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# Reinventing Tax Expenditure Reform: Improving Program Oversight under the Government Performance and Results Act

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## ARTICLES

### REINVENTING TAX EXPENDITURE REFORM: IMPROVING PROGRAM OVERSIGHT UNDER THE GOVERNMENT PERFORMANCE AND RESULTS ACT

*Mary L. Heen*<sup>\*</sup>

*In this Article, Professor Heen examines the new framework for performance-based management and oversight of federally-funded programs, describes emerging efforts to incorporate tax expenditures into the performance review process, and places these developments into context by evaluating past experiences with tax expenditure reform. Professor Heen concludes that the new framework provides a promising executive branch mechanism for achieving a more coordinated review of functionally related government programs, whether funded or implemented through direct expenditures, tax expenditures, or regulatory programs. However, as past experience illustrates (including, for example, experience with employment subsidies such as the*

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*Work Opportunity Tax Credit and the Welfare-to-Work Tax Credit), significant institutional obstacles stand in the way of comprehensive reform. The Article ends with a discussion of the type of fundamental structural reforms that will be needed before meaningful legislative oversight of functionally related government programs can be achieved.*

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INTRODUCTION

A new framework for management and oversight of federal government programs is emerging under the Government Performance and Results Act of 1993 (“Results Act” or “GPRA”).<sup>1</sup> The Results Act is part of a broader “government reinvention” reform effort<sup>2</sup> and movement toward performance review of government programs. The Act requires federal agencies to prepare performance goals and plans covering budget-listed program activities,<sup>3</sup> and to measure and report program “outputs” and “outcomes”<sup>4</sup> to the Office of Manage-

1. Pub. L. No. 103-62, 107 Stat. 285 (1993) (codified in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.). See Paul R. Verkuil, *Is Efficient Government an Oxymoron?*, 43 DUKE L.J. 1221, 1235 (1994) (describing the Results Act as “little-noticed” legislation with “potentially radical reform possibilities”). For a discussion of the political impetus behind the Results Act, which grew out of regulatory initiatives begun during the Reagan administration and was first introduced during the Bush administration, see *infra* Part I.A. As discussed *infra* in Part I.B, the Results Act initially provided for implementation through pilot programs. Its performance management requirements have more generally been in effect since 1997. See 31 U.S.C. §§ 1118, 1119 (1994).

2. Government reinvention reforms, which have been implemented in the United States and abroad, have been described as follows:

Although the rhetoric might have varied around the world, most of the recent efforts at governmental reinvention, restructuring, and renewal have shared similar goals—to improve the effectiveness and efficiency of the public sector, enhance the responsiveness of public agencies to their clients and customers, reduce public expenditure, and improve managerial accountability. The choice of policy instruments has also been remarkably similar: commercialisation, corporatisation, and privatisation; the devolution of management responsibilities; a shift from input controls to output and outcome measures; tighter performance specification; and more extensive contracting out.

JONATHAN BOSTON ET AL., PUBLIC MANAGEMENT: THE NEW ZEALAND MODEL 2 (1996). See also, e.g., COLIN CAMPBELL & GRAHAM K. WILSON, THE END OF WHITEHALL: A COMPARATIVE PERSPECTIVE 90 (1995) (describing Britain and New Zealand as having made the greatest changes, followed by Australia, and then by the relatively modest reforms implemented by Canada).

3. Under the Results Act, federal agencies are required to prepare multi-year strategic plans and annual performance plans and reports covering each of their program activities listed in the annual budget. 5 U.S.C. § 306 (1994); 31 U.S.C. § 1115(a), (f)(6) (1994).

4. 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). An “output measure” is the “tabulation, calculation, or recording of activity or effort and can be expressed in a quantitative or qualitative manner.” *Id.* at § 1115(f)(3). An “outcome measure” is defined as “an assessment of the results of a program activity compared to its intended purpose.” *Id.* at § 1115(f)(2). As discussed *infra* in

ment and Budget ("OMB") and to Congress. In addition, it requires the president's annual budget submission to include a government-wide performance plan.<sup>5</sup>

This Article examines the Results Act's performance management and budgeting requirements and outlines the type of additional reforms that will be needed before meaningful review of functionally related government programs can be achieved. The Results Act offers a framework for assessing the performance of traditional federal programs or services provided by government agencies as well as programs or financial assistance provided through various alternative, more private or decentralized mechanisms—including tax incentives used to encourage private businesses or individuals to engage in certain socially or economically desirable activities. The Act thus provides a new opportunity to address the difficult management and oversight problems caused by the availability of alternative program funding and implementation mechanisms. As experience with prior reform efforts has shown, significant institutional obstacles stand in the way of achieving comprehensive Results Act reforms. The following introductory sections provide additional background and further define the focus of discussion for the remainder of the Article.

#### A. *Government Reinvention: Managing for Results*

The Results Act performance management requirements are related to a broader reform movement, at the state and local level<sup>6</sup> as well as at national<sup>7</sup> and international levels,<sup>8</sup> encompassing mul-

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Parts I and IV, identifying and measuring appropriate "outputs" and "outcomes" for government programs can be quite difficult to accomplish.

5. See 31 U.S.C. §§ 1105(a)(28) (Supp. IV 1998) (requiring the president's budget submission to Congress to include a "performance plan for the overall budget as provided for under section 1115"). 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. See 31 U.S.C. § 1105(a)(1) (1994); EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2001, ANALYTICAL PERSPECTIVES, BUDGET SYSTEM CONCEPTS AND GLOSSARY 451 (2000) [hereinafter BUDGET, FY 2001].

6. See, e.g., DAVID OSBORNE & TED GAEBLER, REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR 138-65 (1992).

7. Implementation of the Results Act has been incorporated into the Clinton administration's reinvention initiative, the National Partnership for Reinventing Government ("NPR"), formerly the National Performance Review, as part of its program of "empowering employees to get results." NATIONAL PERFORMANCE REVIEW, FROM RED TAPE TO RESULTS: CREATING A GOVERNMENT THAT WORKS BETTER AND COSTS LESS 72-73 (1993) [hereinafter NATIONAL PERFORMANCE REVIEW, FROM RED TAPE TO RESULTS] (specifying that the Government Performance and Results Act be implemented as an action to be taken to hold federal employees accountable for results). The NPR is an interagency

tifaceted and sometimes conflicting public sector trends toward participatory and market-based models, government downsizing, decentralization, and greater administrative flexibility and accountability.<sup>9</sup> Because of the multifaceted forces behind the "reinvention" movement, the "reinvention" rhetoric accommodates a broad range of political objectives,<sup>10</sup> business management and assessment prac-

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task force led by Vice President Al Gore, which is designed to "reinvent government to work better, cost less, and get results Americans care about." *Vice President Gore's National Partnership for Reinventing Government* (visited on Aug. 1, 2000) <<http://www.npr.gov/library/vision2000.html>>. For a preliminary assessment of the federal government's "reinvention" reform efforts, see DONALD F. KETTL, REINVENTING GOVERNMENT: A FIFTH-YEAR REPORT CARD v-ix (1998), and John J. DiIulio, Jr., *Works Better and Costs Less? Sweet and Sour Perspectives on the NPR*, in INSIDE THE REINVENTION MACHINE: APPRAISING GOVERNMENTAL REFORM 1, 5-6 (Donald F. Kettl & John J. DiIulio, Jr. eds., 1995).

8. See, e.g., ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT ("OECD"), IN SEARCH OF RESULTS: PERFORMANCE MANAGEMENT PRACTICES (1997) (describing performance management practices in Australia, Canada, Denmark, Finland, France, the Netherlands, New Zealand, Sweden, the United Kingdom, and the United States); OECD, PERFORMANCE MANAGEMENT IN GOVERNMENT: CONTEMPORARY ILLUSTRATIONS (1996) (containing studies of public sector reforms in New Zealand, Sweden, the United States, and the Netherlands); OECD, PERFORMANCE MANAGEMENT IN GOVERNMENT: PERFORMANCE MEASUREMENT AND RESULTS-ORIENTED MANAGEMENT (1994) (discussing performance measurement systems adopted by OECD countries).

9. See, e.g., B. GUY PETERS, THE FUTURE OF GOVERNING: FOUR EMERGING MODELS 2, 13-20 (1996).

10. Politicians from both major parties in the United States have built on popular support for the view, expressed by President Reagan in his first inaugural address, that "government is not the solution to our problem; government is the problem." Ronald Reagan, Inaugural Address (Jan. 20, 1981), in PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: RONALD REAGAN, 1981: JANUARY 20 TO DECEMBER 31, 1981, at 1 (1981). President Clinton echoed elements of that perspective when he announced in his 1996 State of the Union address that "[t]he era of big Government is over," explaining that the administration had "worked to give the American people a smaller, less bureaucratic Government in Washington." William J. Clinton, Address Before a Joint Session of Congress on the State of the Union (Jan. 23, 1996), in 1 PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES: WILLIAM J. CLINTON, 1996: JANUARY 1 TO JUNE 30, 1996, at 79 (1997).

Unlike Republican reinvention advocates, the New Democrats tend to emphasize practical solutions rather than ideology. See Christopher H. Schroeder, *Third Way Environmentalism*, 48 U. Kan. L. Rev. 801, 807-09, 822-23 (2000) (contrasting the Clinton administration's nonideological "third way" approach with the efforts to articulate a coherent third way political ideology in Great Britain and Europe as an "alternative to socialism and communism, on the one hand, and neoliberal free market capitalism, on the other hand"). Vice President Al Gore has led the Clinton administration's reinvention efforts by emphasizing the need to cut bureaucratic red tape and to focus on what "work[s] better, [and] cost[s] less." *Vice President Al Gore's National Partnership for Reinventing Government*, *supra* note 7. Performance management reforms, if successfully implemented, could facilitate the reevaluation of government-funded programs in a period of decentralization, devolution, and downsizing.

tices,<sup>11</sup> and views about the appropriate level of legislative oversight of executive agencies.<sup>12</sup> Nevertheless, the reform trends generally mark a shift in management focus from program inputs (such as staff supervised, equipment purchased, or grants dispensed) to program outputs or outcomes, that is, on "results."<sup>13</sup>

This new focus on program results coincides with the more generalized public law shift from New Deal-type centrally managed federal programs and command-and-control regulatory models to decentralized devolution and market-based models, in which federally funded programs are managed by state or local government officials or are contracted out—sometimes in conjunction with nonprofit organizations or private contractors, or by quasi-governmental bodies.<sup>14</sup> Reinvention advocates argue that, in this decentralized environment, a management system based on results makes more sense than one based on hierarchical process or input controls on the management of equipment, staff, and budgets.<sup>15</sup>

Although reinvention initiatives involving new regulatory models have been the subject of a growing body of commentary from the legal academy,<sup>16</sup> relatively little attention has been paid, outside of

At the same time, if the New Democrats are correct, the reforms may blunt some of the conservative ideological arguments against big government.

11. See, e.g., VICE PRESIDENT AL GORE, NATIONAL PERFORMANCE REVIEW, BUSINESSLIKE GOVERNMENT: LESSONS LEARNED FROM AMERICA'S BEST COMPANIES (1997) (describing employee empowerment and customer-centered management practices); OSBORNE & GAEBLER, *supra* note 6, at 159-180 (describing Total Quality Management ("TQM"), as a set of initiatives for increased quality and "customer" awareness in public and private organizations, derived from the writings of W. Edwards Deming and others).

12. Reinvention initiatives such as the National Performance Review and the Results Act reflect different views about the roles of the executive and legislative in controlling the bureaucracy. See, e.g., Gerald Garvey, *False Promises: The NPR in Historical Perspective*, in INSIDE THE REINVENTION MACHINE: APPRAISING GOVERNMENTAL REFORM, *supra* note 7, at 87, 87-106; see also, e.g., Donald F. Kettl, *Building Lasting Reform: Enduring Questions, Missing Answers*, in INSIDE THE REINVENTION MACHINE: APPRAISING GOVERNMENTAL REFORM, *supra* note 7, at 9, 9-83 [hereinafter *Building Lasting Reform*]; discussion *infra* Part I.A.

13. See OSBORNE & GAEBLER, *supra* note 6, at 139.

14. See 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, e.g., JOHN J. DIJULIO, JR. ET AL., IMPROVING GOVERNMENT PERFORMANCE: AN OWNER'S MANUAL 39-40 (1993); Nancy J. Knauer, *Reinventing Government: The Promise of Institutional Choice and Government Created Charitable Organizations*, 41 N.Y.L. SCH. L. REV. 945, 946-48, 952-53, 956, 966-67 (1997).

15. See OSBORNE & GAEBLER, *supra* note 6, at 139.

16. For discussion of "reinvention" initiatives focusing on the regulatory process, see, e.g., Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 6-7 (1995) (describing Reagan, Bush, and Clinton administration executive orders asserting centralized control over the regulatory process and evaluating Clinton's executive order as part of a "reinventing government" program). See also, e.g., Jeffrey S. Lubbers, *Better Regulations: The National Performance Review's Regulatory Reform Recommendations*,

government circles, to initiatives involving performance management. As explained below, however, the emerging Results Act performance-based framework should prompt new thinking about the difficult management and oversight problems posed by functionally substitutable program funding and implementation mechanisms.

*B. Program Funding and Implementation: Direct Expenditures, Tax Expenditures, and Regulatory Programs*

Federal programs can be funded and implemented directly or indirectly. Programs are implemented and funded most directly, and visibly, through traditional tax-and-spend programs.<sup>17</sup> Whether run directly by government agencies or contracted out to others, these programs involve the direct expenditure of federal revenues raised through taxation and include discretionary<sup>18</sup> and mandatory (including entitlements such as social security and Medicare) spending programs.<sup>19</sup> Discretionary programs, which are funded through the annual appropriations process, are subject to budget

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43 DUKE L.J. 1165 (1994) (describing regulatory reform recommendations); Jerry L. Mashaw, *Reinventing Government and Regulatory Reform: Studies in the Neglect and Abuse of Administrative Law*, 57 U. PITT. L. REV. 405, 406 (1996) (criticizing both executive managerial and legislative regulatory reform initiatives). Much of the legal commentary on new regulatory models has focused on efforts to "reinvent" environmental regulation. See, e.g., Schroeder, *supra* note 10, at 820, 822-23 (discussing use of market-based incentives and information disclosure as alternatives to or supplements to traditional command-and-control regulation).

17. See A CITIZEN'S GUIDE TO THE FEDERAL BUDGET, in BUDGET, FY 2001, *supra* note 5, at 8.

18. Discretionary spending is further divided into the categories of defense and non-defense discretionary spending. The fiscal year 2001 federal budget documents estimate that defense discretionary spending will total an estimated 16% of all federal spending, or \$292 billion out of a total \$1835 billion (\$1.8 trillion) federal expenditures. See *id.* at 10-11. Non-defense discretionary spending, which includes a wide range of programs, including education, training, employment, social services, housing, energy, transportation, science, and foreign aid, is estimated to comprise approximately 19% of all federal spending, or \$348.65 billion out of a total \$1835 billion (\$1.8 trillion) federal expenditures. See *id.*

19. Mandatory spending, sometimes called "direct spending," refers to spending that is not controlled through appropriations. It includes the largest entitlement programs, 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. The fiscal year 2001 federal budget estimates that social security will account for 23% of all federal spending and that Medicare will account for 12% of federal spending. See *id.* at 10-11. Medicaid accounts for 7% of federal spending, other means-tested entitlements account for 6% of federal spending, net interest payments on federal debt accounts for 11% of spending, and other mandatory spending comprise the remaining 6% of the federal budget. See *id.*

process discretionary spending caps<sup>20</sup> and comprise a shrinking portion of the overall federal budget.<sup>21</sup> By contrast, entitlements, which are not funded through the appropriations process, account for a growing share of federal spending.<sup>22</sup>

Federal programs can also be funded and implemented indirectly, either through provisions in the tax code or by way of government regulation. Although much of the tax code is designed to raise revenue or to accomplish specific tax policy objectives, many tax provisions involve "tax expenditures."<sup>23</sup> These tax expenditure provisions represent a form of government spending because they reduce the tax revenue that would otherwise be collected absent the tax expenditure provision.<sup>24</sup> This type of government spending may take the form of permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special tax rates.<sup>25</sup>

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20. See 2 U.S.C. § 901 (1994) (providing for statutory discretionary spending caps). Discretionary spending caps are implemented through the budget and appropriations processes. The congressional budget committees draft budget resolutions, which establish a total amount that can be expended for discretionary programs during the year. House and Senate appropriations committees allocate these totals among their subcommittees. The budget process keeps score of spending, and provides for various procedural mechanisms to enforce the spending caps set by the budget resolution. If appropriations exceed the statutory discretionary caps, the excess is eliminated by sequestering resources in programs that are funded in the spending category in which the overage occurred. For additional discussion, see *infra* Part II.C.

