulty of distinguishing "tax preferences" from "normal" or structural tax provisions deemed necessary to define the income tax base.[161] There is no precise definition of the income tax baseline or the exceptions to it. As Professor Boris Bittker explained, in responding to the suggestion that we should lean over backward to avoid tax preferences, "in the absence of a generally acceptable or scientifically determinable vertical, we cannot know whether we are leaning backward or forward."[162]

Some scholars have suggested ways of addressing the definitional issues, ranging from narrowly confining the tax expenditure list to those universally recognized as spending programs, to broadly including all arguable tax expenditures, or to a more middle ground position of redefining tax expenditures as "substitutable" tax provisions—that is, to those provisions that could be easily substituted by direct expenditure programs because they do not serve significant tax-related functions.[163]

The tax expenditure concept has also generated political controversy. Some business representatives immediately rejected the asserted equivalence between tax preferences and direct government outlays, arguing that tax expenditure analysis

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[159] Comprehensive tax base proposals and the tax expenditure concept do not completely overlap, having some different antecedents and proponents, but they are related to the extent that they both seek to broaden the income tax base. *Cf.* Boris I. Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244, 251 (1969).

[160] For an early discussion of these issues, see *id.*; Boris I. Bittker, *The Tax Expenditure Budget—A Reply to Professors Surrey and Hellmuth*, 22 NAT'L TAX J. 538 (1969); Stanley S. Surrey & William F. Hellmuth, *The Tax Expenditure Budget—Response to Professor Bittker*, 22 NAT'L TAX J. 528 (1969).

[161] *See, e.g.*, William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 313 (1972) (examining whether certain personal deductions can be seen as a refinement of ideal income); Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 934 (1967) [hereinafter Bittker, *Comprehensive Tax Base*] (criticizing the internal inconsistencies and individual judgments made by Surrey's income tax baseline); Thomas D. Griffith, *Theories of Personal Deduction in the Income Tax*, 40 HASTINGS L.J. 343, 344–45 (1989) (evaluating the different models of personal deductions applied by Surrey, Andrews, and Kelman); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 835 (1979) (criticizing Andrews' analysis and proposing an alternative net income tax base).

[162] Bittker, *Comprehensive Tax Base*, *supra* note 161, at 985.

[163] Michael J. McIntyre, *A Solution to the Problem of Defining a Tax Expenditure*, 14 U.C. DAVIS L. REV. 79, 82–83, 88–89 (1980) (proposing a methodology for identifying tax expenditures that would bypass problems of defining the normal tax structure); Thuronyi, *supra* note 133, at 1163–70, 1181–82, 1186–87 (summarizing the definitional issues and arguing that substitutable tax provisions can be classified by identifying the significant purposes of the provision and then by determining whether a non-tax program could serve those purposes equally well).

"rests on the presumption that government has a preeminent claim on income and resources" and that tax incentives instead properly acknowledge the productive owner's "prior, even natural, ownership claim to that income."[164] Some members of Congress similarly have been skeptical of treating tax expenditures as equivalent to spending programs. Elimination of tax expenditures is perceived by them to be a tax increase, thus politically difficult unless combined with a highly visible rate reduction or some other popular offset.[165]

Despite the theoretical and political difficulties with defining tax expenditures, Congress has required the listing of tax expenditures as part of the budget process since 1974.[166] The tax expenditure budget is used primarily for information purposes, to help policymakers determine the "relative merits of achieving specified public goals through tax benefits or direct outlays."[167] Both Congress and Treasury prepare lists of tax expenditures organized according to budget functions.[168] However, currently, they each use slightly different tax baselines in defining tax expenditures.

During the Reagan Administration,[169] the Treasury developed a baseline

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[164] Carl H. Madden & James R. Morris, *Tax Incentives: Employment and Training of the Disadvantaged*, *in* TAX INCENTIVES, SYMPOSIUM CONDUCTED BY THE TAX INSTITUTE OF AMERICA, NOV. 20–21, 1969, at 231, 234–45 (by economic analysts employed by the Chamber of Commerce of the United States).

[165] *See* Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501 (1998) [hereinafter Garrett, *Offset Requirements*]; Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609 (1995).

[166] Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(3), 88 Stat. 297 (codified as amended in scattered sections of 2 U.S.C. and 31 U.S.C.) (defining "tax expenditures" as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability").

[167] J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008, *supra* note 132, at 2.

[168] Tax expenditures are listed according to their budget function, in budget categories such as national defense, agriculture, housing and commerce, education, and income security. The tax credit for production of non-conventional or alternative fuels, for example, is found under the budget category for "energy." BUDGET, FY 2002, *supra* note 135, at 63 tbl.5-1; J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004-2008, *supra* note 132, at 20–21 tbl.1.

[169] The Bush Administration's fiscal 2002 budget revisited themes introduced twenty years earlier in the Reagan Administration's tax expenditure budget presentation. *See* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: FISCAL YEAR 1983: SPECIAL ANALYSIS G, at 1 (1982) [hereinafter BUDGET, FY 1983: SPECIAL ANALYSIS G] ("The very term 'tax expenditure' is misleading in several respects, and there are formidable difficulties in trying to define the underlying concept or to measure the effect of 'special' tax provisions.").

The Reagan Administration's tax expenditure budget was criticized as departing from the tax expenditure concept and from standards established by the Budget Act of 1974. *See* Paul R. McDaniel & Stanley S. Surrey, *Tax Expenditures: How to Identify Them; How to Control Them*, 15 TAX NOTES 595, 595–601 (1982) [hereinafter McDaniel & Surrey, *Tax Expenditures*]; *see also* different from the standard used by the Congressional Joint Committee on Taxation. Under the Joint Committee's approach, tax expenditures have generally been defined by reference to a modified normative tax base. The normative model is based on the Haig-Simons economic definition of income,[170] modified in several important respects.[171] Due to practical administrative concerns, the model excludes unrealized gains and losses, imputed income from services provided by owner-occupied homes and durable goods, and inflation adjustments.[172] In addition, it generally assumes the classical system of taxing most corporations on their income separately from the taxation of shareholders.[173]

Under the "reference tax" baseline adopted by Treasury during the Reagan Administration, a provision is treated as a tax expenditure only if it constitutes an exception from some general rule stated in the law.[174] For example, the Treasury omitted accelerated depreciation from the tax expenditure list because accelerated depreciation had been the general rule since 1981, not the exception.[175] Treasury's reference tax baseline was criticized as overly politicizing the tax expenditure

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Sullivan, *supra* note 150, at 702.

[170] HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938) ("Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."); Robert Murray Haig, *The Concept of Income—Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1, 7 (Robert Murray Haig ed., 1921), *reprinted in* AM. ECON. ASS'N, READINGS IN THE ECONOMICS OF TAXATION 59 (Richard A. Musgrave & Carl S. Shoup eds., 1959) ("Income is the *money value of the net accretion to one's economic power between two points of time*.").

[171] Past reports prepared by the Staff of the Joint Committee have discussed the normative model. By contrast, more recent reports simply state that "[t]he determination of whether a provision is a tax expenditure is made on the basis of a broad concept of income that is larger in scope than 'income' as defined under general U.S. income tax principles." J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008, *supra* note 132, at 2; *accord* J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2002–2006, *supra* note 132, at 2. For this reason, the report notes, the tax expenditure list includes estimates for "the net exclusion of pension contributions and earnings, the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation." *Id.* at n.6.

[172] J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008, *supra* note 132, at 5.

[173] *Id.* at 7.

[174] *See* BUDGET, FY 1983: SPECIAL ANALYSIS G, *supra* note 169, at 5 (stating that "[f]or a provision to involve a tax subsidy, two conditions are necessary:—The provision must be 'special' in that it applies to a narrow class of transactions or taxpayers; and—There must be a 'general' provision to which the 'special' provision is a clear exception").

[175] *See id.* at 6–7. In addition, the "reference" tax baseline differs in its treatment of the corporate tax graduated rate structure (the lower rates are not treated as tax expenditures), the exclusion from income of government transfer payments (not treated as tax expenditures), and the deferral of tax on income from controlled foreign corporations (not treated as a tax expenditure).

budget[176] and defended as avoiding many of the judgments made under the normative approach.[177] However, the two different approaches do not currently result in major differences in the tax expenditures listed; with some exceptions, the Treasury and Joint Committee lists have been roughly similar since 1986.[178]

As a tax reform effort, tax expenditure analysis has had mixed results. Some reforms suggested by tax expenditure theorists have been adopted, including the listing of tax expenditures in the budget since 1974,[179] the movement toward a more comprehensive tax base with the enactment of the Tax Reform Act of 1986,[180] and the adoption in 1990 of certain budgetary restrictions on new tax preferences.[181]

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[176] SURREY & MCDANIEL, TAX EXPENDITURES, *supra* note 153, at 595; Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407, 424–27 (1999).