21. Nondefense discretionary spending comprised 23% of the budget in 1966, compared to less than 19% projected for fiscal year 2001. See A CITIZEN'S GUIDE TO THE FEDERAL BUDGET, in BUDGET, FY 2001, *supra* note 5, at 11.

22. See *id.* at 10-11.

23. See STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES vii (1973) [hereinafter PATHWAYS TO TAX REFORM].

24. 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 system. Tax expenditures, thus, are viewed as functionally equivalent to spending programs. See, e.g., STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 1-30 (1985) [hereinafter TAX EXPENDITURES]; PATHWAYS TO TAX REFORM, *supra* note 23, at 6, 30-49; see also 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 (1969). For discussion of tax expenditure analysis, including the difficulty of defining a "tax expenditure," see *infra* Part II.B.

25. Surrey and McDaniel, leading tax expenditure theorists, have explained the 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 struc-

Whatever their form, tax expenditures represent government spending effected through the tax system rather than through direct grants, loans, or other forms of government assistance.<sup>26</sup> Thus, in addition to its revenue-raising function, the tax system plays a role as a funding and delivery mechanism for certain government programs.

Although a listing of tax expenditures has been required as part of federal budget submissions since 1974,<sup>27</sup> and newly enacted tax provisions have been subject to "pay-as-you-go" budget process reforms since 1990,<sup>28</sup> the funding of tax expenditures by foregone revenue tends to be less publicly visible than the funding of discretionary spending programs. Tax expenditures, like entitlements, are not subject to the appropriations process.<sup>29</sup> Both tax expenditures and entitlements are part of the jurisdiction of the congressional tax-writing committees.<sup>30</sup> Outlay equivalents of tax expendi-

ture 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.

TAX EXPENDITURES, *supra* note 24, at 3.

26. Tax expenditures involve two payments: "the imputed tax payment that would have been made in the absence of the special provision (all else remaining the same) and the simultaneous expenditure of that payment as a direct grant to the person benefited by the special provision." PATHWAYS TO TAX REFORM, *supra* note 23, at 6-7.

27. See Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297 (codified as amended in scattered sections of 2 U.S.C. and 31 U.S.C.). Tax expenditures are listed in the president's annual budget submission according to their budget function, in budget categories such as national defense, agriculture, housing and commerce, education, and income security. The deduction for home mortgage interest, for example, is listed under housing and commerce. Tax expenditure budgets, prepared by both the executive and the legislative branches, are used primarily for informational purposes. See discussion *infra* Part II.B.

28. See Budget Enforcement Act of 1990, Title XIII of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990) (codified as amended in scattered sections of 2 U.S.C.) (establishing the "pay-as-you-go" 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). For further discussion of "pay-as-you-go" budget requirements (also referred to as "paygo"), see discussion *infra* Part II.C.

29. See Elizabeth Garrett, *Accountability and Restraint: The Federal Budget Process and the Line Item Veto Act*, 20 CARDOZO L. REV. 871, 903 (1999).

30. The House Ways and Means and Senate Finance Committees have jurisdiction over tax provisions as well as major entitlement programs, including social security, Medicare, and numerous other programs providing social welfare benefits. See COMM. ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, 105TH CONG., 2D SESS., 1998 GREENBOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 836 (Comm. Print 1998) [hereinafter COMM. ON WAYS AND MEANS, 1998 GREENBOOK].

tures<sup>31</sup> now exceed the total amount of discretionary spending funded through the appropriations process<sup>32</sup> and, like entitlements, comprise an expanding part of overall federal expenditures.<sup>33</sup>

Programs also may be implemented through regulation, which can have an effect economically equivalent to a tax on those regulated.<sup>34</sup> The public policy implications of the functional substitutability of taxation and regulation,<sup>35</sup> as well as the related intergovernmental issue of federal regulatory programs and unfunded

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31. The president's annual budget includes a listing of tax expenditures computed as outlay equivalents. Outlay equivalents estimate the amount of total direct outlays necessary to place taxpayers in the same after-tax position as they would be under a tax expenditure. The outlay equivalent may be greater than the revenue loss from a tax expenditure, for example, if the outlay would be included in the taxable income of the recipients.

32. Because of the way tax expenditures are measured, comparisons of aggregate tax expenditure revenue losses with total discretionary spending amounts should be made with caution. The budget documents estimate fiscal year 2001 outlay equivalent revenue loss from tax expenditures totaling over \$661 billion, which exceeds the combined amount for defense and nondefense discretionary spending. See BUDGET, FY 2001, *supra* note 5, at 382 tbl.32-4, 388 n.\* (noting that, "[b]ecause of interactions across provisions, these estimates are only rough approximations of the total revenue loss for the functions"). This continues a pattern that has been observed in past years. See Harry L. Gutman, *Reflections on the Process of Enacting Tax Law*, 86 TAX NOTES 93, 94 (2000) (citing budget figures for fiscal year 1999); Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407, 408 (1999) (noting that "the federal government spent more money through the [tax] [c]ode [in 1998] than through the discretionary appropriations process").

33. See, e.g., CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 34-37, 35 tbl.1.4, 183 (1997) (concluding that tax expenditures function like budgetary entitlements; since 1975, the "hidden welfare state" of tax expenditures has grown faster than the "visible welfare state" expenditures for income security, health, housing, etc.).

34. See MARK KELMAN, STRATEGY OR PRINCIPLE? THE CHOICE BETWEEN REGULATION AND TAXATION 1 (1999); see also, e.g., Henry E. Smith, *Ambiguous Quality Changes from Taxes and Legal Rules*, 67 U. CHI. L. REV. 647, 653-69 (2000) (citing law and economics literature on the analogy of legal rules to taxation and highlighting certain measurement difficulties in evaluating the efficiency and equity of legal rules).

35. As Professor Kelman notes in his discussion of regulation as an alternative to taxation, "[a]t times, this interchangeability or substitutability of taxation and regulation is quite transparent, and it is debated publicly whether certain regulatory mandates ought to be thought of as new taxes." KELMAN, *supra* note 34, at 2 (discussing, as an example, a proposed health reform employer mandate to provide health insurance for uncovered employees). "At other times, this functional interchangeability may be less transparent but no less real." *Id.* at 3. In addition, as Kelman points out, governments can charge user fees for government services or allow private parties to bear losses or insurance costs rather than to expend public funds to prevent losses. *Id.* at 3-4. He states, "[w]hile not identical to substituting regulatory for public tax-and-spend programs, user fees and deliberate inaction also represent alternative solutions to public policy problems." *Id.* at 4.

mandates,<sup>36</sup> have provoked much controversy and commentary. At the most transparent and direct level, however, federal agencies with responsibility for implementing regulatory programs are created and funded through the authorization and appropriations process.<sup>37</sup>

Appropriately tailored tax expenditures or regulations can be used as alternatives to, or in combination with, direct expenditures to achieve particular governmental goals.<sup>38</sup> Although tax expenditures, regulatory programs, and direct expenditures can be substituted for each other from a functional design perspective,<sup>39</sup> they each operate in distinct institutional settings.

The markedly different political, budgetary, and institutional consequences of these otherwise interchangeable mechanisms provide policymakers with great flexibility in designing programs, but they also create enormous challenges for the effective management and oversight of functionally related government programs. The focus here will be on the institutional challenges posed by performance-based review of tax expenditures and their direct expenditure program alternatives.

### C. *The Need for Comprehensive Coverage*

Although reinvention advocates show strategic awareness of the various means used by governments to achieve programmatic

36. See, e.g., Julie A. Roin, *Reconceptualizing Unfunded Mandates and Other Regulations*, 93 NW. U. L. REV. 351 (1999); Edward A. Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest, and Public Services*, 46 VAND. L. REV. 1355 (1993).

37. See Pete V. Domenici, *Fighting the Good Fight: Washington's Quest for a Balanced Budget*, 16 ST. LOUIS U. PUB. L. REV. 17, 19 (1996).

38. See generally, e.g., MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 56-57 (3d ed. 1995) (listing a variety of public-law and private-law mechanisms that the government could use to accomplish its goals, including tax deductions or credits, grants, production quotas, regulation, revision of legal rules or imposition of criminal sanctions, and raising efficacy and equity issues about the various choices).

39. Suppose, for example, that Congress determined that it would be "in the national interest to reduce the consumption of home heating fuels by encouraging" increased thermal efficiency in residential housing. *Id.* at 56. Congress could enact an "income tax credit equal to [the first] 15 percent of the first \$2,000 of [qualified] 'energy conservation expenditures,' . . . estimated to reduce federal revenues by more than \$600 million a year . . . [or provide] an income tax deduction that would result in an equivalent revenue loss." *Id.* The income tax credit or deduction could be provided either to homeowners or to producers of thermal efficiency products (manufacturers of insulation or storm windows, for example). Alternatively, Congress could (1) "[p]rovide individuals [with] a direct subsidy equal to 15 percent of the first \$2,000 of their expenditures" for qualified energy conservation expenditures, or (2) provide manufacturers of thermal efficiency equipment with "direct subsidies totaling \$600 million," or (3) prohibit the distribution of federal funds to any locality whose housing code regulations do not require a certain minimum thermal efficiency, or (4) "require a 'thermal efficiency certificate' to be provided to all purchasers of housing." *Id.*

goals,<sup>40</sup> most have paid little attention to achieving comprehensive coverage for performance-based reforms. They have focused primarily on the need for performance-based review of traditional tax-and-spend government programs and on implementing new regulatory models. This leaves out tax expenditures, which, as explained above, comprise a large and expanding category of government-funded programs. This Article explains the need for an expanded focus, describes efforts made so far to broaden the reach of the performance management requirements, and identifies the types of institutional obstacles that must be overcome if the Results Act is to achieve more comprehensive coverage.

The failure of most reinvention advocates to focus on the performance of tax expenditures may be explained in part by the notion, shared by many in politics and business, that tax expenditures, like tax cuts, reduce the size of government.<sup>41</sup> For those who believe that tax expenditures are largely self-administered by taxpayers and, thus, permit less government involvement, the increased use of tax expenditures is consistent with a perceived need for government downsizing. Alternatively, and more cynically, if the president and members of Congress believe that channeling subsidies through the tax code creates the appearance of reducing the size of government—even though they know that tax expenditures do not really shrink government—re-invention politics may lead to the same result.<sup>42</sup>

Nevertheless, gaps in coverage tend to invite circumvention of reforms through a gradual shifting of programs and resources into less visible or accountable alternatives. Failure to evaluate the performance of tax-delivered programs would, over time, undermine the central reinvention goal of making government more accountable for results. Tax expenditures, once enacted, should be evaluated under standards applicable to functionally related direct expenditures; thus, they should be fully incorporated into the Results Act performance review process.

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40. Reinvention advocates urge experimentation with alternatives to government-provided services. See, e.g., OSBORNE & GAEBLER, *supra* note 6, at app. A (listing alternatives to service delivery by government employees, including regulation or deregulation, monitoring or investigation, legal rules or sanctions, licensing, tax policy, grants, subsidies, loans, loan guarantees, contracting, franchising, public-private partnerships, public-public partnerships, quasi-public or private corporations, public enterprise, procurement, insurance, rewards, changing public investment policy, technical assistance, information, referral, volunteers, vouchers, impact fees, catalyzing nongovernmental efforts, quid pro quos, restructuring the marketplace, or the sale, exchange or use of property).

41. See discussion *infra* note 166 and accompanying text.

42. See generally Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. Rev. 1861, 1926-33 (1994) (discussing political constraints on fiscal policies due to the prominence of the budget deficit and public perceptions about the size of government).

*D. The Need for New Ways for Congress to Structure Program Oversight*

As mentioned above, some of the problems caused by the substitutability of program funding and implementing mechanisms can be addressed by ensuring comprehensive coverage of Results Act reforms. Some obstacles to reform are so deeply embedded in the congressional committee jurisdictional divisions and budgetary processes, however, that they will require new thinking about congressional oversight and budgetary structures. These problems are more intractable. Although the Results Act requires new executive branch reporting and coordination procedures,<sup>43</sup> it attempts no major restructuring of congressional processes. These Results Act requirements, once in place, may prompt discussion of workable ways to modify program oversight structures. Although the primary focus of this Article is on incorporating tax expenditures into the Results Act performance review process, the Article suggests the type of fundamental structural reforms that should be considered in the future.

*E. Plan of Discussion*

This Article is organized into four parts. Part I describes the Results Act performance management and budgeting reforms in greater detail after briefly summarizing the theoretical ideas and political impetus behind them.

Part II examines the efforts made so far to incorporate tax expenditures into the emerging Results Act performance review process<sup>44</sup> and places these developments into context by recounting experience with past efforts at tax expenditure reform. That experience also provides important lessons about the obstacles ahead for broader Results Act reforms.

For readers unfamiliar with tax expenditure reform, Part II provides a brief explanation of tax expenditure theory and the overall impact of its program for legislative reform. Part II then examines the budget and tax reform ideas of tax expenditure analysis more closely, focusing on legislative process proposals, such as sunset provisions, aimed at triggering more meaningful congressional review of tax expenditures.<sup>45</sup> It describes early experience with

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43. See discussion *infra* Part I.B.

44. Steps are being taken, first through pilot studies to establish frameworks for review and next through improved data development, to facilitate a more systematic performance review of tax expenditures. See discussion *infra* Part II.A.

45. Leading tax expenditure theorists have argued that tax expenditures should be identified and included in budget policy analysis as a means of controlling federal expenditures. They also have argued for the elimination, whenever feasible, of tax expenditures from the tax system and, where appropriate, replacement by direct expenditure programs. Accordingly, unlike reinvention reformers, tax expenditure reformers have emphasized the tax system benefits

these reforms and the obstacles that blocked full implementation. Part II ends with a discussion of how intervening budget procedures have made reform more difficult by increasing the separation between tax expenditures and discretionary programs for purposes of policy analysis.

Part III discusses recent experience with congressional review of tax expenditures and functionally-related direct expenditures by examining employment subsidy programs. These programs, which include employer tax credits for wages paid to certain low-income workers—the welfare-to-work tax credit,<sup>46</sup> the work opportunity tax credit,<sup>47</sup> and their predecessors—provide an important example of the institutional obstacles ahead for the Results Act. Although these programs provide employment subsidies to private employers through the income tax code, they have not been self-administering. Experience with tax credits, which have been regularly sunsetted and then extended, shows why tax expenditure analysis has been more effective as a change agent for budgetary analysis than as a tool for achieving meaningful program management and oversight. Part III also illustrates how past efforts at reform have failed to achieve integrated performance review by Congress of both tax expenditure and direct expenditure programs.<sup>48</sup>

Part IV discusses the implications of the failed reform efforts and analyzes prospects for more meaningful review of a broad range of federally funded programs under evolving Results Act reforms. Emerging efforts to incorporate performance review of tax expenditures into the performance-based management and oversight process provide a promising executive branch mechanism—through agency performance management and preparation of the president's annual budget—for achieving more coordinated review of related government programs. The government-wide, performance-based measurement and reporting process should generate information about a broad range of previously unexamined programs. Program performance information is less likely to be used as a budget dodge than mechanical rules, like sunset provisions. Nevertheless, as Parts II and III reveal, budget rules and congressional committee jurisdictional divisions make it quite difficult to achieve a coordi-

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to be gained from reducing the number of tax expenditures in the tax code. Fewer tax expenditures in the tax code, leading tax expenditure theorists have argued, would lead to a more equitable, more efficient, and less complex tax system. See discussion *infra* Part II.B.

46. See I.R.C. § 51A (West Supp. 2000).

47. See *id.* § 51.

48. As used here, “performance review” refers to an evaluation of the effectiveness of a program or subsidy in meeting its goals. An integrated performance review refers to an evaluation of the advantages and disadvantages of providing the subsidy through the income tax code (with or without time limits) versus providing it via a discretionary spending program, an entitlement, or through a regulatory program.

nated review of functionally related direct expenditures and tax expenditures. In the absence of adequate congressional structures to respond to the Results Act program performance information provided by the executive branch, the information will not lead to more effective congressional oversight of tax expenditures or related (or alternative) spending programs.

This Article closes with an example of the type of congressional structural and jurisdictional coordination reforms that should be considered as a next-stage reinvention reform, and raises questions for future analysis and development. As we enter a period of balanced budgets (and surpluses) for the first time since 1969,<sup>49</sup> the changing budgetary and political environment eliminates much of the consensus that led to the budget process rules, nominally in effect through 2002.<sup>50</sup> Increased budgetary flexibility should permit more pragmatic attention to these issues, but it remains to be seen whether both Congress and executive agencies will follow through on the performance management and oversight reforms begun pursuant to the Results Act.

The incremental development of a responsive performance-based review system by Congress could provide an opportunity for more coordinated review of programs delivered by government

49. The surplus reflects cash flow accounting for governmental receipts and payments. This cash flow measure has been criticized as an arbitrary concept, which fails to reflect real economic values or policy commitments for the future. See, e.g., LAURENCE J. KOTLIKOFF, *GENERATIONAL ACCOUNTING: KNOWING WHO PAYS, AND WHEN, FOR WHAT WE SPEND* 143-63 (1992) (arguing in favor of an alternative measure which describes the government's treatment of current and prospective generations over their lifetimes); DANIEL SHAVIRO, *DO DEFICITS MATTER?* 65-150 (1997) (reviewing the debate in economic literature about the deficit); Laurence J. Kotlikoff, *From Deficit Delusion to the Fiscal Balance Rule: Looking for an Economically Meaningful Way to Assess Fiscal Policy*, in *GENERATIONAL ACCOUNTING AROUND THE WORLD* 9, 10-11 (Alan J. Auerbach et al. eds., 1999) (discussing arbitrary nature of government deficits).

50. See Balanced Budget Act of 1997, Pub. L. No. 105-33, §§ 10201-205, 111 Stat. 697-702 (extending discretionary spending limits and pay-as-you-go requirements until October 1, 2002, and to 2003 for expenditures for highways and mass transit); ANALYTICAL PERSPECTIVES, in *BUDGET, FY 2001*, *supra* note 5, at ch. 13, 285-91 (discussing the allocation of the surplus to "complement BEA restraints" in the BEA preview report); cf., e.g., Bud Newman, *U.S. Budget: Clinton's Budget Extends Pay-Go Rules But Uses Surplus to Fund His Tax Cuts*, 26 *DAILY TAX REP.* (BNA) GG-7 (Feb. 8, 2000) (noting that the administration's fiscal 2001 budget documents do not explain how its apparently contradictory surplus allocations and the current budget rules could coexist); 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) (reporting observations by congressional staff that the budget surplus has eliminated the congressional consensus that kept pay-go on the books, that the discretionary spending caps have had more influence than pay-go, and that the latest budget restriction to have an impact on potential tax code changes is the understanding that neither tax cuts nor entitlement spending can result in the use of the social security surplus).

through direct spending as well as through the tax system. The altered fiscal environment presents an opportunity for movement away from the deficit-driven budgetary game-playing that has dominated the legislative process for the last fifteen years.<sup>51</sup> How Congress responds to the program performance information provided by the Treasury and other executive agencies in the budget and program oversight process poses a central challenge for the future.

## I. THE GOVERNMENT PERFORMANCE AND RESULTS ACT OF 1993: AN OVERVIEW

This Part provides an overview of the Results Act and describes the progress made so far in implementing it. The Results Act creates a framework for reviewing government programs based on their results and, thus, provides an opportunity for more systematic assessment of the performance of tax expenditures as well as direct expenditures. The next Part of this Article describes efforts made so far to incorporate tax expenditures into the performance review process. The following sections provide background information for that discussion by setting forth the theoretical and political ideas behind government reinvention and the Results Act, and by outlining the Results Act performance-based criteria and the performance management and budgeting goals and timetables.

### A. *The Theoretical and Political Ideas Behind Reinvention Initiatives*

Because the politics and rhetoric behind reinvention initiatives encompass multiple views about what is wrong with government, and sometimes conflicting conceptions about how the public sector should be organized, reinvention initiatives in this country tend to lack theoretical coherence.<sup>52</sup> However, some of the performance-

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51. For a discussion of the effect of budget reforms on the tax legislative process, see 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); Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501, 503-04 (1998) [hereinafter *Harnessing Politics*] (viewing the changes more positively); Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 668 n.132 (1995) [hereinafter *Paint-by-Numbers*] (citing economic literature on the problems created by the use of revenue estimates in the tax lawmaking process); 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 Karla W. Simon, *The Budget Process and the Tax Law*, 40 TAX NOTES 627, 630-34 (1988) (arguing in favor of including tax expenditures in the budget process).

52. See *supra* note 9 and accompanying text; see also, e.g., Daniel A. Farber, *Triangulating the Future of Reinvention: Three Emerging Models of Environmental Protection*, 2000 U. ILL. L. REV. 61, 68-79 (describing three models for the future of environmental regulation); David L. Markell, *The Role of Deter-*

based reforms adopted in the United States have been informed by management and budgeting reforms adopted in New Zealand, Britain, Australia, and other OECD countries during the 1980s and 1990s,<sup>53</sup> with the New Zealand model figuring prominently in the United States reform discussions.<sup>54</sup> As discussed below, the governmental reforms in New Zealand developed from an analytic framework informed by a relatively coherent theoretical perspective.

Implementation of the New Zealand reforms occurred during a period of budgetary downsizing and a general ideological shift toward political conservatism (preference for a smaller public sector and more reliance on market mechanisms) and was influenced by a desire for greater political control over the bureaucracy as well as greater accountability of the executive to Parliament.<sup>55</sup> The New Zealand public management reforms were shaped by a set of economic and administrative theories, which were articulated and translated into an analytical framework and specific policy proposals by the Treasury.<sup>56</sup> Particularly influential, according to an analysis of the ideas and theories underpinning the New Zealand reforms,<sup>57</sup> were public choice theory,<sup>58</sup> organizational economics (or the

*rence-Based Enforcement in a "Reinvented" State/Federal Relationship: The Divide Between Theory and Reality*, 24 HARV. ENVTL. L. REV. 1, 61-68, 109-14 (2000) (analyzing ideas for reinventing the state/federal environmental enforcement relationship).

53. See *supra* note 8 (listing reports on performance management reforms adopted by member countries). The Organization for Economic Cooperation and Development ("OECD") brings together 29 member countries in an organization in which governments discuss and develop economic and social policy. The original 20 members of the OECD, located only in Europe and North America, were later joined by Japan, Australia, New Zealand, Finland, and then by Mexico, the Czech Republic, Hungary, Poland, and Korea. See *OECD Online* (visited Aug. 4, 2000) <<http://www.oecd.org/about/general/member-countries.htm>>.

54. See OSBORNE & GAEBLER, *supra* note 6, at 328-30.

55. See BOSTON ET AL., *supra* note 2, at 16. The study explains that, historically, New Zealand politics has been dominated by strong prime ministers under single-party majority governments: "Ironically, these very institutional arrangements facilitated the public sector reforms of the mid to late 1980s, which were in some respects a reaction against that style of government." *Id.* at 68.

56. See *id.* at 16 (citing DEPT OF TREASURY, GOVERNMENT MANAGEMENT: VOLUMES I AND II (1987) and DEPT OF TREASURY, ECONOMIC MANAGEMENT (1984)). In considering why the theories and management approaches were "embraced with such enthusiasm in New Zealand," the authors conclude that "part of the answer lies in the gathering together of a group of reform-minded policy analysts in the Treasury, their familiarity with the new institutional economics and public choice, and their sustained efforts to apply this literature to the problems of governance in the public sector." *Id.* at 28. In addition, they note that "these efforts might well have been in vain had it not been for the openness of senior ministers to the Treasury's proposals and their willingness to implement them, notwithstanding the political risks involved." *Id.*

57. The study, by four academics from the fields of public policy, accountancy, and industrial relations at Victoria University at Wellington, documents

new institutional economics, especially agency theory and transaction cost economics),<sup>59</sup> and managerialism (or the new public management).<sup>60</sup>

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and analyzes the public sector reforms introduced in New Zealand since the mid 1980s. *See id.* at vii-x.

58. According to the New Zealand study, public choice theory influenced the "climate of opinion" within which the model developed—"with its emphasis on the budget-maximizing behavior of bureaucrats, its suspicion of politicians' motives, and its concern over provider capture." *Id.* at 17, 27. It also inspired, at least in part, the New Zealand model's "drive to separate the provision of policy advice from policy implementation," the "emphasis on transparency (e.g. in the area of state subsidies and other political interventions), the various attempts to curb the role of vested interests in governmental policy-making," and the "efforts to reduce the scope for political interference in certain policy domains (e.g. monetary policy)." *Id.*; *see also, e.g.*, WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971) (analyzing theories of bureaucratic decision-making).

59. Although the study notes that public choice theory and managerialism influenced public sector reforms in many other countries, it observes that this has been less true of organizational economics, making the "intellectual origins" of the New Zealand reforms "distinctive" in this regard. BOSTON ET AL., *supra* note 2, at 17. According to the study, agency theory (understanding social and political life as a series of contracts between principals and agents) "played an important role in developing the policy framework that underpinned the corporatisation and privatisation programmes." *Id.* at 18, 27.

[Agency theory] influenced thinking on matters relating to employment relations, incentive structures, remuneration systems, and performance management, contributing, for instance, to the move to fixed-term employment contracts for senior public servants, the emphasis on the relationship between ministers and departmental [chief executives], and the introduction of [chief executive] performance agreements and monitoring arrangements.

*Id.* at 27.

The study notes that the influence of transaction-cost economics (closely related to agency theory, but focusing primarily on the exchange of physical goods rather than on the exchange of services, and dealing with the optimal governance structures for various types of transactions) is more difficult to trace, but connects these ideas with "heightened interest in various forms of contracting" and that concepts underpinning transactional cost economics "have been widely used, especially by the Treasury, in formulating policy on issues of institutional design." *Id.* at 21, 27. *See generally* Edward L. Rubin, *Commentary: The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1413-16 (1996) (describing the new institutional economics and summarizing the work of Oliver E. Williamson, Douglass North, and others).

60. The authors of the study describe "managerialism" as "[d]riven primarily by practitioners and private sector consultants rather than academics or theoreticians" and that its "slogans include the now familiar 'Let the Managers Manage' and 'Managing for Results.'" BOSTON ET AL., *supra* note 2, at 25. They observe the influence of managerialism in the way policy debates have been "characterised by a frequent resort to private sector analogies and commercial models to explain or critique public sector arrangements." *Id.* at 27-28.

In addition, the study describes "a remarkably close fit" between the doctrines of managerialism and the policy decisions of the New Zealand model, including "the shift from process to output accountability," as well as the empha-

Although reinvention initiatives in the United States have not been forged from a comparably articulated analytical framework, the New Zealand model, as well as ideas from other countries and from states and localities in this country, have provided a set of policy ideas for the federal reforms.<sup>61</sup> The performance-based management reforms, based on managerialism (or new public management), developed from a set of ideas more influenced by management consultants and private sector business practices than by economic or political theory.<sup>62</sup>

In the United States, the performance-based reinvention initiatives have been fueled primarily by the desire for greater administrative control over the bureaucracy, combined with both ideological and budget-driven efforts toward government downsizing.<sup>63</sup> The Clinton administration's major government reinvention initiative, the National Partnership for Reinventing Government ("NPR"), formerly known as the National Performance Review,<sup>64</sup> has focused on improving the performance of federal executive agencies while, at the same time, holding down costs.<sup>65</sup> The NPR recommends increased flexibility for agencies in the use of resources in exchange for greater executive oversight and accountability.<sup>66</sup> Although the NPR has endorsed implementation of the Results Act,<sup>67</sup> it has not generally addressed the issue of the agencies' dealings with Congress,<sup>68</sup> other than advocating relief from "wasteful" congressional

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sis on consumers, cost-cutting and labor discipline, the preference for private ownership and contracting out, the disaggregation of bureaucratic structures, and the adoption of private sector management practices. *Id.* at 28.

61. For example, the NPR describes the performance agreements ("specific commitments, accompanied by measurable performance indicators") that President Clinton is signing with Cabinet secretaries and other agency heads as another "cornerstone," along with the Results Act, of the "new accountability." NATIONAL PERFORMANCE REVIEW, CREATING A GOVERNMENT THAT WORKS BETTER & COSTS LESS 41 (September 1994 Status Report). In implementing these reforms, the administration studied similar agreements used in Australia, Canada, New Zealand, and the United Kingdom, and also looked to agreements and other approaches utilized in Sunnyvale, California and by the state of Oregon. *See id.* at 43.

62. *See supra* note 60.

63. *See supra* note 10.

64. *See supra* note 7.

65. *See* NATIONAL PERFORMANCE REVIEW, FROM RED TAPE TO RESULTS, *supra* note 7, at 2.

66. *See id.* at 7 (recommending increased agency budgetary flexibility and "empowering employees to get results" by decentralizing decision making power and holding federal employees accountable for results).

67. *See id.* (specifying that the Results Act "will introduce performance measurement throughout the federal government").

68. *See* Mashaw, *supra* note 16, at 413. Mashaw states:

On the political side, for example, NPR I seems committed to a "Greyhound theory" of congressional legislation and oversight. "Just tell us the destination and leave the driving to the front line administrators," seems to be the message to Congress. Indeed, it is hard to see how

restrictions or micromanagement.<sup>69</sup>

The legislative desire for greater control over the bureaucracy has been less prominent than the executive's goal of achieving greater administrative control through performance-based management.<sup>70</sup> Nevertheless, that desire, at least in part, underlies the Results Act structure for congressional oversight of agency performance management reforms. In addition, some members of Congress may perceive the reforms as leading to new power centers in Congress.<sup>71</sup> These oversight reforms and other legislatively imposed regulatory reforms, which increase accountability for agency rule-making,<sup>72</sup> have the potential to clash with the executive's reinvention agenda to improve agency flexibility and efficiency.

The emphasis on these potentially conflicting aspects of the reinvention agenda tend to shift, depending on which political party controls the executive and the legislative branches of government.