[177] Thuronyi, *supra* note 133, at 1182–86.

[178] For the Joint Committee's comparisons with Treasury's list of tax expenditures, see J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008, *supra* note 132, at 1, 13–16 (noting, for example, that Treasury's list contains a section that lists estate and gift tax provisions considered to be tax expenditures but that the Joint Committee includes only provisions outside of the normal income tax structure).

[179] *See supra* notes 136 and 166 and accompanying text.

[180] Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended beginning at 26 U.S.C. § 1); *see* 1 OFFICE OF THE SEC'Y, DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT vii (1984) (discussing proposal to reform the income tax system); *see also* TIMOTHY J. CONLAN ET AL., TAXING CHOICES: THE POLITICS OF TAX REFORM 45–80, 242–44 (1990) (describing the role played by tax policy experts in developing the concept of comprehensive tax reform); John F. Witte, *The Tax Reform Act of 1986: A New Era in Tax Politics?*, 19 AM. POL. Q. 438, 443 (1991) (stating that "[s]eventy-two provisions tightened tax expenditures, including 14 that involved complete repeal, a figure approximately equal to the total number of tax expenditures that had been repealed from 1913 through 1985"). *But cf.* Thuronyi, *supra* note 133, at 1176–77 (finding only one instance in which the 1986 Act substituted a direct expenditure for a repealed provision, i.e., the amendment of the Social Security Act to provide federal spending support for expenses of adopting children with special needs in place of an itemized tax deduction for such expenses).

[181] In 1990, federal budget legislation required that certain new tax benefits be offset by tax increases, cuts in other tax expenditures, or cuts in entitlement programs. *See* Budget Enforcement Act of 1990, Title XIII of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (codified as amended in scattered sections of 2 U.S.C.) (establishing "pay-as-you-go" [hereinafter PAYGO] budget requirement that tax changes resulting in revenue loss be paid for by tax increases, by reductions in current tax subsidies, or by certain direct spending reductions in entitlement programs). Although nominally in effect through 2002, the rules had little impact since the late 1990s. *See* Balanced Budget Act of 1997, Pub. L. No. 105-33, §§ 10201–205, 111 Stat. 251, 697–702 (extending discretionary spending limits and PAYGO requirements until October 1, 2002, and to 2003 for expenditures for highways and mass transit). In later years, Congress bypassed or waived the requirements. *See, e.g.*, BUDGET, FY 2002, *supra* note 135, at 243 (stating that "Congress and the previous Administration began to skirt the budget enforcement mechanisms" after the reporting of budget surpluses in 1998); Warren Rojas, *Budget Heads Say PAYGO, Spending Caps Need Updating*, 2001 TAX NOTES TODAY, LEXIS 2001 TNT 125-2, June

However, much of the tax expenditure reform agenda was never implemented. Relatively few tax expenditures identified since 1974 have been eliminated from the tax code. Since 1986, tax expenditures have grown again in both in number and in their overall budgetary impact.[182] During the 1990s, the trend was toward substitution of discretionary spending with tax expenditures.[183] During that period, tax scholars also began shifting their focus from the theory's definitional problems to its insight that the tax system could function as a delivery mechanism for financial assistance, utilizing that institutional insight to analyze the tax system within the overall governmental tax and transfer system.[184]

C. *Public Resources v. Private Ownership*

27, 2001 (reporting that Dan L. Crippen, director of the Congressional Budget Office, told House Budget Committee members that the $1.35 trillion tax cut enacted in 2001 had already been added to the PAYGO scorecard and would likely be waived because of the surplus). *See* discussion *infra* Part IV.A.

[182] U.S. GEN. ACCT. OFFICE, NO. 122, TAX POLICY: TAX EXPENDITURES DESERVE MORE SCRUTINY 17 fig.1.1, 35–37 (1994) (finding an upward trend in the total number of tax expenditures and in Joint Committee on Taxation estimates of aggregate tax expenditure revenue losses from 1974 to 1986, a downward trend in revenue losses after implementation of the Tax Reform Act of 1986, followed by another trend upward in the 1990s approaching the high point of revenue losses in the 1980s); *accord* STEUERLE, *supra* note 40, at 43 fig.3.2, *Trends in Tax Expenditures, 1980–2003* (showing tax expenditures peaking at about 8% of GDP in 1985, dropping to 5.6% in 1990, and increasing to about 6.5% of GDP in 2003).

[183] *See, e.g.*, Toder, *supra* note 57, at 361–62; Sugin, *supra* note 176, at 408 (noting that the federal government spent more money through the Code in 1998 than through the discretionary appropriations process and that the "tax law's traditional revenue-raising function is being eclipsed as it becomes a principal tool of federal policy"); *see also* Leonard E. Burman, *Surplus Tax Policy?*, 52 NAT'L TAX J. 405, 409 (1999) (explaining that "budget rules create a strong incentive to channel new spending through the tax side of the budget"). *See generally* CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 190 (1997) (observing that, since the links between tax expenditures and direct expenditures were recognized by policymakers in the 1970s, the "most common response" by moderate Republicans and conservative Democrats "has been to use tax expenditures as a means of slowing the growth or preventing the creation of traditional social programs").

[184] *See, e.g.*, David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 977 (2004) (observing that "[o]nce definitions are put aside, the tax expenditures question really is the integration question" and considering integration from an organizational institutional design framework of specialization and coordination, using the earned income tax credit and food stamp programs as examples); Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 564–70 (1995) (examining the institutional advantages and disadvantages of tax and transfer integration, using the earned income tax credit as an example of tax-based welfare reform); *see also, e.g.*, Mary L. Heen, *Welfare Reform, Child Care Costs, and Taxes: Delivering Increased Work-Related Child Care Benefits to Low-Income Families*, 13 YALE L. & POL'Y REV. 173, 210–16 (1995) (considering taxing and spending programs related to work-related child care benefits for low-income families).

The idea that tax incentives "subsidize" private behavior with public resources provokes strong objections in some quarters. According to those who reject the concept of tax expenditures, a tax incentive cannot be viewed as a "subsidy" because the money that would have gone to the government in the form of taxes belongs to the taxpayer in the first instance.[185] Under this view, a tax incentive or tax preference is equivalent to a tax cut. Even if it is not an across-the-board rate decrease but is instead a tax break targeted to benefit certain individual taxpayers or industries, such a tax break returns money to the people's pockets or to the industries' bottom line.

This viewpoint also presumes that tax incentives are largely self-administered by taxpayers and, thus, permit less government involvement. The asserted equivalence between tax preferences and tax cuts makes the use of tax incentives conceptually consistent with an effort to limit or downsize government.

According to a contrary view, as articulated by tax expenditure theorists, and as currently applied under federal budgetary requirements, a tax incentive that departs from the "normal" revenue-raising income tax structure or income tax base constitutes a "tax expenditure." As acknowledged in the tax expenditure budget, the tax system plays a role as a funding and delivery mechanism for certain government programs in addition to its revenue-raising function.

Although tax expenditures are less transparent as budgetary items than appropriations, tax expenditure theorists argue that their use does not necessarily result in smaller government. Tax expenditures create additional management burdens on the tax system and administrators, requiring tax administrators to issue regulations, rulings, and conduct audits of "spending" programs outside their basic area of expertise.[186]

Tax expenditure theory distinguishes between across-the-board tax cuts and targeted tax breaks. Because the tax rate structure is viewed as part of the "normal" income tax structure by tax expenditure theorists, an across-the-board tax rate reduction would not be classified as a "tax expenditure." By contrast, a special tax

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185 *See The $91 Billion Loophole*, WALL ST. J., Mar. 20, 1975, at 22 (objecting to the tax expenditure concept):

> As we all should know by now, or at least should learn by 1984, nothing any of us earn really belongs to us. Everything belongs to the federal government. . . . The idea, we suppose, is that maybe the government would do a better job of keeping this money and spending it directly. To look at it this way, maybe we'd be better off if the government kept all of what really belongs to it, $1.3 trillion of personal income, and made all our purchases for us. Now *there's* a loophole.

Id.

186 SURREY & MCDANIEL, TAX EXPENDITURES, *supra* note 153.; s*ee, e.g.*, Alstott, *supra* note 184, at 546–70; Tracy A. Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit*, 38 VILL. L. REV. 871, 874–909 (1993); George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225 (1994).

deduction, credit, or rate applied to the profits of certain industries (from oil exploration, for example) would be classified as a tax expenditure. Such preferences or incentives generally violate the tax norms of equity and neutrality. However, because they serve an expenditure function, not a revenue-raising tax function,[187] tax expenditure theorists argue that they should be evaluated using criteria applicable to other government spending programs.