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moving authority down the hierarchy could fail to lessen congressional control of public policy. . . . This is unlikely to be supported by a Congress already concerned about its ability to oversee the federal administrative establishment.

*Id.*

For development of the argument for increased regulatory flexibility, see Timothy A. Wilkins & Terrell E. Hunt, *Agency Discretion and Advances in Regulatory Theory: Flexible Agency Approaches Toward the Regulated Community as a Model for the Congress-Agency Relationship*, 63 GEO. WASH. L. REV. 479 (1995) (arguing that agencies should be delegated more control over regulatory method and proposing outcome-based performance standards to guide agency discretion). *But cf.* Matthew Diller, *The Revolution in Welfare Administration: Rules, Discretion, and Entrepreneurial Government*, 75 N.Y.U. L. REV. 1121, 1212-18 (2000) (arguing that the new entrepreneurial model raises serious questions of public accountability).

69. See NATIONAL PERFORMANCE REVIEW, THE BLAIR HOUSE PAPERS pt. III, § 4 (Jan. 1997) (urging the cabinet to "reinvent to get the job done with less" by seeking "Congressional relief from wasteful restrictions"); NATIONAL PERFORMANCE REVIEW, FROM RED TAPE TO RESULTS, *supra* note 7, at 32 (eliminating "regulatory overkill" by reducing the burden of congressionally mandated reports); see also, e.g., Garvey, *supra* note 12, at 87-106 (recounting the history of reform efforts to construct administrative capacity and to ensure the responsiveness of the bureaucracy to the legislative branch, and observing that "much of the point of the NPR [National Performance Review] is to undo—or at least to moderate—the instruments of bureaucratic control that Americans have inherited from the scientific managers and administrative lawyers").

70. See *Building Lasting Reform*, *supra* note 12, at 69.

71. See *id.* at 68-70 (noting that most Members of Congress have "little incentive to worry about results" but "everything to gain from publicly embracing the broad principles of reinvention and then protecting their constituents and favorite programs behind the scenes in committee rooms and little-noticed riders to complex bills," but that members of the House Government Operations Committee and the Senate Government Affairs Committee recognize that these issues have "created the potential for new power centers in Congress").

72. See Mashaw, *supra* note 16, at 420 (stating that, "[w]hile arguably reinforcing the accountability, reasonableness, and procedural fairness of administrative policy-making, these 'regulatory reform' proposals are designed to stall and derail many rule-making efforts").

Although the Results Act was enacted in 1993 by a Democratic Congress and embraced by the Clinton administration, one of its most vocal supporters was Senator William V. Roth, Jr. (R., Del.).<sup>73</sup> The legislative antecedent of the Results Act was drafted during the Bush administration and championed in its original and later forms by Senator Roth,<sup>74</sup> who had served during the Reagan administration as chair of the Governmental Affairs Committee.<sup>75</sup>

### B. *The Results Act Framework: Performance-Based Management and Budgeting*

The Results Act creates a new performance-based framework for management and oversight of government programs.<sup>76</sup> The framework, as described below, requires executive agencies to set goals for program performance,<sup>77</sup> to measure performance results,<sup>78</sup>

73. See William V. Roth, Jr., *Reinventing Government: Maintaining the Momentum*, 22 PUB. MANAGER 15 (1993-94). Senator Roth was defeated in his bid for reelection in November 2000. See Eric Schmitt, *The 2000 Elections: The Senate*, N.Y. TIMES, Nov. 9, 2000, at B11. He served as chair of the Senate Finance Committee prior to his defeat. See *id.*

74. See Roth, *supra* note 73, at 15 (describing bipartisan reform efforts and referring to Vice President Gore's National Performance Review as "a strong and natural manifestation of the momentum which has been building concerning government reform"); Christopher H. Foreman, Jr., *Reinventing Politics?: The NPR Meets Congress*, in INSIDE THE REINVENTION MACHINE: APPRAISING GOVERNMENTAL REFORM, *supra* note 7, at 152, 159 (noting that Roth's "frustration with government's focus on inputs rather than results meshed with a new Democratic administration's desire for significant administrative reform that did not simply gut programs"); see also 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 Results Act, a Reagan administration OMB report, legislation proposed by Senator Roth based on experiences over the previous decade in Sunnyvale, California, and the requirements regarding program performance measures and information in the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (codified beginning at 31 U.S.C. § 501)).

75. The Senate Governmental Affairs Committee has jurisdiction, among other matters, over the organization and reorganization of the executive branch, the Federal Civil Service, the census, intergovernmental relations, and is charged with studying "the efficiency, economy, and effectiveness of all agencies and departments of the Government." SENATE MANUAL CONTAINING THE STANDING RULES, ORDERS, LAW AND RESOLUTIONS AFFECTING THE BUSINESS OF THE UNITED STATES SENATE, S. DOC. NO. 104-1, at 31-32 (1994). The House Committee (which has similar jurisdiction), formerly the Government Operations Committee, is now called the Committee on Government Reform.

76. 31 U.S.C. § 1115(a) (1994).

77. See 5 U.S.C. § 306(a)-(f) (1994) (requiring agency strategic plans for program activities); 31 U.S.C. § 1115(a)(1)-(3) (regarding performance goals in agency performance plans), (f)(4). For purposes of the performance plans and reports, a "performance goal" is defined as "a target level of performance expressed as a tangible, measurable objective, against which actual achievement can be compared, including a goal expressed as a quantitative standard, value, or rate." *Id.* at § 1115(f)(4).

and to report the results on an annual basis to the president and Congress.<sup>79</sup> The framework gives managers greater flexibility by allowing the waiver of various administrative controls and limitations in exchange for greater accountability for the performance of their programs and operations.<sup>80</sup> As explained below, the Results Act also provides for the development and testing of performance-based budgeting, although that part of the overall reform program has made relatively little headway.<sup>81</sup>

In enacting the Results Act, 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 policy making, spending decisions and program oversight are seriously handicapped by insufficient attention to program performance and results.”<sup>82</sup> The purposes of the Results Act, 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 decision making by providing more objective information on achieving statutory objectives, and on the relative effectiveness and efficiency of Federal programs and spending.”<sup>83</sup>

### 1. Performance Management

The Results Act initially created pilot programs to assess the costs and benefits of the performance-based management framework

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78. See 31 U.S.C. § 1115(a)(4)-(6).

79. See *id.* § 1116.

80. See *id.* § 9703 (providing for OMB review and approval of agency proposals to waive administrative procedural requirements and controls); 31 U.S.C.A. § 9704 (West 2000) (providing for pilot projects to test the managerial accountability and flexibility provisions and requiring a report by OMB by May 1, 1997); see also EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, THE GOVERNMENT PERFORMANCE AND RESULTS ACT REPORT TO THE PRESIDENT AND CONGRESS FROM THE DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET, I.B.2., I.B.7. (May 1997) [hereinafter 1997 OMB RESULTS ACT REPORT] (reporting on the reasons for the lack of designations for flexibility pilot projects, including the reforms earlier adopted as part of the National Performance Review and the efforts underway to create “Performance Based Organizations,” which are given greater personnel and procurement flexibility for a commitment to achieve specific improvements in performance).

81. See 1997 OMB RESULTS ACT REPORT, *supra* note 80, at I.C.

82. Pub. L. No. 103-62, § 2(a), 107 Stat. 285 (including, in addition to the two findings mentioned in the text, a finding about waste and inefficiency in federal programs).

83. *Id.* § 2(b) (articulating six purposes for the Results Act including, in addition to the two mentioned in the text, improving the confidence of the American people in the federal government, initiating program performance reform with a series of pilot projects, helping managers improve service delivery, and improving the internal management of the federal government).

as well as to test the specifications for performance plans.<sup>84</sup> Congress required the OMB to report the results of the performance management pilot studies to the president and Congress by May 1, 1997, and since then, the requirements have been more broadly implemented.<sup>85</sup> The Results Act now more generally requires federal agencies<sup>86</sup> to develop multiyear strategic plans,<sup>87</sup> annual performance plans,<sup>88</sup> and annual program performance reports.<sup>89</sup> The Results Act also requires the OMB to prepare a government-wide performance plan, based on the agencies' performance plans, as part of the president's budget presentation to Congress.<sup>90</sup>

Under the Results Act requirements, an agency's performance plans and reports are to cover each of their program activities listed in the annual budget.<sup>91</sup> The performance plans must "establish performance indicators to be used in measuring or assessing the relevant outputs, service levels, and outcomes of each program activ-

84. 31 U.S.C. § 1118(a)-(b) (1994).

85. See 31 U.S.C. § 1118(c); see also 1997 OMB RESULTS ACT REPORT, *supra* note 80, at Introduction (reporting on agency progress and efforts in meeting the requirements of the Results Act).

86. The Results Act applies to cabinet departments, government corporations (owned or controlled by the federal government), and nearly all independent establishments. See 31 U.S.C. § 1115(f) (referring to 5 U.S.C. § 306(f), which, in turn, refers to "executive agency" as defined in 5 U.S.C. § 105 (2000), but not including the Central Intelligence Agency, the General Accounting Office, the Panama Canal Commission, the United States Postal Service, and the Postal Rate Commission). The OMB may also exempt from certain requirements any agency with annual outlays of \$20 million or less. See 31 U.S.C. § 1117.

87. 5 U.S.C. § 306(b) (1994). The strategic plans must cover at least a five-year period, and must be updated and revised every three years (except for the Department of Defense, which is required to update and revise its plan every four years). See 5 U.S.C. at § 306(b).

88. 31 U.S.C. §§ 1105(a)(28), 1115(a) (1994 & Supp. IV 1998) (beginning with a performance plan for fiscal year 1999, which began on October 1, 1998, comparing performance with the goals set in the annual performance plan).

89. *Id.* § 1116(a) (1994) (beginning with the annual report for fiscal year 1999, due on March 31, 2000).

90. *Id.* § 1105(a)(28) (Supp. IV 1998). In the agency and government-wide performance plans, the program performance goals correspond with the program funding categories in the budget.

91. *Id.* § 1115(a), (f)(6) (1994). 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." *Id.* § 1115 (f)(6); see also BUDGET, FY 2001, *supra* note 5, at app. (detailing the information provided by the "program and financing schedule," which includes "obligations by program activity," and explaining that the "activity structure is developed for each appropriation or fund account to provide a meaningful presentation of information for the program"). The detailed budget estimates, designed primarily for use by the Appropriations Committees, are arranged according to each separate branch of government, with the executive branch organized by agency. Tax-delivered programs are not listed in the Treasury Department's program and financing schedules unless they involve direct outlays (for example, refundable tax credits).

ity."<sup>92</sup> An "output measure" is defined as "the tabulation, calculation, or recording of activity or effort and can be expressed in a quantitative or qualitative manner."<sup>93</sup> An "outcome measure" is defined as "an assessment of the results of a program activity compared to its intended purpose."<sup>94</sup>

Steady progress has been made toward implementing the statutory requirements. Agencies have been developing and submitting plans and reports to the OMB, the OMB has undergone a major reorganization to respond to Results Act requirements,<sup>95</sup> and congressional committees review agency Results Act plans and reports as part of the oversight process.<sup>96</sup> Although the efforts have been uneven, a government-wide shift toward performance management implementation is now unmistakably underway.

## 2. Performance Budgeting

In addition to implementing government-wide performance management requirements, the Results Act provides for experimentation with performance budgeting.<sup>97</sup> The concept of performance

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92. 31 U.S.C. § 1115(a)(4).

93. *Id.* § 1115(f)(3).

94. *Id.* § 1115(f)(2).

95. *See Building Lasting Reform, supra* note 12, at 9, 60-64.

96. *See, e.g.,* H.R. REP. NO. 106-78, at 3 (1999) (containing the observation by the Committee on Government Reform that the use of the Results Act "is affirmed in most committee oversight plans" and recommending that "each House committee continue using agency strategic plans and performance plans mandated by the Results Act as a basis for conducting oversight of agencies and programs in its jurisdiction, and for holding government more accountable for the activities and services it delivers"); H.R. REP. NO. 105-429, at 45 (1998) (describing the agency strategic plan consultation process with Congress, with congressional teams formed around each of the twenty-four largest federal agencies and departments, and criticizing and grading the draft strategic plans).

97. The performance budgeting provisions of the Results Act will require additional legislation before they can be more broadly implemented. Some of the ideas behind performance budgeting developed from progressive era proposals for a national executive budget, first proposed in 1912 by President Taft's Commission on Economy and Efficiency. *See* MESSAGE OF THE PRESIDENT OF THE UNITED STATES TRANSMITTING REPORT OF THE COMMISSION ON ECONOMY AND EFFICIENCY ON THE SUBJECT OF THE NEED FOR A NATIONAL BUDGET, H.R. DOC. NO. 62-854, at 1-12 (2d Sess. 1912). *See generally* RONALD C. MOE, REORGANIZING THE EXECUTIVE BRANCH IN THE TWENTIETH CENTURY: LANDMARK COMMISSIONS 11, 18-21 (CRS Report for Congress No. 92-293, Mar. 19, 1992) (describing the rise and fall of progressive movement organizational ideas and observing that presidents today tend to "view the design of organizational structures as simply a chip to be played in the larger game of politics"); JAMES L. SUNDQUIST, THE DECLINE AND RESURGENCE OF CONGRESS 37-60 (1981) (describing the shift in managerial authority and fiscal leadership from Congress to the president as beginning with the Budget and Accounting Act of 1921, as expanding during the Roosevelt administration, and as receiving more bipartisan support after the first report of the Hoover Commission on government reorganization in 1949, which contributed to reorganization of the executive branch

budgeting is to link performance information with the budget to “improve budget decision making by focusing funding choices on program results.”<sup>98</sup> The Act calls on the OMB to designate pilot projects in at least five agencies to test preparation of performance budgets for fiscal years 1998 and 1999.<sup>99</sup> A report to Congress by the OMB on the pilot projects is due by March 31, 2001.<sup>100</sup>

Under the Act, the performance-budgets pilot projects “shall present, for one or more of the major functions and operations of the agency, the varying levels of performance, including outcome-related performance, that would result from different budgeted amounts.”<sup>101</sup> The Results Act directs the OMB to include in its report a description of any difficulties encountered by the pilot agencies in preparing performance budgets,<sup>102</sup> an assessment of the feasibility and advisability of including a performance budget as part of the annual budget submitted to Congress,<sup>103</sup> and a recommendation whether legislation to require performance budgeting should be proposed.<sup>104</sup>

Relatively little progress has been made so far on the performance-based budgeting aspects of the Results Act, except at a very basic level. In 1997, the OMB reported that it had deferred the selection of pilot projects.<sup>105</sup> The government’s General Accounting Of-

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into a hierarchy controllable from the top); AARON WILDAVSKY, *THE NEW POLITICS OF THE BUDGETARY PROCESS* 53-64 (1988) (describing the early twentieth century executive budget movement).

During the last forty years, several budget reform initiatives have been implemented by executive directive, including the Program, Planning, and Budgeting System (PPBS) in the 1960s, the Management by Objective (MBO) and Zero-Base-Budgeting (ZBB) programs in the 1970s, followed in the 1980s by productivity improvement, quality management, and a short-lived revival of MBO. See GAO, *PERFORMANCE BUDGETING: PAST INITIATIVES OFFER INSIGHTS FOR GPRA IMPLEMENTATION*, GAO/AIMD-97-46, at 4 (1997) (tracing interest in performance budgeting to the first Hoover Commission and its reforms to downsize the post WWII government, describing prior budget reforms, and comparing and contrasting the earlier reform efforts to the Results Act); Groszyk, *supra* note 74, at 73 (1996) (noting that these initiatives “largely failed to take root” beyond the end of a presidential term and distinguishing the Results Act from earlier efforts).

98. GAO, *REPORT TO THE CHAIRMAN, COMM. ON GOVERNMENTAL AFFAIRS, U.S. SENATE, PERFORMANCE BUDGETING: INITIAL EXPERIENCES UNDER THE RESULTS ACT IN LINKING PLANS WITH BUDGETS*, GAO/AIMD/GGD-99-67, at 4 (1999) [hereinafter *GAO PERFORMANCE BUDGETING REPORT*].

99. 31 U.S.C. § 1119(a) (1994).

100. See *id.* § 1119(d).

101. *Id.* § 1119(b).

102. *Id.* § 1119(d)(2).

103. *Id.* § 1119(d)(1).

104. *Id.* § 1119(d)(3) (1994). In addition, the OMB is directed to set forth recommended changes in other Results Act requirements. *Id.* § 1119(d)(4).

105. The 1997 OMB Report to Congress explained a planned one-year delay in selecting performance budgeting pilot projects as follows:

Correlating different levels of performance with different funding levels can be seen as one form of performance budgeting. Performance is measured using a single variable. Another form, outlined in

fic ("GAO") last year reported to the Senate Committee on Governmental Affairs an indefinite delay in the performance budgeting pilots called for by the Results Act and recommended that the OMB "develop a constructive and practical agenda to further clarify the relationship between budgetary resources and results."<sup>106</sup> Although the GAO found that agency performance plans have begun to display linkage between budget requests and performance goals,<sup>107</sup> it noted that pilot projects were intended to show more specifically "how performance would change if the agency received more or less than requested."<sup>108</sup> The GAO explained the delay in the pilot projects by reference to the OMB's determination that the performance budgeting pilot projects would require agencies to calculate the effects on performance of marginal changes in cost and funding, a task beyond the current capabilities of most agencies.<sup>109</sup>

Although functional presentation of budget information<sup>110</sup> is now

the Senate Committee Report on GPRA envisions the use of multi-variate analysis. In doing this analysis, the performance budgeting pilots would examine the varying performance levels for each measure in a group of measures, and how these levels relate to funding amounts and changes in these amounts. As certain performance levels are emphasized above others, the pilot projects would describe the choices and tradeoffs made in the course of defining the preferred performance levels for a program.

This technique often also known as optimization analysis, is largely beyond the current capacity of many Federal agencies to do.

Agencies designated as a performance budgeting pilot project, and doing multi-variate analysis, should have adequate cost accounting systems. For the programs or operations covered by the pilot projects, the agencies should also possess baseline data for both performance measures and the cost of achieving different performance levels for each measure. This will be needed if agencies are to calculate how marginal changes in funding incrementally affect the performance levels.

Significant progress has occurred in recent years in establishing a cost accounting capability in the Federal agencies. . . . For the few agencies presently having a cost accounting capability, their ability to develop marginal cost information is very limited. OMB's assessment of the current extent of cost accounting capability among the agencies was an important factor in deciding to defer the start of the performance budgeting pilot projects.

1997 OMB RESULTS ACT REPORT, *supra* note 80, at I.C (reporting on the performance budgeting pilot projects required by the Results Act).

106. GAO PERFORMANCE BUDGETING REPORT, *supra* note 98, at 3, 5-8, 37 (recommending that the OMB assess the linkages between performance goals and program activities presented in the fiscal year 2000 plans and then develop its agenda to clarify the relationship between resources and results, "beginning with specific guidance for the preparation of agencies' fiscal year 2001 plans").

107. *Id.* at 12-28.

108. *Id.* at 7.

109. *Id.* at 7, 31-34.

110. For discussion of functional budgeting, in which budget resources are grouped and allocated according to the purposes or objectives they serve, see *infra* note 173 and accompanying text.

included as part of the government-wide performance plan in the president's budget submission,<sup>111</sup> it is unclear whether the Results Act will ever lead to development of performance-based budgetary analysis. As experience with reform in other countries has shown, performance-based budgeting is more likely to be achieved in a setting with full cost activity accounting,<sup>112</sup> with output-based budgeting (rather than input-based line item budgeting), and in which the programs being evaluated consist of a set of tangible and measurable products or services with visible effects soon after the services or products are provided.<sup>113</sup> Therefore, it remains to be seen whether the Results Act will prompt next-stage developments, which might eventually lead to a broader structural reform of the budget process. Accordingly, the following discussion focuses primarily on the performance-based management aspects of the Results Act.

## II. INCORPORATION OF TAX EXPENDITURES INTO THE RESULTS ACT FRAMEWORK

As described above, the Results Act, now in its formative stages, offers an opportunity for more integrated analysis of programs through a combination of executive and legislative performance review of federal agencies and programs. The Results Act requires agencies to develop multi-year strategic plans for their program activities, to establish measurable performance goals, and to develop annual plans to help them meet their performance goals. They then must report their progress annually to the president and to Congress.

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111. See, e.g., BUDGET, FY 2001, *supra* note 5, 166-69 & tbl.10-1 (including budget function estimates for spending, credit activity, and tax expenditures), 171-287 (discussing programs by budget function and incorporating tax expenditures into presentation); EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF UNITED STATES GOVERNMENT, FISCAL YEAR 2000, at 39, 41, ch. VI tbl.12-1 (1999) [hereinafter BUDGET, FY 2000] (describing the increased emphasis on functional analysis in presentation of the budget as part of the "reinventing government" efforts under the Government Performance and Results Act of 1993).

112. See Groszyk, *supra* note 74, at 77 (explaining that cost accounting data will be required for "optimization analyses," which presents "choices and trade-offs between different levels of performance for the same or different budget levels").

113. See generally, e.g., BOSTON ET AL., *supra* note 2, at 260-314 (describing New Zealand's financial management and budget reforms, which shifted a traditional focus on annual cash costs of inputs (staff, maintenance, materials, travel, etc.) to an emphasis on output budgeting and accrual accounting); OECD, PUBLIC MANAGEMENT SERVICE, INTEGRATING FINANCIAL MANAGEMENT AND PERFORMANCE MANAGEMENT, PUMA/SBO-(99)4/FINAL, at 9, 13-15 (1999), available at <[http://www.olis.oecd.org/olis/1999doc.nsf/63c71d2d4054d0fdc125685d0053aee4/4a1f6b123769a96fc12567b70042a366/\\$FILE/07E97729.ENG](http://www.olis.oecd.org/olis/1999doc.nsf/63c71d2d4054d0fdc125685d0053aee4/4a1f6b123769a96fc12567b70042a366/$FILE/07E97729.ENG)> (explaining that performance management and budgeting have tended to operate in separate spheres in member countries and discussing the technical and political reasons why integration is difficult and often does not take place).

The following discussion describes the efforts made so far to incorporate tax expenditures into the Results Act framework, puts these steps toward reform into context by describing past efforts at tax expenditure reform, and then explains why budget process reforms have made tax expenditure reform more difficult.

A. *Tax Expenditures and the Results Act*

In its report on the bill that became the Results Act, the Senate Committee on Governmental Affairs emphasized the need for increased oversight and analysis of tax expenditures and called on the OMB to develop a framework for periodic analysis of the effect of tax expenditures on the achievement of the goals and objectives in strategic and annual plans.<sup>114</sup> In outlining its expectations,<sup>115</sup> the Committee specified that the government-wide “performance plans should include a schedule for periodically assessing the effects of specific tax expenditures in achieving performance goals” and that the “annual performance reports would subsequently be used to report on these tax expenditure assessments.”<sup>116</sup> The assessments “should consider the relationship and interactions between spending programs and related tax expenditures.”<sup>117</sup> Finally, the Committee expressed the hope “that such reports will foster a greater sense of responsibility for tax expenditures with a direct bearing on substantial missions and goals.”<sup>118</sup>

The GAO made some more detailed suggestions to the OMB and to the Treasury regarding Results Act-related reforms in a study of tax expenditures published in 1994.<sup>119</sup> In its report, the GAO re-

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114. See S. REP. 103-58, at 27-28 (1993). In addition to calling on the OMB to establish an appropriate analytical framework, and to describe the framework in OMB's 1997 report to Congress and the president, the Committee called for a periodic assessment of the effects of specific tax expenditures in meeting performance goals. See *id.* at 28.

115. See *id.* at 28. The Report stated as follows:

To increase significantly the oversight and analysis of tax expenditures, the Committee believes that the annual overall Federal Government performance plans should include a schedule for periodically assessing the effects of specific tax expenditures in achieving performance goals. (This schedule would be in addition to the primary content of the overall plan—the program performance goals tied to the direct expenditure of funds.) The Committee expects that annual performance reports would subsequently be used to report on these tax expenditure assessments. These assessments should consider the relationship and interactions between spending programs and related tax expenditures. The Committee hopes that such reports will foster a greater sense of responsibility for tax expenditures with a direct bearing on substantial missions and goals.

*Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. GAO, TAX POLICY: TAX EXPENDITURES DESERVE MORE SCRUTINY,

viewed the advantages and disadvantages of various general options that could be used to control the growth of tax expenditures.<sup>120</sup> The GAO report discussed three main options: (1) strengthening or extending current techniques for controlling tax expenditures with little or no change in congressional processes and jurisdictions;<sup>121</sup> (2) increased integration of tax expenditures into the budget process;<sup>122</sup> or (3) more integrated reviews of tax expenditures with functionally related outlay programs.<sup>123</sup>

The report's first and third options have the greatest applicability to the Results Act performance management reforms. With regard to the first option, incorporating tax expenditures into the

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GAO/GGD/AIMD-94-122 (1994) [hereinafter GAO TAX EXPENDITURE STUDY].

120. *Id.* at 95 (summarizing the agency's conclusions).

121. These techniques include controls on individual tax expenditures by imposing ceilings or floors on eligibility, requiring the reporting of information on tax expenditures, or imposing periodic review on them through sunset provisions. Ceilings on eligibility include caps on the amount of activity that qualifies for the tax benefit or on the amount of benefit a taxpayer can receive in a given year. Floors require a taxpayer to spend a certain amount on an activity before qualifying for the benefit. *See* GAO TAX EXPENDITURE STUDY, *supra* note 119, at 3, 39-56. For examples of such provisions, see *infra* Parts III.B and III.C (describing the employment tax credits).

122. One such approach discussed in the GAO study would be for Congress to decide whether cuts in existing tax expenditures are desirable and, if so, to set specific targets for reduction in foregone revenue in annual budget resolutions. The cuts would then be enforced through the existing budget reconciliation process. Although these steps could be accomplished within the framework of current budget procedures, this approach would expand the role of the budget committees in tax policymaking. *See generally* GAO TAX EXPENDITURE STUDY, *supra* note 119, at 3-4, 57-70.

123. *See generally* GAO TAX EXPENDITURE STUDY, *supra* note 119, at 4, 71-93. In its discussion of the third option, the GAO described an integrated review system, temporarily used by Canada, as follows:

In the 1980s, Canada tried and subsequently discontinued a formal system of integrating proposed tax expenditures into its policy-making process. This system involved the allocation of overall expenditures into nine "envelopes," with increased flexibility for program departments to make trade-offs from one spending program to another within each "envelope." The envelope system subtracted the revenue cost of any new or expanded tax expenditure from the targeted amount available for spending within the program envelope. According to Treasury officials, the envelope system may have failed in part because the finance minister had the flexibility to propose new tax expenditures, thus undermining the discipline intended by the process. However, any revenue savings from proposals to reduce existing tax expenditures in an "envelope" were not automatically allocated to that envelope. Therefore, this system did not provide an incentive to make trade-offs between existing tax expenditures and other spending programs within a given functional area.

If Congress or the executive branch adopts an integrated system for reviewing outlay programs and tax expenditures, incentives for making such trade-offs may be necessary.

*Id.* at 73.

Results Act framework, without more, would require the executive branch to make more information available about tax expenditures, but it would not necessarily require changes in congressional procedures.<sup>124</sup> With regard to the third option, the GAO report observed that more integrated reviews of functionally related programs could "make the government's overall funding effort more efficient" and "could be done by the executive or legislative branches, or both."<sup>125</sup>

The GAO report noted that "[b]ecause fewer jurisdictional hurdles would arise, the executive branch annual budget preparation process may offer a more expeditious opportunity" than integrated Committee procedures<sup>126</sup> to implement reviews of spending programs and related tax expenditures.<sup>127</sup> The GAO report observed that the Results Act, when implemented, could provide "a link between budget reviews and an assessment of how well tax expenditures and outlay programs meet agency performance goals,"<sup>128</sup> and that the "OMB, in consultation with Treasury, could develop a process to annually review selected tax expenditures in conjunction with the budget review process for related spending programs."<sup>129</sup> The roles of the OMB, the Treasury, and the agencies with direct expenditure programs "would need to be established to most effectively assess tax expenditures' performance, as well as their interaction with related spending programs."<sup>130</sup>

In its 1997 Results Act report to Congress, the OMB set forth an

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124. *Id.* at 52-53.

125. GAO TAX EXPENDITURE STUDY, *supra* note 119, at 4. Increased coordination could reduce overlap and inconsistencies among programs. As noted in the GAO study, current budget and tax policy processes "provide no systematic way of avoiding duplication and overlap among discretionary spending programs and tax expenditures that serve similar purposes." *Id.* at 71.

126. *Id.* at 7.

127. The GAO recommended that joint review of spending programs and related tax expenditures be implemented by holding joint hearings or, more formally, by adopting sequential jurisdiction for tax expenditure subsidy programs or by establishing joint committees in functional areas. *See id.* at 6-7, 73-76.

128. *Id.* at 92.

129. *Id.* at 97. The Treasury's comments on the GAO study agreed "that a more comprehensive periodic review of tax expenditures would be useful" (Option 1). *Id.* at 132. The Treasury was not convinced that either Option 2 or 3 would provide the benefits anticipated in the report, however. The Treasury pointed out that tax expenditures are already subject to budget discipline under the "pay-go" rules. *See id.* at 132. The Treasury cautioned that measurement and conceptual problems underlying tax expenditure estimates would be quite serious if tax expenditures were explicitly integrated into the budget process (Option 2). With regard to Option 3, the Treasury pointed out that the Canadian experience with incorporating tax expenditures into their budget process (by assigning responsibility for the cost of new tax expenditures to the program minister proposing the expenditure) had not been very encouraging. Although it led "to a significant reduction in demands for new tax expenditures by the program ministers," it did not last long. *Id.* at 134.

130. *Id.* at 92.

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.”<sup>131</sup> The framework gave the Treasury “lead responsibility for pilot evaluations of several selected tax-expenditure provisions . . . [t]o explore methods for tax expenditure evaluation” and “to gather experience on a cross-section of issues.”<sup>132</sup>

The Treasury’s initial pilot study selected three tax expenditures—one from each of the separate areas of individual, business, and international taxation<sup>133</sup>—to study the evaluation methods and resource needs connected with evaluating the relationship between tax expenditures and performance goals. The Treasury found that much of the data needed for analysis is not currently available.<sup>134</sup> 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.”<sup>135</sup> The Treasury plans to undertake additional studies in the next few years.<sup>136</sup>

The above described movement toward performance review within the government, with corresponding increased congressional oversight over executive agencies, may eventually provide the information needed for analysis of functionally related government programs. However, much remains unclear about how performance information will be used once it is developed. Additionally, it re-

131. 1997 OMB RESULTS ACT REPORT, *supra* note 80, at IV.

132. *Id.*

133. The tax expenditures studied in the pilot program were 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. See ANALYTICAL PERSPECTIVES, in BUDGET, FY 2000, *supra* note 111, at ch. 5, 121.