The differing views of ownership and "subsidy" in the debate about tax expenditures obscure underlying disagreements about the role of government and how its costs should be allocated. The debate masks a basic disagreement about the scope of the government's power to tax.

Drawing the line between public and private resources by reference to "ownership" suggests a continuing entitlement to the fruits of one's labor or property[188] and a rejection of the government's coercive power to collect funds for redistributive purposes.[189] If one accepts the government's power to tax for such purposes, however, the notion of private ownership loses its force in this context. The issues instead center on choices regarding the provision of public goods, distributive justice, and the collective financing of certain redistributive governmental programs rather than on preserving pretax distributions of resources.[190]

The more pertinent question becomes how the political system defines the tax base to secure certain social outcomes, and how it determines what each individual or business must transfer to the public sector. The practical question of whether the funds are actually collected by the government and then disbursed through spending programs, or whether the collection step is skipped by virtue of a special tax break for a particular individual or industry so that a benefit can be delivered through the tax system, raises issues of administration, management, and legislative process rather than of political or philosophical justifications for the government's power to tax.

D. *The Tax Baseline in a Hybrid Tax World*

Although the conflicting views about private ownership and public subsidies

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[187] *See* discussion *supra* Part II.B.1 (discussing cases interpreting the Origination Clause, which requires that all bills for "raising revenue" originate in the House of Representatives).

[188] *See, e.g.*, JOHN LOCKE, THE SECOND TREATISE OF GOVERNMENT §§ 27, 28, at 305–07 (Peter Laslett ed., Cambridge Univ. Press 1963) (1690). In discussing the extent of legislative power, Locke emphasized that the power to tax derives from the consent of the people, given by a majority of the people or their representatives. *Id.* §§ 140–42, at 380–81.

[189] *See* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 174–82 (1974) (adopting a theory of property rights under which a person has an entitlement to property if acquired in accordance with "justice in acquisition" or with "justice in transfer" from someone else who was entitled to it).

[190] *See* MURPHY & NAGEL, *supra* note 3, at 76–95.

illustrate the stark differences in assumptions between those who accept the idea of tax expenditures and those who reject it, most of the theoretical controversy about the tax expenditure concept among tax experts has focused on the difficulty of defining the "normal" tax base.

The reconsideration of tax baseline issues by the Bush Administration is related to the policy question of whether the income tax should be replaced by a tax on consumption,[191] and to the technical issue of how the baseline should be defined under our current system: a hybrid of income and consumption tax features.[192] Instead of focusing on the government's power to tax, these questions raise issues about what should be taxed and on the relative values one might place on neutrality and equity norms.

In theory, the tax base choice between an income or consumption tax is largely a question of how savings or changes in wealth should be treated by the tax system.[193] This question has been debated by economists and political theorists for over a century,[194] and has received renewed political and scholarly attention in the United States during the last few decades.[195]

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[191] BUDGET, FY 2003, *supra* note 140, at 96–97.

[192] *E.g.*, Michael S. Knoll, *Designing a Hybrid Income-Consumption Tax*, 41 UCLA L. REV. 1791, 1798–1810 (1994) (summarizing the features of a consumption tax and an income tax); Edward J. McCaffery, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145, 1147, 1174–75 (1992) (arguing that a hybrid may be an appropriate policy goal); *see* Glenn, *supra* note 139 (quoting Treasury official on the nature of the reconsideration).

[193] This is related to the argument, traced back to Hobbes, that wealth is not appropriated for private purposes until withdrawn for personal use from the "common pool" of national savings. *See* NICHOLAS KALDOR, AN EXPENDITURE TAX 87–91 (1955); Barbara H. Fried, *Fairness and the Consumption Tax*, 44 STAN. L. REV. 961, 962 (1992). As explained by Hobbes:

> [T]he equality of imposition, consisteth rather in the equality of that which is consumed than of the riches of the persons that consume the same. For what reason is there that he which laboureth much, and sparing the fruits of his labour, consumeth little, should be more charged than he that living idlely, getteth little, and spendeth all he gets, seeing the one hath no more protection from the commonwealth than the other? But when the impositions are laid upon those things which men consume, every man payeth equally for what he useth, nor is the commonwealth defrauded by the luxurious waste of private men.

THOMAS HOBBES, LEVIATHAN 228 (Edwin Curley ed., Hackett 1994) (1651).

[194] HOBBES, *supra* note 193; s*ee also, e.g.*, RICHARD GOODE, THE INDIVIDUAL INCOME TAX 21–25 (rev. ed. 1976).

[195] *E.g.*, Alvin C. Warren, Jr., *Three Versions of Tax Reform*, 39 WM. & MARY L. REV. 157, 157–75 (1997) (describing different approaches to tax reform, including improving the existing tax base, modifying the tax base by adopting a consumption tax such as the Flat tax or the USA tax, and rationalizing the relationship between taxes); *see, e.g.*, William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1140–50 (1974); Michael J. Graetz, *Implementing a Progressive Consumption Tax*, 92 HARV. L. REV. 1575, 1578–80 (1979); *see also* ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX 40 (2d ed. 1995); U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977) [hereinafter BLUEPRINTS].

Economic income has been defined as the market value of rights exercised in personal consumption plus the net change in wealth during the taxable period.[196] An income tax imposes a "double" tax on savings or investment: once when the investment asset is purchased with the taxpayer's after-tax earnings and again when the investment incrementally increases in value or generates additional earnings.[197] The income tax code frequently departs from this ideal of taxing "accretions" to wealth because of pragmatic considerations, as exemplified by its general failure to tax the unrealized appreciation of property[198] and the imputed income from property or services.[199]

A consumption tax, on the other hand, taxes personal consumption and exempts net savings from the tax base. Personal consumption taxes can be implemented in the form of general retail sales taxes, value added taxes, or taxes on luxury purchases. As tax scholars have pointed out, they also can be implemented within the overall structure of a personal "income" tax in two different ways: 1) by allowing a deduction for savings and by including dissavings in the tax base, called the "cash flow" or "qualified account" method;[200] or 2) by taxing income as it is earned but exempting from tax the return of invested capital and the yield on investments, called the "tax prepaid" or "yield exemption" method.[201]

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[196] *See supra* note 170 and accompanying text (discussing the Haig-Simons definition of income).

[197] As John Stuart Mill observed, income that is earned and consumed is subject to a single level of tax, and income that is earned and invested is subject to two levels of tax. JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 550–57 (J. Laurence Laughlin ed., 1884).

In 2002, Pamela F. Olson, the then incoming Assistant Secretary of the Treasury for Tax Policy, focused in part on the double tax on savings when asked at her Senate Finance Committee nomination hearing what priorities ought to be followed for tax reform:

> Well, I think that radical simplification may be the first step. But I do think that we need to look at some of the issues related to our double taxation of savings, because we have too many disincentives built into the system right now with respect to the taxation of savings. So, I think it is important for us to bear that in mind as we look at reform for the future.

Unofficial Transcript of Finance Committee Hearing on Olson Nomination (Aug. 1, 2002), TAX NOTES TODAY 154-27, Aug. 9, 2002, LEXIS 2002 TNT 154-27.

[198] I.R.C. § 1001(a), (b) (2003) (defining gain from the sale or other disposition of property as the amount realized over the adjusted basis of the property). *But see* I.R.C. § 1296 (2003) (election of mark-to-market for marketable stock); I.R.C. § 1256 (2003) (mark-to-market requirements for certain futures contracts and options).

[199] Imputed income includes the market value of services a taxpayer performs for himself. *See* SIMONS, *supra* note 170, at 52. It also includes the annual rental value of property owned by the taxpayer, such as the house she lives in or the car she drives during the year. *See* BLUEPRINTS, *supra* note 195, at 7, 89.

[200] *See* Andrews, *supra* note 195, at 1116; BLUEPRINTS, *supra* note 195, at 113–14.

[201] *See* BLUEPRINTS, *supra* note 195, at 115 (using the two different methods as design features in a model consumption tax); Graetz, *supra* note 195, at 1586 (arguing for caution in

Our current income tax system has been described as a hybrid of income and consumption design features.[202] With regard to savings, the hybrid nature of the current system can be illustrated by the treatment of personal savings in regular interest-bearing bank accounts as compared with the special tax treatment accorded certain types of retirement savings. The treatment of a personal savings account comports with the model income tax "double" tax on savings: the nondeductible deposits are made with after-tax dollars and the interest earned on the account is taxable.[203] By contrast, the special tax treatment of individual retirement accounts and qualified pension plans comports with a consumption tax model.[204]

For example, certain Individual Retirement Accounts (IRAs) and qualified pension plans allow a deduction for qualified retirement contributions, permit tax-free buildup of investment earnings, and impose tax on the distributions made after retirement (or dissavings).[205] This pattern comports with the treatment of savings under a "cash flow" or "qualified account" method of taxing consumption.