134. *See id.*

135. *Id.*

136. The Treasury plans studies over the next several years focusing on the availability of data needed to assess the effects of “selected significant tax expenditures, primarily those designed to increase savings.” *Id.* In addition, the Treasury will develop “summarized data on the beneficiaries and other economic properties of such provisions,” where feasible, to complement information published by the Joint Committee on Taxation and the Senate Budget Committee. *Id.* As part of this effort, the Treasury’s Office of Tax Analysis and the IRS Statistics of Income Division are “developing the specifications for a new data sample which will follow the same individual income tax filers over an extended period of time.” ANALYTICAL PERSPECTIVES, in BUDGET, FY 2001, *supra* note 5, at ch. 5, 124. This “panel” sample will attempt to capture the effect of changes in tax law over an extended period of time, permitting “more extensive, and better, analyses of many tax provisions than can be performed using only cross-section data” of the effects of tax law at a single point in time. In particular, Treasury intends that data from the panel sample will “enhance our ability to analyze the effect of tax expenditures designed to increase savings.” *Id.*

mains to be seen whether the executive agencies and Congress will continue, over the long-term, the level of management and oversight commitment necessary to make functional performance-based analysis a reality.

### *B. Some History: Past Attempts at Tax Expenditure Reform*

If successful, the Results Act reform efforts described above could broaden the role of tax expenditure analysis from its current use as a budgetary information tool into a program assessment and oversight tool. Such a shift in function has previously eluded reformers, however, largely due to the difficulty of achieving meaningful programmatic and legislative review of tax expenditures. This section summarizes the major budget and tax reform claims of tax expenditure theory, focusing on its program for legislative reform. After a brief historical overview of the influence of tax expenditure analysis on the tax legislative process, the remaining subsections explain specific legislative reform proposals and describe some of the institutional and political obstacles that have blocked their full implementation.

#### *1. Past Tax Expenditure Reforms: Impact on the Legislative Process*

Under tax expenditure analysis, tax expenditures require evaluation as subsidies or spending provisions, rather than as income measurement or revenue raising provisions in the tax code.<sup>137</sup> Once a provision is identified as a "tax expenditure,"<sup>138</sup> tax expendi-

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137. See Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1156 (discussing how tax expenditures function as government subsidies).

138. Legal scholars have extensively debated issues related to defining and measuring a "tax expenditure." 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. There is no precise definition of the income tax baseline or the exceptions to it.

For an early discussion of these problems, see Boris I. Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244 (1969) [hereinafter *Accounting for Federal "Tax Subsidies"*]; Boris I. Bittker, *The Tax Expenditure Budget—A Reply to Professors Surrey and Hellmuth*, 22 NAT'L TAX J. 538 (1969); and Stanley S. Surrey & William F. Hellmuth, *The Tax Expenditure Budget—Response to Professor Bittker*, 22 NAT'L TAX J. 528 (1969). See also Michael J. McIntyre, *A Solution to the Problem of Defining a Tax Expenditure*, 14 U.C. DAVIS L. REV. 79, 82-83 (1980) (proposing a methodology for identifying tax expenditures that bypasses problems of defining the normal tax structure); Thuronyi, *supra* note 137, at 1163-70 (summarizing the academic criticism of the tax expenditure concept and suggesting a reformulation that does not rely on a normative income tax); see also, 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 refinement of ideal income); Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*,

ture 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.<sup>139</sup> Fewer tax expenditures in the tax code, they explain, would lead to a more equitable, more efficient, and more administrable tax system and, thus, to better tax policy.<sup>140</sup> The tax reform project of tax expenditure theorists, therefore, combines the related goals of achieving a more comprehensive income-measuring tax base with the elimination, whenever feasible, of tax expenditures from the tax code.<sup>141</sup>

Although some reforms suggested by tax expenditure theorists have been adopted by Congress, including the identification and listing of tax expenditures as part of the budget process since 1974,<sup>142</sup> as well as movement toward a more comprehensive tax base with the adoption of the Tax Reform Act of 1986,<sup>143</sup> much of the tax expenditure reform agenda remains unaccomplished. As explained

80 HARV. L. REV. 925, 934 (1967) (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).

139. See TAX EXPENDITURES, *supra* note 24, at 99-117; Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 713-34 (1970) [hereinafter *Tax Incentives as a Device*].

140. See TAX EXPENDITURES, *supra* note 24, at 25-27.

141. 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. *Accounting for Federal "Tax Subsidies" in the National Budget*, *supra* note 138, at 251 (distinguishing between comprehensive tax base and tax expenditure concepts).

142. See Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297 (codified as amended in scattered sections of 2 U.S.C. and 31 U.S.C.). Although both the Treasury and the Joint Committee on Taxation list tax expenditures under the functional headings used in the budget, the listings are informational in nature. Budget decisions are not based on these listings.

143. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended beginning at 26 U.S.C. § 1); see also 1 OFFICE OF THE SECRETARY, 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) [hereinafter TREASURY I]. See generally 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). *But cf.* Thuronyi, *supra* note 137, at 1179-81 (arguing that tax expenditure analysis requires treating tax expenditures as spending programs, and that the tax reform proposals leading to the 1986 Act failed to perform this analysis).

in greater detail below,<sup>144</sup> other budget reforms and structures have interceded in the meantime, such as discretionary spending caps and the pay-as-you go ("paygo") system,<sup>145</sup> which have institutionalized certain budgetary separations between tax expenditures and direct expenditures.<sup>146</sup> Relatively few tax expenditures identified in the budget since 1974 have been eliminated from the tax code.<sup>147</sup>

In recent years, tax expenditures have proliferated. The Clinton administration proposed the adoption of new and expanded tax incentives and credits<sup>148</sup> as a means of accomplishing many aspects of its domestic social policy agenda. In dollar amounts, revenue losses from tax expenditures have increased,<sup>149</sup> reflecting a phe-

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144. See discussion *infra* Part II.C.

145. See Budget Enforcement Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-573 (codified as amended beginning at 2 U.S.C. § 900); see also discussion *infra* Part II.C.

146. See Elizabeth Garrett, *Rethinking the Structures of Decisionmaking in the Federal Budget Process*, 35 HARV. J. ON LEGIS. 387, 397-405 (1998) (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). The two-part division of the budget means that there is no process for making trade-offs between discretionary spending programs and tax expenditures or to force evaluation of which type of program would be the most effective for a given purpose.

147. The Tax Reform Act ("TRA") of 1986 may have represented a high-water mark for such reform efforts. See 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"); see also JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 271-72* (1985) (acknowledging the controversy surrounding any attempt to measure the costs and effects of tax expenditures and explaining the methodology of his tax expenditure study). *But cf.* Thuronyi, *supra* note 137, 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).

148. See, e.g., I.R.C. § 25A (Supp. IV 1998) (Hope and Lifetime Learning credits), § 51 (Supp. IV 1998) (work opportunity credit), § 51A (Supp. IV 1998) (welfare-to-work credit), § 1396 (West Supp. 2000) (empowerment zone employment credit), § 1397A (West Supp. 2000) (increase in § 179 expensing for enterprise zone businesses), § 1397E (West Supp. 2000) (credit to holders of qualified zone academy bonds); see also I.R.C. § 32 (West Supp. 2000) (expanded earned income tax credit). For some recently proposed tax initiatives, see THE BUDGET MESSAGE OF THE PRESIDENT, *in* BUDGET, FY 2001, *supra* note 5, at 3-9 (describing administration proposals to expand the earned income tax credit, extend and expand empowerment zone tax credits, create "new markets" tax incentives to attract private investment to distressed rural and urban areas, provide a long-term care tax credit, a tax credit for Medicare buy-in premiums, etc.).

149. See GAO TAX EXPENDITURE STUDY, *supra* note 119, at 17 & fig. 1.1, 35-37 (finding an upward trend in the total number of tax expenditures and in JCT

nomenon that some commentators have analogized to the growth in entitlements in the direct expenditure budget.<sup>150</sup> Over the last decade, there has been a movement away from the reforms proposed by tax expenditure theorists.<sup>151</sup> The trend is now toward substitution of discretionary spending with tax expenditures.<sup>152</sup>

## 2. *The Legislative Reform Proposals*

The legislative reform proposals<sup>153</sup> of tax expenditure theorists

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).

150. See, e.g., HOWARD, *supra* note 33, at 34-37 & tbl.1.4, 183. See generally, Surrey, *Tax Incentives as a Device*, *supra* note 139, at 726 (noting the similarity of tax expenditures to "uncontrollable direct expenditures in the budget").

151. As noted in the introduction, outlay equivalents of total tax expenditures now exceed amounts for all discretionary spending in the federal budget. See Gutman, *supra* note 32, at 94 (citing budget figures for fiscal year 1999, and noting an aggregate revenue loss from tax expenditures equal to 130% of the direct spending budget and an outlay equivalent for tax expenditures of approximately 140% of direct spending); Sugin, *supra* note 32, 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").

152. See 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 also Sheryl Stratton, *The 1990s: The Tax Expenditure Decade?*, 2000 TNT 66-4, April 4, 2000 (explaining that tax expenditures have increasingly been used as a substitute for direct spending, particularly in promoting social goals). See generally HOWARD, *supra* note 33, at 190 (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").

153. In comparison to the attention paid to the normative tax base issues raised by the definition of tax expenditures, relatively few tax scholars have focused on tax expenditure legislative reform proposals. See, e.g., *Harnessing Politics*, *supra* note 51, at 569 (arguing that "a better strategy for proponents of rigorous and meaningful tax expenditure analysis" is to modify current pay-as-you-go budget procedures "rather than continuing to advocate the adoption of other mechanisms that might spark congressional deliberation of these issues"); Thuronyi, *supra* note 137, at 1170-81 (proposing an alternative tax expenditure definition as a means of facilitating institutional reforms); cf. Edward A. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973, 975 (1986) [hereinafter *Efficiency and Income Taxes*] (defending certain tax expenditures under the efficiency norm of tax policy); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1166 (1993) (critiquing the asserted expertise of direct expenditure institutions and defending tax institutions as less susceptible to interest group capture). For a sampling of contributions by scholars to the definitional issues, see *supra* note 138; *infra* notes 165-70 and accompanying text.

were proposed within a broad framework of corrective reform measures, which included both direct and indirect approaches.<sup>154</sup> Under the preferred direct corrective approach, policymakers would survey the list of tax expenditures, determining which items on the list could be dropped without any substitute financial assistance, which should be replaced with direct assistance programs, and which should be retained because the tax system provides the best delivery vehicle for providing the desired financial assistance.<sup>155</sup> A leading proponent of tax expenditure analysis, Stanley S. Surrey,<sup>156</sup> suggested that "de-escalation" of the use of tax preferences be accomplished as a practical matter by identifying existing tax expenditures, allowing some time for development of alternative direct expenditure programs where appropriate, imposing time limits on tax expenditures, and, upon termination of the expenditures, funding the direct expenditure programs with dollars returned to the revenue side of the budget.<sup>157</sup> Any new tax incentive adopted by Congress, he argued, should similarly be enacted with an automatic termination date to encourage the eventual shift to a direct expenditure program or, at a minimum, to prompt an evaluation of the tax expenditure's effectiveness.<sup>158</sup>

Acknowledging that "direct approaches [sometimes] incur head-on opposition,"<sup>159</sup> Surrey also proposed indirect approaches to moderate the abuses and inequities caused by tax expenditures.<sup>160</sup> Indirect corrective measures include imposing restraints on the operation of tax expenditures, such as limitations on the creation of tax shelters,<sup>161</sup> and on the taxpayer's overall use of tax expenditures, such as personal deduction allocation requirements, interest deduc-

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154. See PATHWAYS TO TAX REFORM, *supra* note 23, at 247.

155. See Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352, 361-62 (1970).

156. Stanley S. Surrey, a Harvard Law School professor, served as Assistant Secretary of Treasury for Tax Policy from 1961 to 1969. See Erwin N. Griswold, *A True Public Servant*, 98 HARV. L. REV. 329 (1984). Under Surrey's leadership, the Treasury published its first tax expenditure analysis in 1968. 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, at 35-36, at 322 ex.29 (1969).

157. Stanley S. Surrey, *Tax Incentives—Conceptual Criteria for Identification and Comparison with Direct Government Expenditures*, in TAX INCENTIVES, SYMPOSIUM CONDUCTED BY THE TAX INSTITUTE OF AMERICA, NOVEMBER 20-21, 1969, 3, at 36 (1971) [hereinafter *Tax Incentives—Conceptual Criteria*].

158. See *id.*; *Tax Incentives as a Device*, *supra* note 139, at 737-38.

159. PATHWAYS TO TAX REFORM, *supra* note 23, at 247.

160. See *id.*; see also Stanley S. Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145, 1149 (1957).

161. See PATHWAYS TO TAX REFORM, *supra* note 23, at 248-53 (suggesting ways to reduce the scope of tax shelters and to limit the tax shelter "ingredients" of deferral, leverage, and capital gain treatment).

tion limitations, and an alternative minimum tax.<sup>162</sup> Surrey viewed these measures as problematic because of the additional complexity introduced into the tax system to offset the effects of tax expenditures. He argued that the more direct approach to legislative reform would result in a simpler, more administrable income tax system as well as a more rational budget policy.<sup>163</sup>

Congress requires the listing of tax expenditures as part of the budget process, as mentioned above,<sup>164</sup> despite the theoretical<sup>165</sup> and political difficulties<sup>166</sup> with defining tax expenditures. During the Reagan administration, the Treasury Department developed a definition<sup>167</sup> different from the standard used by the Joint Committee on

162. See *id.* at 254-82.

163. A number of provisions, conceptually similar to indirect corrective measures catalogued by Surrey, were later adopted or expanded as part of the tax base broadening efforts culminating in the Tax Reform Act of 1986. See Tax Reform Act of 1986, Pub. Law. No. 99-514, 100 Stat. 2085 (1986); see e.g., I.R.C. § 469 (1994 & Supp. IV 1998) (passive loss limitations); § 163(h) (Supp. IV 1998) (personal interest limitations); § 163(d) (1994) (investment interest limited to net investment income); § 57(a)(6)(A) (repealed 1993) (certain appreciation in property donated to charity treated as preference for alternative minimum tax purposes). See generally Lawrence Zelenak, *When Good Preferences Go Bad: A Critical Analysis of the Anti-Tax Shelter Provisions of the Tax Reform Act of 1986*, 67 TEX. L. REV. 499, 502 (1989) (criticizing the approach of restricting tax shelters without eliminating preferences).

164. See *supra* note 27; see also 2 U.S.C. § 622(3) (1994) (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").

165. Tax scholars have challenged Surrey's underlying assumptions, questioning, as a threshold matter, whether a list of tax expenditures could be identified based on other than arbitrary criteria and, if so, how the criteria should be determined. See *supra* note 138.

166. Business representatives immediately rejected the asserted equivalence between tax preferences and direct government outlays. See 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, NOVEMBER 20-21, 1969, at 231, 234-35 (including argument by economic analysts employed by the Chamber of Commerce of the United States that tax expenditure analysis 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"). Some members of Congress have similarly been skeptical of treating tax expenditures as equivalent to direct outlays rather than as equivalent to tax cuts. Elimination of tax expenditures is perceived by them to be a tax increase and, thus, difficult politically unless combined with a highly visible rate reduction or some other popular offset.