Roth IRAs,[206] on the other hand, follow the "tax prepaid" or "yield exemption" consumption tax method. Contributions to the account are made with after-tax dollars[207] and the investment returns and distributions are tax-free.[208]

Because these provisions depart from the "normal" income tax treatment of savings (no deduction for contributions and tax on earnings), they are currently listed as "tax expenditures."[209] As tax-favored forms of savings, they provide incentives for individuals to save for their retirement years during their working years.

E. *Example: Public Debate Regarding Savings and Investment*

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treating the two methods as equivalent due to the number of unrealistic assumptions that must be met for the equivalence to hold); Alvin C. Warren, Jr., *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931, 938 (1975). The equivalence was first stated by E. Cary Brown, *Business-Income Taxation and Investment Incentives*, *in* INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN 300, 301 (1948).

[202] *See, e.g.*, William D. Andrews & David F. Bradford, *Savings Incentives in a Hybrid Income Tax*, *in* UNEASY COMPROMISE: PROBLEMS OF A HYBRID INCOME-CONSUMPTION TAX 269, 270 n.4 (Henry J. Aaron et al. eds., 1988).

[203] *See* I.R.C. § 61(a)(4) (2003).

[204] *See* Jonathan Barry Forman, *The Tax Treatment of Public and Private Pension Plans Around the World*, 14 AM. J. TAX POL'Y 299, 305–11 (1997).

[205] *See* I.R.C. §§ 219, 401, 402, 501 (2003). For qualified pension plans, the employer is permitted a deduction for the contribution to the plan and the contribution is excluded from the employee's income. *See* I.R.C. § 404 (2003).

[206] *See* I.R.C. § 408A (2003).

[207] *See* I.R.C. § 408A(c) (2003) (allowing no deduction for contributions).

[208] *See* I.R.C. § 408A(d) (2003) (excluding qualified distributions from gross income).

[209] *See* J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2002–2006, *supra* note 132, at 26, 27 (listing under income security, net exclusion of pension contributions and earnings, and separately tabulated for employer plans, individual retirement plans, Keogh plans, etc.).

The use of a "normal" income tax as the tax baseline for purposes of the tax expenditure budget means that the consumption-based savings features in the code will be identified as "tax expenditures." If the Administration's policy goal is to move toward a consumption-based tax system,[210] either incrementally or through more comprehensive tax reform,[211] the revenue losses identified in adopting features inconsistent with an income tax create budgetary and political obstacles to achieving such a goal. Hence, adoption of either 1) a modified "hybrid" reference tax baseline[212] based on current hybrid features of the code,[213] or 2) a consumption tax baseline could make such a transformation somewhat easier to achieve. The associated revenue losses could entirely disappear under either alternative baseline.

The Bush Administration took an incremental approach to tax reform by proposing expansion of various types of tax-favored private retirement savings,[214] education savings accounts,[215] and health savings accounts.[216] These types of provisions expand tax-favored savings beyond a primary focus on retirement savings to include private savings for other purposes. Removing a level of tax on a broader set of savings accounts moves the tax system closer toward a consumption base tax system. Over time, that shift could have an impact on the level of retirement savings

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210 The shift to a consumption-based tax system has been linked to certain privatization goals. *See* Lester B. Snyder & Marianne Gallegos, *Redefining the Role of the Federal Income Tax: Taking the Tax Law "Private" Through the Flat Tax and Other Consumption Taxes*, 13 AM. J. TAX POL'Y 1, 18–23, 33, 85 (1996) (suggesting that consumption tax proposals should be viewed as an attempt to reduce the size of government by lowering tax burdens on capital and by reducing tax revenues).

211 The various consumption tax proposals (flat tax, USA tax, etc.) proposed during the 1990s as replacements for the income tax code did not attract sufficient political support for enactment by Congress. *See* Warren, *supra* note 195, at 174–75.

212 *See supra* note 139 and text accompanying notes 174 and 202.

213 Although comments by Treasury officials after the submission of the first Bush budget appeared to suggest that such a baseline might be considered as an option, the second budget did not list a hybrid baseline as an option, but instead pointed to the development of two separate baselines: one based on comprehensive income and one based on consumption. *See supra* note 139 and text accompanying notes 140–43.

214 *See* Economic Growth and Tax Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (creating a new nonrefundable tax credit for up to $2,000 of elective contributions to qualified pension plans and IRAs for taxable years 2002–2006, increasing contribution limits and catch-up contributions for IRAs, increasing contribution and benefit limits for qualified plans, and providing a tax credit for certain administrative expenses for new pension plans adopted by small businesses).

215 *See id.* (increasing the annual limit on contributions to Coverdell education savings accounts from $500 to $2,000); I.R.C. § 530 (2003).

216 *See* STAFF OF THE J. COMM. ON TAXATION, 107TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2003 BUDGET PROPOSAL 53–57 (J. Comm. Print 2002); *see also* I.R.C. §§ 220, 223 (2003) (health savings accounts added for taxable years beginning after 2003 by Title XII of the Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, 117 Stat. 2066 (2003)).

for lower and moderate income taxpayers by altering the existing incentives.[217] Furthermore, expanded private retirement provisions, combined with recharacterization of their revenue cost for purposes of the tax expenditure budget, may make it politically more feasible to reform social security along lines favored by the Bush Administration.[218]

IV. ACCOUNTABILITY FOR COLLECTIVELY FINANCED PERFORMANCE

Tax incentives are subject to less monitoring on an ongoing basis than other types of discretionary spending by the government. Tax provisions are not subject to the appropriations process and, thus, generally are not subject to spending caps or to annual appropriations from Congress.[219] Unless enacted with a sunset provision, tax incentives become a potentially permanent part of the tax code, remaining in effect until amended or repealed.[220] Tax incentives typically are not subject to the types of

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[217] *See, e.g.*, MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY 265 (1999) (observing that "[t]he effectiveness of incentives for employer-sponsored pensions also depends significantly on the presence or absence of other tax-preferred alternatives" and that "vulnerability to unrelated tax policy shifts" has been suggested as a reason for mandatory employment-related pension plans or mandatory contributions to individual retirement accounts); Daniel I. Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1, 46–50 (1993) (discussing the impact of income tax incentives and other factors on retirement savings).

[218] President George W. Bush's State of the Union Address, 39 WEEKLY COMP. PRES. DOC. 109, 110 (Jan. 28, 2003), *available at* http://www.whitehouse.gov/news/releases/2003/ (proposing offering "younger workers a chance to invest in retirement accounts that they will control and that they will own"); *see also* Specifics on the The President's Plan to Strengthen Social Security, *at* http://www.whitehouse.gov/infocus/social-security/ (Feb. 28, 2002) (including tax provisions aimed at expanding ownership of retirement assets).

[219] As explained by the Staff of the Joint Committee on Taxation, tax expenditures "are similar to those direct spending programs that are available as entitlements to those who meet the statutory criteria established for the programs." J. COMM. TAX EXPENDITURE ESTIMATES FOR FY 2004–2008, *supra* note 132, at 2; *see also* STAFF OF THE J. COMM. ON TAXATION, 107TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2001–2005, at 2 n.5 (J. Comm. Print 2001) (noting that a few tax expenditures have statutory limits and giving the example of the tax credit for low-income rental housing, which is available only to those who have received statutorily limited credit allocations from State housing authorities). *See generally* Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379, 400–09 (1998) (describing the varied and overlapping nature of tax and direct spending programs; comparing them to each other by reference to factors including permanence, eligibility, and quantity, that is, whether the expenditures are capped like appropriations or uncapped like entitlement programs).

[220] Sunset provisions automatically terminate unless they are extended by Congress. The periodic extension of a set of "expiring" tax provisions has become an established feature of the tax legislative process. *See, e.g.*, The Tax Relief Extension Act of 1999, Pub. L. No. 106-170, §§ 500–512, 113 Stat. 1861, 1918–25 (extending many expiring tax provisions through December 31,

alternative forms of monitoring possible in negotiated relationships, such as in governmental contracting.[221]

The tax-writing committees provide oversight of Internal Revenue Service implementation of hundreds of programs provided through the tax code, covering many program areas, from agriculture to welfare-related provisions. However, tax-delivered subsidies largely escape performance management requirements currently imposed by Congress on other federal agency programs.[222]

The discussion below is divided into two sections. The first section discusses the expiration of certain budgetary monitoring mechanisms applied to tax incentives and describes the need for a new consensus. The second section discusses the need for performance monitoring of tax incentives. The use of tax incentives without accountability for results is inconsistent with the Administration's rhetoric of governmental reform, which has emphasized citizen-centered, results-oriented, market-based reforms.[223]

2001). An across-the-board sunset provision was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. The Act expires after 2010, unless Congress extends it. Pub. L. No. 107-16, § 901, 115 Stat. 38, 150 (2001).

[221] *See* Freeman, *Private Role*, *supra* note 7, at 550–51 (discussing negotiated relationships).

[222] *See* Mary L. Heen, *Reinventing Tax Expenditure Reform: Improving Program Oversight Under the Government Performance and Results Act*, 35 WAKE FOREST L. REV. 751, 817–25 (2000) (arguing that tax expenditures should be subject to the performance management requirements applied to discretionary expenditures).

[223] OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: CREATING A BETTER GOVERNMENT: IMPROVING GOVERNMENT PERFORMANCE: FISCAL YEAR 2002, at 11–14 (2001), *available at* http://www.whitehouse.gov/omb/budget/fy2002/budget.pdf [hereinafter BUDGET, CREATING A BETTER GOVERNMENT: FY 2002] (listing priorities for those reforms). The FY 2003 Budget expanded on those priorities by setting forth five areas for improved management performance. OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: GOVERNING WITH ACCOUNTABILITY: OVERVIEW: FISCAL YEAR 2003, at 43–54 (2002), *available at* http://www.whitehouse.gov/omb/budget/fy2003/pdf/bud09.pdf (including strategic management of human capital, competitive sourcing, improved financial performance, expanded e-government, and budget and performance integration). A color-coded scorecard kept score on agency progress towards those goals. *Id.* at 48–50; *see also* THE PRESIDENT'S MANAGEMENT AGENDA, *supra* note 21, at 3–30.

The FY 2004 Budget presented a new Program Assessment Rating Tool (PART), with a stated goal of rating one-fifth of all federal programs each year, on four areas of assessment: "purpose and design, strategic planning, management, and results and accountability", with "overall qualitative ratings that range from Effective, to Moderately Effective, to Adequate, to Ineffective." OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: RATING THE PERFORMANCE OF FEDERAL PROGRAMS: FISCAL YEAR 2004, at 47–53 (2003), *available at* http://www.whitehouse.gov/omb/budget/fy2004/pdf/budget/performance.pdf. As reported in the FY 2005 Budget, about forty percent of federal programs (including both mandatory and discretionary programs) have been initially assessed under PART. *See* BUDGET, FY 2005, *supra*

A. *Collective Financing: The Budget Process*

Budget process restrictions, adopted in 1990[224] and now expired, are under review by the Administration and by Congress.[225] The budgetary surpluses reported in the last part of the 1990s eliminated much of the deficit-related consensus that led to the adoption of the Budget Enforcement Act of 1990 (BEA).[226] Although the BEA requirements were nominally in effect through fiscal year 2002 for most categories of spending,[227] the rules had less impact as deficits declined.[228] Congress largely ignored them in enacting the major tax cut in 2001.[229] The following

note 144, at 9, 12 (about forty percent of programs evaluated were found to be effective or moderately effective, twenty-five percent were found to be adequate or ineffective, and forty percent were unable to demonstrate results). With regard to the Treasury Department, the only tax-related program listed as evaluated under PART is the earned income credit program, a refundable credit requiring direct federal outlays, which received a rating of "ineffective." *Id.* at 19.

224 Budget Enforcement Act of 1990, Title XIII of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 [hereinafter BEA] (codified as amended in scattered sections of 2 U.S.C.).

225 BUDGET, FY 2003, *supra* note 140, at 283.

226 *Testimony of Mitchell E. Daniels, Jr., Director, Office of Management and Budget, Before the House Budget Committee on the Budget Enforcement Act*, TAX NOTES TODAY 125-32, June 27, 2001, LEXIS 2001 TNT 125-32 [hereinafter *OMB Director's House Budget Committee Testimony*] (stating that "the Administration believes that the BEA should be modernized in order to guide budget decisions in an era of surplus").

227 *See* Balanced Budget Act of 1997, Pub. L. No. 105-33, §§ 10201–205, 111 Stat. 251, 697–702 (extending discretionary spending limits and PAYGO requirements until October 1, 2002); Transportation Equity Act for the 21st Century, Pub. L. No. 105-178, §§ 8101–03, 112 Stat. 107, 488–92 (1998) (extending limits to 2003 for expenditures for highways and mass transit); Department of the Interior and Related Agencies Appropriations Act, 2001, Pub. L. No. 106-291, 114 Stat. 922 (adding a new category for conservation spending with limits on budget authority and outlays for 2002–2006, with limits on discretionary spending until 2006). According to recent budget documents, "[b]ecause the BEA itself expired after 2002, the categories in later years will apply to budgets for those years only if an extension of the BEA is enacted and those categories are retained." BUDGET, FY 2004, *supra* note 59, at 460.

228 See BUDGET, FY 2002, *supra* note 135, at 243 (stating that "Congress and the previous Administration began to skirt the budget enforcement mechanisms" after the reporting of budget surpluses in 1998). "In 2001 alone, appropriations exceeded the discretionary spending levels set in the BEA, requiring a $95.5 billion increase in the cap for that year to accommodate the increase. In 2001, PAYGO requirements for $17 billion in spending were also waived." *Id. See also* BUDGET, FY 2003, *supra* note 140, at 291 (explaining that the PAYGO process requires OMB to maintain a "scorecard" that shows the cumulative net cost impact of PAYGO legislation, and that for 2002, net costs of $130.3 billion were removed from the PAYGO scorecard, thus skirting PAYGO constraints).

229 *See* Rojas, *supra* note 181 (reporting that Dan L. Crippen, director of the Congressional Budget Office, told House Budget Committee members that the $1.35 trillion tax cut had already been added to the PAYGO scorecard and would likely be waived because of the surplus). For a description of the mechanisms used by Congress to bypass BEA requirements in legislation

subsections discuss the BEA rules, the Administration's publicly stated position with regard to BEA-type procedures, and the need for a new consensus in Congress to replace them.

1. *BEA and the Budget Process*

Under the BEA,[230] budget tradeoffs were made within the two separate packages of 1) discretionary spending programs and 2) tax and entitlement programs.[231] The BEA's limitations on these two parts of the budget are discussed in greater detail below, beginning with discretionary spending limits, followed by an explanation of the procedures applied to tax and entitlement programs. Across-the-board reductions of non-exempt spending, known as "sequestration," enforced compliance with the BEA's requirements.[232]

The BEA limited discretionary spending through spending caps and certain statutory enforcement procedures.[233] The spending caps provided a form of budget discipline within the overall budget process. The congressional budget committees drafted budget resolutions, which established a total amount that could be expended for discretionary programs during the year.[234] House and Senate appropriations committees allocated those totals among their subcommittees. Under the spending caps, new discretionary programs competed for funds with all discretionary programs within certain broad categories and then with all the existing programs within the purview of the relevant appropriations subcommittee.[235]

The budget process kept score of spending and provided for various procedural

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enacted after 2000, see Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Process*, 43 B.C. L. REV. 863, 919–20 (2002) (including classifying legislation as "emergency" legislation, and thus effectively removing it from the PAYGO scorecard, and directing the Office of Management and Budget to set the scorecard back to zero).

[230] *See supra* note 224.

[231] *See* Elizabeth Garrett, *Rethinking the Structures of Decisionmaking in the Federal Budget Process*, 35 HARV. J. ON LEGIS. 387, 397–405 (1998) [hereinafter Garrett, *Rethinking*] (describing the two-part division of the budget into discretionary programs, containing subdivisions corresponding to the jurisdiction of the thirteen appropriations subcommittees, and tax and entitlement legislation, falling within the jurisdiction of the tax-writing committees).

[232] *See* BUDGET, FY 2002, *supra* note 135, at 243.

[233] *See, e.g.*, 2 U.S.C. §§ 645, 901 (1994 & Supp. III 1997).

[234] The budget resolution is a concurrent resolution, which is not signed by the President and is not law. Its spending limits for discretionary programs could differ from the caps set by the BEA. The budget resolution is enforced through parliamentary points of order. *See* Elizabeth Garrett, *The Congressional Budget Process: Strengthening the Party-in-Government*, 100 COLUM. L. REV. 702, 715–17 (2000) [hereinafter Garrett, *The Congressional Budget Process*] (describing the budget committees and the budget resolution, the reconciliation process, and budget summits as centralized decision-making procedures).

[235] *See* Garrett, *Rethinking*, *supra* note 231, at 399.

mechanisms to enforce the spending caps set by the budget resolution. Under the BEA, if appropriations exceeded the statutory spending caps, a sequestration "reduce[d] spending for most programs in the category by a uniform percentage,"[236] eliminating the excess in programs that are funded in the spending category in which the overage occurred.

The BEA controlled new tax and entitlement legislation[237] through restrictions known as "pay-as-you-go" or "PAYGO" requirements.[238] The BEA did "not cap mandatory spending[239] or require a certain level of receipts,"[240] but instead adopted a PAYGO principle of "revenue neutrality" for new legislation.