167. Under the reference tax baseline approach adopted by the Treasury, a provision is treated as a tax expenditure only if it is an exception from some general rule stated in the law. See EXECUTIVE OFFICE OF THE PRESIDENT, OMB, THE BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1983, SPECIAL ANALYSIS G, 1, 5 (1982) (stating that "[f]or a provision to involve a tax subsidy, two conditions are necessary: —The provision must be 'special' in that it applies

Taxation.<sup>168</sup> Scholars have suggested other ways of addressing the definitional issues, ranging from narrowly confining the list to those universally recognized as spending programs, to broadly including all arguable tax expenditures, 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.<sup>169</sup> Despite the difficulty of arriving at a consensus about which tax code provisions should be included on any list of “tax expenditures,” the following discussion assumes that a workable definition could be devised to identify “subsidy” programs provided through the income tax system.<sup>170</sup>

What, then, does tax expenditure theory offer as a more detailed blueprint for legislative reform? Specific budget reform proposals are discussed below, including functional budgeting and other more modest reforms, followed by a summary of tax system reforms related to the evaluation of tax expenditures as spending programs. As discussed in greater detail below, many of the obstacles to reform were anticipated by Surrey and others early on. Some have become

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to a narrow class of transactions or taxpayers; and – There must be a ‘general’ provision to which the ‘special’ provision is a clear exception”). For example, the Treasury omits accelerated depreciation from the tax expenditure list because accelerated depreciation has been the general rule since 1981, not the exception. *See id.* at 6-7; *see also* Sugin, *supra* note 32, at 424-27 (arguing that the reference tax law baseline politicized the tax expenditure budget); *cf.* Thuronyi, *supra* note 137, at 1182-86 (discussing the development by the Treasury of the reference tax baseline to avoid many of the judgments made under the normative approach).

168. Under the Joint Committee’s approach, tax expenditures are defined by reference to a modified normative tax base. The normative model is based on the Haig-Simons economic definition of income as the sum of the taxpayers consumption and savings during the taxable period, modified in several important respects. Due to practical administrative concerns, it excludes unrealized gains and losses, imputed income, and inflation adjustments. In addition, it assumes the present classical system of taxing most corporations on their income separately from the taxation of shareholders. *See* STAFF OF THE JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2000-2004 (JCS-13-99), December 22, 1999, *reprinted in* 86 TAX NOTES 103, 107-09 (2000) (explaining the differences between the Joint Committee staff and Treasury lists of tax expenditures).

169. *See* McIntyre, *supra* note 138, at 88-89; *see also* Thuronyi, *supra* note 137, at 1163-71, 1181-2, 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 nontax program could serve those purposes equally well).

170. These definitional questions have recently received attention again as scholars show renewed interest in exploring the constitutional law ramifications of tax expenditure analysis. *See, e.g.,* Donna D. Adler, *The Internal Revenue Code, the Constitution, and the Courts: The Use of Tax Expenditure Analysis in Judicial Decision-Making*, 28 WAKE FOREST L. REV. 855 (1993); Sugin, *supra* note 32; Edward A. Zelinsky, *Are Tax “Benefits” Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379 (1998).

more difficult to overcome as budgetary reforms and spending limitations have been implemented over the intervening years.

a. *Budget reforms.* Leading tax expenditure theorists argue that both direct expenditures and tax expenditures should be taken into account in setting spending priorities, controlling overall federal spending, and evaluating and controlling spending for particular programs within the budget.<sup>171</sup> Tax expenditure theorists and others have proposed various ways of reforming the budget process to accomplish greater integration and control of both tax expenditures and direct spending.<sup>172</sup>

One proposed approach would include tax expenditures in an integrated functional analysis of the budget, in which budget resources would be classified and evaluated according to the purposes they serve.<sup>173</sup> Although the budget currently contains some functional presentation of programs,<sup>174</sup> functional analysis is not an important part of the budget process.<sup>175</sup> Functional budgeting would

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171. See TAX EXPENDITURES, *supra* note 24, at 32-33.

172. In terms of controlling overall federal spending, suggestions have included making tax expenditures subject to across-the-board spending cuts, the line item veto, multiyear budgeting and appropriations, entitlement caps, and, more generally, imposing a constitutionally based balanced budget requirement on Congress. See generally, e.g., ALLEN SCHICK, THE FEDERAL BUDGET: POLITICS, POLICY, PROCESS 196-203 (1995) (outlining and critiquing various proposed spending controls); SHAVIRO, *supra* note 49, at 221-304 (1997) (analyzing proposed ways of limiting both spending and tax levels); WILDAVSKY, *supra* note 97, at 396-439 (critiquing various approaches and arguing that substituting budget controls for governing will be unworkable).

173. See discussion *supra* Part I.A (discussing GAO's Option 3 and Canada's short-lived efforts to establish a more functionally integrated budgetary process, *supra* notes 123, 129).

For discussion of proposals for a more integrated functional analysis in budgeting, in which budget resources (including budget authority, outlays, direct loans, loan guarantees, and tax expenditures) would be classified in terms of the purposes they serve, see Garrett, *supra* note 146. Professor Garrett describes the proposal generally as follows:

Using such a functional approach, lawmakers would first develop general categories describing major governmental missions or national objectives. They would then decide, based on a determination of the country's relative priorities, how much to allot to each function (perhaps within an overall limitation on spending). Finally, they would choose the particular ways in which the allocated resources would be delivered to beneficiaries, through tax expenditures, entitlement programs, or annually appropriated spending.

*Id.* at 389.

174. See IMPROVING GOVERNMENT PERFORMANCE, *in* BUDGET, FY 2001, *supra* note 5, at ch. 5, 166-69 & tbl.10-1 (including budget function estimates for spending, credit activity, and tax expenditures), 171-287 (discussing programs by budget function and incorporating tax expenditures into presentation).

175. See Garrett, *supra* note 146, at 389 (observing that, although some budget documents include functional presentations, integrated functional analysis "is not now an important part of federal budgeting").

require both executive agencies and Congress to determine the appropriate mix of direct and tax expenditure spending within amounts allocated to accomplish various priorities, goals, or purposes.<sup>176</sup> Institutional obstacles, not least among them congressional committee jurisdictional issues, make this major type of change difficult to accomplish.<sup>177</sup> Functional integration of the budget would require major adjustments in the institutional structures of Congress and would be greatly resisted.<sup>178</sup>

Several more modest techniques have been suggested to accomplish regular review of tax expenditures and direct spending programs as a means of achieving the budget policy objective of evaluating and controlling spending for particular programs. These include automatic expiration dates for each program and other procedures for sunset review.<sup>179</sup>

Tax expenditure theorists explain that automatic expiration dates provide a "review point" for the program.<sup>180</sup> If the review does not occur, an expiration date results in automatic termination.<sup>181</sup> Expiration dates place the burden on proponents of a tax expenditure to justify its continued existence in the tax code.<sup>182</sup> In theory,

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176. *See id.* at 425.

177. *See* TAX EXPENDITURES, *supra* note 24, at 67-68. Surrey and McDaniel proposed that the budget committees "allocate both tax and direct spending by functional categories to the appropriations committees (and then to their appropriate subcommittees)" with a total of tax and direct expenditures "assigned to each budget function." *Id.* Nevertheless, they acknowledged that the proposal would represent a "radical departure" from current practice and would "severely restrict the largely unchecked budgetary power of the tax-writing committees." *Id.* at 68; *see also* Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Legislative Process*, in THE ECONOMICS OF TAXATION 123-44 (Henry J. Aaron & Michael J. Boskin eds., 1980) (discussing the effect of the Congressional Budget Act of 1974 on the tax legislative process during 1976-78 and on committee jurisdiction over tax expenditures).

178. *See* Garrett, *supra* note 146, at 406-15, 432-44 (describing structural reforms necessary for Congress to restructure budget packages under more integrated functional analysis).

179. *See* TAX EXPENDITURES, *supra* note 24, at 54-65 (describing various proposals, including staggered five-year termination dates or prescribed review schedules for tax expenditure programs or for all tax and direct expenditure programs).

180. *See id.* at 54.

181. *See id.*

182. *See* PATHWAYS TO TAX REFORM, *supra* note 23, at 148. According to Professor Surrey, the burden of proof rests heavily on those advocating that the government assistance be provided through the tax system. *See id.* The advantages of using a tax incentive must be "clear and compelling to overcome the losses that accompany the use of the tax incentive, even the well-structured incentive." *Id.* at 148-49. Those losses include "confusion and divided authority in the legislative and administrative processes, difficulties in maintaining budgetary control, confusion in perceiving and setting national priorities, dangers to the tax structure itself." *Tax Incentives—Conceptual Criteria*, *supra* note 157, at 33; *see also* Bernard Wolfman, *Federal Tax Policy and the Support of Science*, 114 U. PA. L. REV. 171, 172 n.2, 182-86 (1965) (evaluating tax prefer-

proponents would be required to show a continued need for the program and to convince legislators that the tax expenditure, as structured, is cost effective, fair, and generally preferable to a similar direct grant program.<sup>183</sup>

By the mid-1980s, after over a decade of experience, several problems with reliance on automatic expiration dates surfaced.<sup>184</sup> For existing tax expenditures, Congress exhibited great reluctance (or unwillingness) to impose expiration dates or scheduled reviews at all.<sup>185</sup> For newer tax expenditures, although Congress imposed termination dates on a number of provisions,<sup>186</sup> it extended many of them, allowed few to terminate, and failed to conduct meaningful review of the effectiveness and continuing need for the particular expiring provisions.<sup>187</sup> In addition, in the absence of integrated procedures for committee review by the tax-writing and other committees, the automatic expiration of tax provisions did not provide an effective mechanism to compare an existing tax delivery mechanism with an alternative direct spending program.<sup>188</sup>

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ences by a balancing of the interests of the integrity of the tax system, freedom for private action and experimentation, and care and efficiency in the use of federally allocated funds). *But see Efficiency and Income Taxes, supra* note 153, at 1023-26 (arguing that the burden of proof should be on opponents of preferences).

Under paygo budget procedures, proponents of tax expenditures have the additional burden of finding revenue offsets to fund new tax expenditures or the extension of expiring tax expenditures. *See Harnessing Politics, supra* note 51, at 516-18, 555-57 (discussing the impact of paygo requirements on tax expenditures).

183. *See* TAX EXPENDITURES, *supra* note 24, at 54.

184. *See id.* at 54-55 (discussing the problems with automatic termination dates).

185. *See id.* at 55-65 (describing opposition to sunset procedures and to scheduled reviews of tax expenditures and direct expenditure programs).

186. *See id.* at 54 n.55 (citing as examples two provisions made effective in 1977—the exclusion for qualified group legal services plans, scheduled to expire after 1981, and the residential energy tax credit, scheduled to expire after 1985); *see also* I.R.C. § 120(e) (1994) (providing that the exclusion for qualified group legal services is not applicable to tax years beginning after June 30, 1992); former I.R.C. § 23 (1988) (applying residential energy credit to tax years beginning after 1983 and ceasing to apply to expenditures made after December 31, 1985) (repealed 1990).

187. *See, e.g.,* TAX EXPENDITURES, *supra* note 24, at 55; Michael J. McIntyre, *A Sunset Bill: A Periodic Review for Tax Expenditures*, 4 TAX NOTES 3, 4-5 (1976) (discussing the need for evaluation of tax expenditures and the unavailability of good data on their performance); Michael J. McIntyre, *Improving the Legislative Process: Cutoff Dates for Tax Benefits*, 3 TAX NOTES 5, 5-9 (1975) (arguing that a cutoff date without a study puts little or no pressure on Congress to re-evaluate a tax expenditure, citing as an example the extension by Congress of the five-year amortization provisions for pollution control facilities); *see also* I.R.C. § 169 (1994) (allowing a deduction for the amortization of certified pollution control facilities based on a sixty month period).

188. *See* TAX EXPENDITURES, *supra* note 24, at 55.

b. *Tax policy reforms.* Tax expenditure theory posits that tax expenditures reflect fiscal policy decisions to provide financial assistance through the tax system, not "traditional" tax policy decisions.<sup>189</sup> However, the presence of tax expenditures in the tax code influences the operation of the tax system as a whole, primarily through effects on tax rates,<sup>190</sup> complexity of the tax system,<sup>191</sup> and tax administration.<sup>192</sup>

Tax administration concerns focus primarily on the additional management burdens on the tax system and administrators caused by the existence of numerous spending programs in the code.<sup>193</sup> A revenue-raising system, overseen by accountants, tax lawyers, and tax administrators, has serious shortcomings as a mechanism for administering social benefit programs, such as distributing income security funds to low-income workers<sup>194</sup> and development funds to low-income housing programs.<sup>195</sup> On the other hand, sometimes the

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189. See *id.* at 69-70. Surrey and McDaniel explain as follows:

Tax policy spans a wide range of decisions made in the federal tax system [including macroeconomic decisions, microeconomic decisions, technical structural decisions, and tax administration decisions]. . . . Other decisions, usually denominated as tax policy, involve provisions classified as tax expenditures, owing to the choice of the tax system as the vehicle for providing financial assistance. Accordingly, the legislative and executive processes that produce those decisions are similar to those involved in structural tax policy decisions. A government's decision to provide assistance through the tax system, however, is really a fiscal policy decision disguised as a tax policy decision. Accordingly the approach and analysis applied should be similar to those used in direct budget spending decisions.

*Id.*

190. See *id.* at 70. If significant tax expenditures were repealed or cut back and were not replaced by direct programs costing an equivalent or greater amount, tax rates could be lowered. The presence of many tax expenditures in the income tax code narrows the tax base, resulting in higher tax rates unless revenue needs are reduced.

191. See *id.*; see also Paul R. McDaniel, *Federal Income Tax Simplification: The Political Process*, 34 TAX L. REV. 27, 28 (1978) (discussing the political process that results in tax system complexity); Surrey, *supra* note 160, at 1145-46 (noting the complexity of a progressive income tax and discussing the role of special-treatment provisions); discussion *supra* at text accompanying notes 160-63.

192. See TAX EXPENDITURES, *supra* note 24, at 70.

193. In addition, the existence of special tax preferences can have a negative effect on self assessment of income tax, which depends upon taxpayers' perceptions about the fairness of the system. See *id.* at 94-97.

194. See, e.g., Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995); 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).

195. See Tracy A. Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit*, 38 VILL. L. REV. 871, 872-75 (1993); see also Florence Wagman Roisman, *Mandates Unsatisfied: The Low Income Housing Tax Credit Program and the Civil Rights Laws*, 52 U. MIAMI L. REV. 1011, 1012 (1998) (describing the failure of the Treasury Department and state and local credit agen-

tax system can deliver benefits to businesses and individuals in an effective and technically efficient manner.<sup>196</sup> Regardless of the appropriateness of using the tax system as a delivery vehicle for specific types of subsidies, special tax breaks for particular groups and industries make tax forms difficult to produce (and for taxpayers to complete). In addition, they require tax administrators to issue regulations, rulings, and conduct audits of programs outside their basic area of expertise.

Tax expenditure theorists acknowledge that wholesale repeal of tax expenditures is neither likely nor desirable because of the need to provide government assistance for certain activities.<sup>197</sup> However, they urge the executive and Congress to review tax expenditure programs under the same type of methodology applicable to any other governmental assistance program.<sup>198</sup> Under this analysis, if the need for government assistance cannot be established, the tax expenditure simply should be repealed and the revenues involved made available for general rate reduction. If there is a need for assistance, the tax expenditure should be compared with a direct spending program of similar substantive design. Sometimes a tax expenditure will overlap with or resemble direct grant programs, and, in such cases, repeal is easily combined with a transfer of revenues to a direct program. In other cases, time and study will be required to develop a substitute program. Only when the tax system provides a better means of delivering the assistance should the program be structured or retained as a tax expenditure, with necessary revisions made to improve the effectiveness of the program.<sup>199</sup>

In sum, under tax expenditure analysis, tax expenditures require review and evaluation as spending programs. As spending programs, tax expenditures should be evaluated under a traditional budget priority and program analysis, with additional analysis of

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cies to operate with regard to civil rights law in administering the Low-Income Housing Tax Credit, currently the largest federal program to fund the development and rehabilitation of low-income housing). Cf. Myrna Zelaya-Quesada, *Housing: Treasury, Justice, HUD Target Discrimination in Low-Income Housing Tax Credit Projects*, 158 DAILY TAX REP. (BNA) G-2 (Aug. 15, 2000) (announcing a joint agreement by the Treasury, Justice, and Housing and Urban Development departments to establish a monitoring and compliance process to ensure that low-income housing tax credit projects comply with the Fair Housing Act, in which the Justice department and HUD will notify the IRS and state housing finance agencies of enforcement actions brought against tax-credit property owners and the IRS will notify involved property owners that a finding of discrimination could result in the loss of the tax credit).