The congressional budget resolution set the amount of revenue to be raised by taxes during the year, provided for the debt limit, and, as noted above, set discretionary spending limits. The tax-writing committees proposed a mix of tax rates and other tax changes that would meet revenue targets specified in the budget resolution.[241] After the expiration of the BEA, PAYGO restrictions continued to apply on a limited basis through internal congressional budget procedures.[242]

Under the BEA's PAYGO provisions, tax changes resulting in revenue loss had to be paid for by tax increases or by offsetting revenue gains from modifications to existing tax provisions or in cuts to the entitlement programs under the jurisdiction of the tax-writing committees.[243] However, they could not be offset by cuts in

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[236] See BUDGET, FY 2002, *supra* note 135, at 443. However, the BEA "specifies special rules for reducing some programs and exempts some programs from sequestration entirely." *Id*.

[237] PAYGO did not apply to increased mandatory spending (which includes entitlement spending) or decreases in tax receipts that are not the result of new laws. *Id*.

[238] *Id*.

[239] Mandatory spending, sometimes called "direct spending," refers to spending that is not controlled through appropriations. It includes the largest entitlement programs, such as social security and Medicare, as well as means-tested entitlement programs (including Medicaid, food stamps, and other programs for low-income families and individuals), and other mandatory spending (including interest payments and federal retirement and insurance programs). Entitlement spending is largely determined by eligibility and benefits formulas.

[240] BUDGET, FY 2002, *supra* note 135, at 443.

[241] *See* Garrett, *The Congressional Budget Process*, *supra* note 234, at 715–17.

[242] *E.g.*, *Concurrent Resolution on the Budget for Fiscal Year 2004*, TAX NOTES TODAY 72-17, § 505, April 11, 2003, LEXIS 2003 TNT 72-17 (adopting a PAYGO point of order in the Senate). The rule may be waived by a supermajority vote of sixty Senators. *Id*. *See* Block, *supra* note 229, at 884–85 (describing the Senate's internal PAYGO mechanisms adopted as point-of-order rules incorporated into yearly budget resolutions); *see, e.g.*, Elizabeth Garrett, *A Fiscal Constitution With Supermajority Voting Rules*, 40 WM. & MARY L. REV. 471, 479–80 (1999).

[243] *See* Block, *supra* note 229, at 884–85. *See generally* COMM. ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, 106TH CONG., 2D SESS., 2000 GREENBOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS vii (Comm. Print 2000) (including jurisdiction over tax provisions as well as major entitlement programs, including social security, Medicare, and numerous other programs providing social welfare benefits).

discretionary spending programs. PAYGO was enforced by its own independent sequestration and enforcement provisions.[244]

Although the BEA slowed the growth of new federal spending during a period of substantial federal deficits,[245] and thus played an important budgetary control role, the BEA increased the separation between tax expenditures and discretionary programs for purposes of policy analysis. It created incentives to channel new spending through the "tax side" of the budget,[246] and resulted in greater tax code complexity.[247] However, at the same time, PAYGO arguably increased the transparency of the tax legislative process.[248]

2. *The Need for a New Consensus*

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[244] *See* 2 U.S.C. § 902 (1994). The procedures were as follows:

> The BEA sequestration procedures require a uniform reduction of mandatory spending programs that are neither exempt nor subject to special rules. The BEA exempts social security, interest on the public debt, Federal employee retirement, Medicaid, most means-tested entitlements, deposit insurance, other prior legal obligations, and most unemployment benefits. A special rule limits the sequestration of Medicare spending to no more than four percent, and special rules for some other programs limit the size of a sequestration for those programs. As a result of exemptions and special rules, only about three percent of all mandatory spending is subject to sequestration, including the maximum amounts allowed under special rules.

BUDGET, FY 2002, *supra* note 135, at 443.

[245] Bud Newman, *U.S. Budget: Pay-As-You-Go Rules Are Irrelevant, Ways and Means Staffer Tells ABA*, 94 DAILY TAX REP. (BNA) G-3 (May 15, 2000) *at* http://pubs.ban.com/ip/BNA/DTR.NSF (reporting observations by congressional staff that the budget surplus eliminated the congressional consensus that kept PAYGO on the books, that the discretionary spending caps had more influence than PAYGO, and that the latest budget restriction to have an impact on potential tax code changes was the understanding that neither tax cuts nor entitlement spending could result in the use of the social security surplus).

[246] *See* Burman, *supra* note 183, at 409. Unlike the offsets available to discretionary spending proponents, the potential offsets available to proponents of new tax expenditures were not limited to a subset of programs related by subject matter within the jurisdiction of the appropriations subcommittees. Instead they included all those tax and entitlement measures under the jurisdiction of the tax-writing committees. Garrett, *Rethinking*, *supra* note 231, at 401. It is possible, however, that discretionary funding advocates might have been able to target unrelated offset options earlier in the budget committee allocation process. *See* Roin, *supra* note 135, at 629.

[247] *See, e.g.*, Charles E. McClure, Jr., *The Budget Process and Tax Simplification/Complication*, 45 TAX L. REV. 25, 28–30 (1989) (describing the interaction between budget policy and tax policy); *see also* MICHAEL J. GRAETZ, THE DECLINE (AND FALL?) OF THE INCOME TAX 186–88 (1997) (describing, in general, the adverse effects of budget politics on tax legislation in the decade following 1986).

[248] *See* Garrett, *Offset Requirements*, *supra* note 165, at 504 (arguing that budget rules provide a mechanism to harness interest group conflict, giving lawmakers an opportunity to review and modify tax subsidies and encouraging them "to provide reasons for their decisions, thus increasing their accountability to the electorate").

Any revival of the BEA, to be effective, must represent a consensus in Congress about both the need for budget discipline and the rules for constraint. No such consensus has emerged since the BEA's expiration in 2002, although growing deficits may prompt reconsideration.

The Bush Administration's first budget submission proposed the extension and modification of BEA requirements by raising the discretionary spending caps and extending them through 2005.[249] In addition, the Administration proposed extending and setting new PAYGO requirements for entitlement spending and tax legislation:[250]

> This Administration proposes to extend the PAYGO requirements. The President's budget sets aside the Social Security surplus and additional on-budget surpluses for debt reduction and contingencies. These levels ensure the President's tax plan and his Medicare Helping Hand and modernization reforms are fully financed by the surplus. The Administration will work with Congress to set new PAYGO requirements that accommodate these proposals.[251]

The Administration's proposal thus apparently proposed a minimum threshold of protecting the Social Security Trust Fund Surplus,[252] suggesting a consensus point used by Congress in the past when PAYGO restrictions were skirted.[253] The Director of the OMB later suggested the following mechanism to implement BEA restrictions:

> Once this minimum threshold is set, new discretionary spending "caps" and "paygo" requirements could be determined on an annual basis through the vehicle of a Joint Budget Resolution. In fact, if one considers the various changes to the BEA since 1990, it could be argued that the Executive Branch and the Legislative Branch have, from time to time, entered into agreements that amounted to de facto joint budget resolutions. I refer here to the Executive-Legislative Summit agreements of 1990, 1993, and 1997. We should consider regularizing this step as an annual process.[254]

If PAYGO were extended and modified along the lines first suggested by the Administration, it would provide a continuing examination of tax incentives from a budgetary perspective. However, the effectiveness of any BEA extension would also depend upon Congress's honoring of the spirit of the agreement over a period of years.

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[249] BUDGET, FY 2002, *supra* note 135, at 243.

[250] *Id.*

[251] *Id.* at 443.

[252] *See OMB Director's House Budget Committee Testimony*, *supra* note 226.

[253] *See* Newman, *supra* note 245.

[254] *OMB Director's House Budget Committee Testimony*, *supra* note 226.

The Bush Administration's second budget, submitted during a "War on Terrorism" and an economic "slowdown that was worsened by the terrorist attacks on September 11, 2001," observed that "budget surpluses for the short term have disappeared; and the general purpose discretionary caps and PAYGO requirements of BEA no longer apply."[255] The Administration pledged to work with Congress during the next session to develop enforcement mechanisms, including future discretionary spending limits and PAYGO requirements for entitlement spending and tax legislation "that are consistent with the needs of the country."[256]

In addition, the Administration proposed a joint budget resolution to set overall levels of spending, receipts, and debt. The joint resolution, which would require the President's signature, would have the force of law and "be enforced by sequesters requiring automatic across-the-board cuts by category to offset any excess spending, similar to the BEA."[257] This mechanism would require the President and Congress to agree "on overall fiscal policy before individual tax and spending bills are enacted, and avoid the 'train wrecks' at the end of the year that frequently occurs under the current process."[258] Alternatively, the budget submission suggested that enforcement could involve extension of the BEA. If so, the Administration "would support discretionary caps that are consistent with the discretionary levels proposed in the 2003 budget and PAYGO requirements that would carry out the 2003 budget's proposals for mandatory spending and receipts."[259] The Administration's third budget renewed its pledge to support renewal of discretionary caps and PAYGO, with discretionary caps and PAYGO requirements to be proposed at levels sufficient to support its budget proposals.[260]

Significantly, the budget submitted in the last year of Bush's four-year term outlined a new position on revenue provisions. The Administration's budget submission supported renewal of discretionary spending caps, consistent with its level of fiscal year 2005 budget proposals, and reimposition of PAYGO for mandatory spending only (including entitlement programs such as Social Security).[261] Accordingly, if the Administration's position were adopted by Congress, PAYGO would not be applied to tax legislation. The budget submission also reiterated its support of a joint budget resolution with the force of law, permitting the President to be engaged earlier in the budget process.[262] In addition, it advocated enactment of a "constitutional" line item veto.[263] As of this writing, the

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[255] BUDGET, FY 2003, *supra* note 140, at 283.

[256] *Id.*

[257] *Id.*

[258] *Id.* at 283–84.

[259] *Id.* at 284.

[260] BUDGET, FY 2004, *supra* note 59, at 315–16.

[261] BUDGET, FY 2005, *supra* note 144, at 215–16.

[262] *Id.* at 218.

[263] *Id.* at 218–19.

BEA had not been extended and Congress had reached an impasse on PAYGO.[264]

3. *Relationship to Privatization*

A reconceptualization of the tax expenditure concept could alter the types of tax provisions viewed as "revenue-losing" provisions. Most significantly, if a consumption tax baseline were used for purposes of defining tax expenditures, tax provisions favoring retirement savings would not be listed as revenue losers. This would place the political debate about individual retirement accounts or education savings accounts in a less transparent political environment by obscuring the political tradeoffs.

If BEA-style PAYGO and discretionary caps were revived, tax and entitlement offsets could once again become a feature of the tax legislative process. If discretionary spending caps return and PAYGO is fully revived, the pressure to channel spending to the tax side of the budget could continue, depending upon the restrictiveness of the caps adopted. The policy separation between the two budget packages of discretionary spending and tax and entitlement programs would continue unabated, unless the budget resolution incorporates a more structured oversight mechanism to permit coordinated review of tax expenditures as well as discretionary spending programs.

As indicated in its fiscal year 2005 budget submission, however, the Administration rejected PAYGO as applied to tax legislation.[265] In the past, the Administration had supported such an extension of BEA, at least in principle if not in practice.[266] Exempting tax legislation from PAYGO while imposing budget process restrictions on discretionary and mandatory spending would shift even more spending to the tax side of the budget.

B. *Private Performance: Accountability Gaps*

New challenges in achieving accountability accompany the shift in public management[267] from Progressive-era and New Deal-type centrally managed federal

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[264] Because of the impasse on PAYGO, the Republican controlled House and Senate have not yet completed action on the 2005 fiscal year budget resolution. Four Senate Republicans joined the Senate Democrats to back PAYGO, and refused to support any final budget plan that failed to contain a multi-year PAYGO provision for tax cuts. Republican negotiators then agreed on a one-year budget, setting the 2005 fiscal year discretionary spending cap at $821 billion. Although the budget resolution conference report passed narrowly in the House, it did not pass in the Senate, where the four Republicans joined the Democrats to block its passage. *See* Bud Newman, *Senate Democrats Unsure Whether to Fight Unprecedented GOP Move to Adjust Budget*, 139 DAILY TAX REP. (BNA) G-8 (July 21, 2004).

[265] *See supra* note 261 and accompanying text.

[266] *See supra* notes 249–60 and accompanying text.

[267] *See generally* Jody Freeman, *The Contracting State*, 28 FLA. ST. U. L. REV. 155, 160–64,

programs and command-and-control regulatory models to decentralized and market-based models. In this decentralized environment, a management system based on results makes more sense, some argue, than one based on hierarchical process or input controls on the management of equipment, staff, and budgets.[268] The federal government has been developing a management framework designed to assess the performance of traditional federal programs or services provided by government agencies as well as for programs or financial assistance provided through various alternative, more private or decentralized mechanisms. This framework could provide a useful model for evaluating the effectiveness of tax incentives. So far the model has been applied to traditional governmental programs but not to tax-delivered programs.

1. *Performance Management Requirements*

Under the Government Performance and Results Act of 1993 (GPRA),[269] Congress requires federal agencies to set goals for program performance, to measure performance results, and to report the results on an annual basis to the President and Congress.[270] The agencies must develop multi-year strategic plans for their program activities,[271] establish measurable performance goals,[272] develop annual plans to

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201–07 (2000) (describing the shift from hierarchical structures, providing specific examples of the contracting out of governmental services, and discussing the challenges posed to administrative law by the shift).

[268] *E.g.*, DAVID OSBORNE & TED GAEBLER, REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR 139 (1992).

[269] Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 [hereinafter GPRA] (codified in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

[270] In enacting the GPRA, Congress found that "[f]ederal managers are seriously disadvantaged" in efforts "to improve program efficiency and effectiveness, because of insufficient articulation of program goals and inadequate information on program performance" and that "congressional policymaking, spending decisions and program oversight are seriously handicapped by insufficient attention to program performance and results." *Id.* § 2(a)(2)–(3). The purposes of the GPRA, among others, are to "improve Federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction" and to "improve congressional decisionmaking by providing more objective information on achieving statutory objectives, and on the relative effectiveness and efficiency of Federal programs and spending . . . ." *Id.* § 2(b)(3), (5).

[271] 5 U.S.C. § 306(b) (2000).

[272] The performance plans must "establish performance indicators to be used in measuring or assessing the relevant outputs, service levels, and outcomes of each program activity . . . ." 31 U.S.C. § 1115(a)(4) (2000). An "output measure" is more specifically defined by the GPRA as "the tabulation, calculation, or recording of activity or effort and can be expressed in a quantitative or qualitative manner . . . ." *Id.* § 1115(g)(3). An "outcome measure" is defined as "an assessment of the results of a program activity compared to its intended purpose . . . ." *Id.* § 1115(g)(2).

help them meet their performance goals,[273] and prepare annual reports on their progress toward meeting their goals.[274]

The GPRA, which grew out of regulatory initiatives begun during the Reagan Administration, was first introduced during the Administration of President George Herbert Walker Bush and enacted into law during the Clinton Administration.[275] The GPRA initially created pilot programs to assess the costs and benefits of the performance requirement and to test the specifications for performance plans. Congress required the OMB to report the results of the performance management pilot studies to the President and Congress by May 1, 1997,[276] and since then, the requirements have been more broadly implemented.[277]

The Agency's performance plans and reports cover each of their program activities listed in the annual budget.[278] The term "program activity" is defined as "a specific activity or project as listed in the program and financing schedules of the annual budget of the United States Government."[279] The program and financing schedules, designed primarily for use by the Appropriations Committees, are arranged according to each separate branch of government, with the executive branch organized by agency.[280] Tax-delivered programs are not listed in the Treasury Department's program and financing schedule unless they involve direct outlays (such as refundable tax credits).

The GPRA also requires the president's annual budget submission to include a government-wide performance plan.[281] Although the statute does not specify that

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[273] *Id.* §§ 1105(a)(28), 1115(a) (2000 & Supp. 2004).

[274] *Id.* § 1115(a)(4)–(6).

[275] *See* Walter Groszyk, *Implementation of the Government Performance and Results Act of 1993*, *in* OECD, PERFORMANCE MANAGEMENT IN GOVERNMENT: CONTEMPORARY ILLUSTRATIONS 71, 74 (1996) (listing as immediate antecedents of the GPRA, a Reagan administration OMB report, legislation proposed by Senator Roth (R., Del.) based on state and local experiences over the previous decade, and program performance measures and information required under the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (codified beginning at 31 U.S.C. § 501)); *see also* William V. Roth, Jr., *Reinventing Government: Maintaining the Momentum*, PUB. MANAGER, Winter 1993–94, at 15, 15–17 (describing bipartisan reform efforts).

[276] 31 U.S.C. §§ 1118(c) (2000).

[277] *See id.* §§ 1105(a)(28), 1115(a) (2000 & Supp. 2004); *id.* § 1116(a) (2000).

[278] *Id.* § 1115(a), (g)(6).

[279] *Id.* § 1115(g)(6).

[280] OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: APPENDIX: DETAILED BUDGET ESTIMATES: FISCAL YEAR 2001, at 4 (2000) (detailing the information provided by the "program and financing schedule," including "obligations by program activity" and explaining that "[t]he activity structure is developed for each appropriation or fund account to provide a meaningful presentation of information for the program").

[281] 31 U.S.C. § 1105(a)(28) (2000) (requiring that the president's budget submission to Congress include a "performance plan for the overall budget as provided for under section 1115").

analysis of tax expenditures be included in the government-wide performance plan,[282] the legislative history of the GPRA requests that the government-wide performance plans contain a "schedule for periodically assessing the effects of . . . tax expenditures in achieving performance goals."[283] As specified by the Senate Committee on Governmental Affairs, the assessments "should consider the relationship and interactions between spending programs and related tax expenditures." [284]

In its 1997 GPRA report to Congress,[285] the OMB set forth an initial framework for tax expenditure review, emphasizing that developing a "comprehensive, accurate, and flexible" framework "to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge."[286] OMB assigned Treasury lead responsibility for pilot evaluations of selected tax expenditures "[t]o explore methods for tax expenditure evaluation" and "to gather experience on a cross-section of issues."[287]

Treasury's initial pilot study selected three tax expenditures[288] to study the evaluation methods and resource needs connected with evaluating the relationship between tax expenditures and performance goals. Treasury found that the information needed for analysis was not available.[289] Assessment of data needs and availability from governmental and non-governmental sources, it concluded, should prove useful to compare the effectiveness of tax expenditures with "outlay, regulatory and other tax policies as means of achieving objectives."[290] It therefore

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Programs are listed in the performance plan under certain functional categories used in the budget (including national defense, agriculture, housing and commerce, education, training, employment and social services, and income security), according to the program's major purpose. BUDGET, FY 2002, *supra* note 135, at 445–46 (discussing functional classification).

[282] 31 U.S.C. § 1105(a)(28) (2000). In past years, the government-wide performance plan has included tax expenditures in a listing of federal resources by function (national defense, energy, agriculture, commerce and housing, etc.). That pattern continued in the Bush Administration's first budget submission. *See* BUDGET, CREATING A BETTER GOVERNMENT: FY 2002, *supra* note 223, at 15–18 tbl.1-1 (2001) (listing spending, credit activity, and tax expenditures by budget function).

[283] S. REP. NO. 103-58, at 28 (1993), *reprinted in* 1993 U.S.C.C.A.N. 327, 354.

[284] *Id.*

[285] *See supra* notes 276–77 and accompanying text (relating to statutory requirement).

[286] OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, THE GOVERNMENT PERFORMANCE AND RESULTS ACT REPORT TO THE PRESIDENT AND CONGRESS FROM THE DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET IV (May 1997).

[287] *Id.*

[288] OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES: FISCAL YEAR 2000, at 121 (1999) (listing the tax exemption for worker's compensation benefits, the tax credit for non-conventional fuels, and the tax exclusion for certain amounts of income earned by Americans living abroad).

[289] *Id.*

[290] *Id.*

planned studies focusing on the availability of data needed to assess the effects of "selected significant tax expenditures, primarily those designed to increase savings."[291]

As part of this effort, Treasury's Office of Tax Analysis and the IRS Statistics of Income Division developed "the specifications for a new data sample which will follow the same individual income tax filers over an extended period of time."[292] The sample will attempt to capture the effect of changes in tax law over an extended period of time to "enhance our ability to analyze the effect of tax expenditures designed to increase savings."[293]

The Bush Administration's first budget submission reported that the specifications had been developed, and that the sample, beginning with tax returns filed in 2000 for the tax year 1999, will follow the same taxpayers "over a period of at least ten years."[294] In addition, it reported that "[o]ther efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years."[295] The second Bush Administration budget reported that the first year of the panel sample was drawn from tax returns filed for the tax year 1999, and that the "sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time."[296] It remains to be seen how the Administration's reconsideration of the tax expenditure concept will affect the data collection effort with regard to savings-related tax expenditures.[297]

Unlike the glacial pace of assessment of tax-delivered programs, the evaluation of mandatory and discretionary federal programs was proceeding on the relatively brisk schedule of about one-fifth of all mandatory and discretionary federal programs per year.[298] The Bush Administration implemented its performance assessment of these collectively financed federal programs as part of its overall program of performance management review. Those assessments included no tax-delivered programs other than the earned income tax credit program, which as a refundable tax credit, involves direct federal outlays.[299] The goal of the Administration's

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[291] *Id.*

[292] OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT: ANALYTICAL PERSPECTIVES: FISCAL YEAR 2001, at 124 (2000).

[293] *Id.*

[294] BUDGET, FY 2002, *supra* note 135, at 77.

[295] *Id.* at 78.

[296] BUDGET, FY 2003, *supra* note 140, at 113.

[297] The FY 2005 budget merely reports that the study of savings related tax expenditures is on-going. BUDGET, FY 2005, *supra* note 144, at 300–01 (reporting that efforts to improve data collection will continue).

[298] *See supra* note 223 (describing the Administration's PART initiative).

[299] BUDGET, FY 2005, *supra* note 144, at 19. *See supra* note 223 (referencing PART assessment of the earned income credit).

performance and budget integration initiative was to have program assessment information routinely considered by Congress and the executive branch in making management and funding decisions.[300]

2. *Relationship to Privatization*

The Bush Administration's reconsideration of the tax expenditure concept places into doubt efforts to incorporate tax expenditures into the performance review process. Without performance information, Congress will have little basis on which to evaluate the effectiveness of tax incentives adopted in furtherance of domestic policy goals. If so, discretionary spending programs will be subject to much higher standards of review than tax-based incentive programs. That may, in turn, lead policy entrepreneurs to favor tax incentive programs, fostering increased privatization through the use of tax incentives.

Nevertheless, such a two-tiered system would be inconsistent with the Administration's reform rhetoric about making government accountable for "results." Without a comparable means of evaluating tax-delivered incentives, tax incentives will be given a "free ride" from accountability. Failure to apply performance review requirements on the very type of market-based, decentralized programs that justify the adoption of performance-based standards presents a challenge to the stated rationale for the requirements—that of increasing the effectiveness of government programs and expenditures.

V. CONCLUSION

Congress coordinates its taxing and spending decisions through the budget process, collectively determining what will be financed and performed through government and what will be left to private choice. As the public sector shifts from centralized, hierarchical public administration models to alternatives based on decentralization, devolution, and privatization, increased attention should be paid to the financing dimension of privatization decisions.

General tax reduction results in more individual financing, which when combined with decreased government spending and private sector performance, leads to a smaller sphere of government action. By contrast, government contracting, outsourcing, and voucher programs retain collective financing but delegate performance to the private sector. Like government contracting, outsourcing, or vouchers, targeted tax incentives are financed collectively, through higher general tax rates (or higher borrowing costs) and involve legislative choices about the use of public resources. Unlike vouchers, which are funded through appropriations, targeted tax incentives rely on private market responses to altered price levels for tax-favored activities.

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[300] BUDGET, FY 2005, *supra* note 144, at 9.

The Bush Administration's reconsideration of the tax expenditure budget coincided with a crucial time of change in centralized governmental structures. During such a period of change, there is a need for more, not less, political transparency and accountability. The use of tax incentives can lead to a loss of political transparency and accountability, as well as a shift in decision making from democratic deliberation about resource allocation to more individualized market choices. The governmental funding choices inherent in tax incentive design should not be obscured by equating targeted tax incentives with overall tax reduction.

Tax incentives can be an effective means of delivering government subsidies, and accordingly, their use could lead to more cost-effective and minimally intrusive government programs. On the other hand, increased use of tax incentives burdens the Internal Revenue Service with administrative and enforcement responsibilities for subsidy programs outside of its traditional revenue collection function, costs that are not always considered when new tax incentives are enacted.

The difficulty of monitoring the governmental provision of vouchers or tax-based assistance illustrates the double-edged relationship between individual choice and democratic accountability. The legislative decision-making process focuses on the financing of the programs and on their initial design. Once in place, these programs do not have the same management accountability structures or the visibility of programs performed by government agencies. Although vouchers and tax benefits may enlarge individual private market choices, they limit democratic deliberation and decision making about their effectiveness. In addition, their use may paradoxically lead to increased governmental regulation of organizations and private firms that participate in such programs.

Administrative lawyers are engaged in studying new ways in which regulation, contracts, and contract monitoring may respond to the accountability problems created by increased "contracting out" or privatizing of governmental services. A parallel effort to study ways in which increased monitoring of tax credits and incentives can be achieved needs to be undertaken. Tax incentives generally do not involve negotiated relationships between government and private contractors, but typically involve tax reporting to the Internal Revenue Service and oversight jurisdiction by the tax-writing committees. The delivery of subsidies through the tax system can mask governmental funding levels and allocations and obscure accountability for outcomes being funded. Although the first steps in that direction have been taken, much more is needed to ensure accountability for such collectively financed private choices.