196. See *Efficiency and Income Taxes*, *supra* note 153, at 1011 (arguing that providing benefits through the tax system is a cost-effective method of implementing government policies, particularly in the case of small businesses and middle-income taxpayers).

197. See TAX EXPENDITURES, *supra* note 24, at 98.

198. See *Tax Incentives as a Device*, *supra* note 139, at 713-15 (applying a cost-benefit analysis).

199. See TAX EXPENDITURES, *supra* note 24, at 98.

the advantages and disadvantages of using the tax system as a delivery mechanism for the expenditures.<sup>200</sup> The next section describes how current budget rules impede this type of legislative analysis.

### C. *The Impact of Current Budget Rules on Tax Expenditure Reforms*

Under Result Act requirements, described in Part I, tax expenditures are included in the presentation of the president's budget to Congress under various budget functions.<sup>201</sup> However, congressional

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200. See generally Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687, 754-58 (1999) (describing and criticizing the Treasury Department's analysis in recent budget documents of the relative advantages and disadvantages of tax expenditures versus direct outlays). Professor Brody summarizes Treasury's description of the advantages and disadvantages of tax expenditures as follows:

The 2000 Budget report begins with the advantages of tax expenditures. First, tax expenditures can be used effectively "when the benefit or incentive is related to income and is intended to be widely available." Second, tax expenditures can make use of the "existing public administrative and private compliance structure for the tax system." Third, tax expenditures "help simplify the tax system, as where they leave certain income sources untaxed." Fourth, tax rules "implicitly subsidize certain activities," although "the beneficiaries experience reduced taxes that are offset by higher taxes (or spending reductions) elsewhere." Finally, the availability of a wide range of tax expenditures tools—"e.g., deductions, credits, exemptions, and deferrals; floors and ceilings; and phase-ins and phase-outs, dependent on income, expenses, or demographic characteristics (age, number of family members, etc.)"—"means that tax expenditures can be flexible and have very different distributional and cost-effectiveness properties."

Next, the administration describes the limitations of tax expenditures. First, they add complexity in some cases, "which can raise both administrative and compliance costs." Second, because "the income tax system does not gather information on wealth," tax subsidies cannot be tailored by this attribute. Third, "the tax system may have little or no contact with persons who have no or very low incomes, and incentives for such persons may need to take the form of refunds." Fourth, tax expenditures "do not enable the same degree of agency discretion as an outlay program." Finally, "tax expenditures tend to escape the budget scrutiny afforded to other programs."

*Id.* at 754-55 (footnotes omitted).

201. See GOVERNMENT-WIDE PERFORMANCE PLAN, in BUDGET, FY 2000, *supra* note 111, at ch. 6, 161, 162-65 & tbl.12-1 (describing the increased emphasis on functional presentation of the budget as part of the "reinventing government" efforts under the Government Performance and Results Act of 1993); see also Gene Steuerle, *How to Achieve Tax Simplification Through Process Reform*, 84 TAX NOTES 463, 463 (July 19, 1999) (stating that the performance plan review "has been extended on an embryonic basis to Treasury's tax expenditure budget"); Gene Steuerle, *Will Performance Measures Raise the Status of Tax Expenditures?*, 78 TAX NOTES 939, 940 (Feb. 16, 1998) [hereinafter *Performance Measures*] (arguing that as extended to tax expenditures, performance reviews "have the potential of revealing in stark terms exactly what it is in each of these programs that works and does not work well" and noting that the Treasury's

procedures do not include tax expenditures in the authorization and appropriation process.<sup>202</sup> Instead, the tax-writing committees consider tax expenditures in meeting the revenue targets set by the budget committees.<sup>203</sup> Thus, in addition to their revenue-raising and tax policy tasks, the tax-writing committees have oversight responsibilities for numerous spending programs operated through the code, as well as the equivalent of authorization and appropriations power over these programs.<sup>204</sup>

These congressional jurisdictional and budgetary structures add to the difficulty of achieving more meaningful review of tax expenditures. Formalized budgetary limitations that did not exist when Surrey developed the “de-escalation” approach provide additional obstacles to an integrated review process.<sup>205</sup> As explained below, budget tradeoffs are currently made within the two separate pack-

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next efforts will focus on the availability of data); discussion *supra* Part II.A.

202. See *Performance Measures*, *supra* note 201, at 939.

203. The budget committees draft and manage the concurrent budget resolution, which guides the congressional budget process. See Elizabeth Garrett, *The Congressional Budget Process: Strengthening the Party-in-Government*, 100 COLUM. L. REV. 702, 714 (2000) [hereinafter *The Congressional Budget Process*] (describing the budget committees and the budget resolution, the reconciliation process, and budget summits as centralized decision making procedures). Under this process, as described below, the tax-writing committees propose the mix of tax rates and tax expenditures that will meet revenue targets specified in the budget resolution:

[T]he budget resolution sets spending limits for discretionary programs (limits which may differ from the caps set by budget laws that are binding for sequestration purposes), determines the amount of revenue that should be raised in taxes every year, and provides for the debt limit. It is a concurrent resolution, so it is not the law and is not signed by the president. Its aggregate totals guide the congressional budget process, however, and are enforced through parliamentary devices. In addition, accompanying legislative documents contain the budget committees’ allocations of discretionary funds to the appropriations and other committees [the appropriations committees make suballocations of discretionary funds to the 13 appropriations subcommittees]. All these allocations, as well as the spending and revenue aggregates, are enforced through substantive points of order that can be raised by any lawmaker to prevent consideration of an appropriations bill in violation of the allocations. In the Senate, this substantive point of order can be waived only by a three-fifths vote, just as is required to waive many other objections to violations of budget process rules. The political costs of blatantly ignoring the budget resolution, even though it is not binding law, may be too great for lawmakers to contemplate seriously. . . . Instead, they must comply or engage in the relatively costly behavior of spending the amounts they want using complex gimmicks that appear to the public to produce bills consistent with spending targets.

*Id.* at 715-17 (footnotes omitted).

204. See McDaniel, *supra* note 191, at 49-50.

205. See generally Garrett, *supra* note 146, at 397-405 (describing the budget process and justifications for the current system).

ages<sup>206</sup> of discretionary spending programs<sup>207</sup> and tax and entitlement programs,<sup>208</sup> fortifying the jurisdictional and procedural barriers between them. Although the budget procedures have slowed the growth of new spending, and thus have played an important budgetary control role, they have exacerbated the separation between tax expenditures and discretionary programs for purposes of policy analysis.

Budget procedures limit discretionary spending through spending caps and certain statutory enforcement procedures.<sup>209</sup> Under the spending caps, new discretionary spending programs must compete 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.<sup>210</sup> If the spending caps are exceeded, a sequestration<sup>211</sup> "reduces spending for most programs in the category by a uniform percentage."<sup>212</sup>

Paygo provisions control new tax and entitlement legislation.<sup>213</sup> The paygo budget rules limit new tax expenditures<sup>214</sup> by requiring that they be paid for by new taxes or by offsetting revenue gains from modifications to existing tax provisions or to the entitlement programs under the jurisdiction of the tax-writing committees.<sup>215</sup> Thus, unlike new discretionary programs, new tax expenditures do not need to find revenue offsets in a set of programs that serve the same general governmental objectives or set of beneficiaries but instead may be funded by revenue increases, elimination of other un-

206. See *supra* note 28. For a summary of Budget Enforcement Act procedures, see ANALYTICAL PERSPECTIVES, in BUDGET, FY 2001, *supra* note 5, at 448.

207. See 2 U.S.C. § 900(c)(7) (1994) (defining "discretionary appropriations" as discretionary spending programs that receive periodic resources provided by appropriation acts).

208. In referring to entitlement spending, the budget rules use the term "direct spending," defined as "(A) budget authority provided by law other than appropriation Acts; (B) entitlement authority; and (C) the food stamp program." 2 U.S.C. § 900(c)(8).

209. See, e.g., 2 U.S.C.A. §§ 645, 901.

210. See Garrett, *supra* note 146, at 399.

211. As budget documents explain, the Budget Enforcement Act ("BEA") requires a "sequestration" procedure for reducing spending in a category "[i]f the amount of budget authority provided in appropriations acts for a given year exceeds the cap on budget authority for a category, or the amount of outlays in that year estimated to result from this budget authority exceeds the cap on outlays for a category." ANALYTICAL PERSPECTIVES, in BUDGET, FY 2001, *supra* note 5, at 448.

212. ANALYTICAL PERSPECTIVES, in BUDGET, FY 2001, *supra* note 5, at 448. However, the BEA "specifies special rules for reducing some programs and exempts some programs from sequestration entirely." *Id.*

213. See *id.*

214. See *id.* Paygo does not apply to increases in entitlement spending or decreases in revenues that are the result of existing provisions. See *id.* at 449.

215. See *id.*; see generally COMM. ON WAYS AND MEANS, 1998 GREENBOOK, *supra* note 30, at vi (describing the major entitlement programs and other activities within the Committee's jurisdiction).

related tax expenditures, or by cuts in certain types of entitlement spending programs.<sup>216</sup> They cannot be paid for by cuts in discretionary spending programs, however.<sup>217</sup> Paygo is enforced by its own independent sequestration and enforcement provisions.<sup>218</sup>

The budget rules discourage the enactment of new discretionary spending programs, and provide a reason for enacting expiration dates for new tax expenditures that is quite independent of "de-escalation" or review point efforts.<sup>219</sup> During periods of strict budget growth limits, new tax expenditures are most easily passed as time-limited programs because they require lesser offsets.<sup>220</sup> Self-interested legislators, knowledgeable about playing the lobbying/political contribution game in the tax arena, may also prefer to supply time-limited legislation, responding to a recurring demand for renewal of special interest legislation by playing interest groups off each other as they seek to retain current tax expenditures or obtain new ones.<sup>221</sup>

216. See Garrett, *supra* note 146, at 400-01.

217. See Donald B. Tobin, *Symposium, Less is More: A Move Toward Sanity in the Budget Process*, 16 ST. LOUIS U. PUB. L. REV. 115, 126 (1996).

218. See 2 U.S.C. § 902 (1994). The procedures are 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.

ANALYTICAL PERSPECTIVES, *in* BUDGET, FY 2001, *supra* note 5, at 448-49.

219. See *Harnessing Politics*, *supra* note 51, at 525-26.

220. New tax expenditures require revenue offsets within the budget window time period applicable under the relevant budget process rules. New tax expenditures enacted for a lesser time period (for example, for a duration of less than five years) would require a lesser total revenue offset. Under current rules, new tax expenditures without an expiration date do not require revenue offsets outside of the applicable budget window. Accordingly, tax expenditures enacted without an expiration date may remain in effect beyond the budget window time period without further budgetary review. For those benefited by the tax expenditure, a permanent provision is therefore more desirable than an expiring provision.

221. See *Harnessing Politics*, *supra* note 51, at 504 (arguing that budget rules "are a mechanism to harness the interest group activity that is already ubiquitous in the tax legislative arena in order to reach substantive policy goals more easily," and that interest group conflict "provides lawmakers with opportunities to review and revise tax subsidies," encouraging them "to provide reasons for their decisions, thus increasing their accountability to the electorate"). See generally, e.g., FRED S. MCCHESENEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION 86-109 (1997) (describing the public choice model of rent extraction and discussing the problem of the durability

As noted in the introduction, the recent budget surplus has changed the political consensus for the budget process rules, which are currently nominally in effect through 2002.<sup>222</sup> This presents an opportunity to rethink the sharp budget process demarcation between tax expenditures and discretionary spending.<sup>223</sup> As has been demonstrated by past experience, however, efforts to employ a comprehensive functional analysis by Congress, of both tax expenditures and direct spending programs,<sup>224</sup> will not succeed without basic changes in the congressional committees' jurisdiction or structures. That is quite unlikely to happen anytime soon, but small steps taken under the Results Act may ultimately lead in that direction.

### III. THE INSTITUTIONAL OBSTACLES AHEAD: AN ILLUSTRATION

This Part of the Article examines management and oversight experience with a specific set of tax expenditures, employment tax credits,<sup>225</sup> and their direct expenditure employment subsidy alternatives. These programs provide a valuable experiential perspective from which to consider Results Act performance review implementation issues, discussed in greater detail in the final Part of this Article. Employment tax credits illustrate the type of institutional obstacles that have blocked meaningful performance review of tax expenditures in the past. Employment tax credits, which have been sunsetted and extended by Congress for nearly thirty years, show how automatic review points have provided little political constraint on the use of tax expenditures. Although sunset provisions were proposed by tax expenditure theorists as a way to prompt congressional review of tax expenditures, they have been used under paygo primarily as a way of enacting tax provisions with lesser budget offsets. Despite the budgetary manipulation of sunset provisions, however, some information about the performance of employment tax credit programs has been accumulated over the years. For these reasons, and others explained below, employment tax credit programs provide a productive vantage point from which to evaluate the prospects for more meaningful review of tax expenditures under the Results Act.

Although the operation of the employment tax credits (and their predecessors) has been studied over the years, making available

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of rent extraction agreements).

222. See *supra* note 50.

223. See Garrett, *supra* note 146, at 397-98.

224. See discussion *supra* in Part II.B.2.a.

225. Most tax experts would categorize the employment tax credits as "tax expenditures;" thus, they avoid troublesome definitional difficulties. See, e.g., Thuronyi, *supra* note 137, at 1189 (referring to the now repealed targeted jobs tax credit); *Efficiency and Income Taxes*, *supra* note 153, at 1034 (referring to the targeted jobs tax credit); see also PATHWAYS TO TAX REFORM, *supra* note 23, at 34-35 (referring to a former tax credit for employers hiring public assistance recipients from the Department of Labor's welfare training programs).

empirical data on the programs' effectiveness,<sup>226</sup> the data also illustrate some inherent difficulties in measuring the results of government-funded social programs. Such programs have goals quite different from the profit-oriented business setting from which the Results Act performance measures were derived.

In addition, as the following descriptions of the programs show, the tax credits have not been self-administering. These particular tax expenditures have many of the characteristics ascribed by tax expenditure theorists to direct grant programs funded through appropriations, including visibility, impermanence, and certain detailed eligibility limitations and certification requirements;<sup>227</sup> thus, they are excellent candidates for substitution by direct grant programs. Despite regular review by Congress, however, they have not been eliminated from the tax code, absorbed by the direct expenditure budget, nor generally accepted by analysts as a subsidy most efficiently provided through the tax system. Accordingly, they provide a particularly challenging context from which to consider whether the management and oversight of tax-delivered programs could be improved under the emerging Results Act framework.

The sections below provide an overview of the employment tax credits (and their predecessors) as expiring provisions, explain in greater detail how the current credits work, summarize the criticisms that have been leveled against employment credits over the years, and briefly outline how the most recent form of the credits responds to these critiques. Despite some modification of the credits in recent years, fundamental questions about their effectiveness remain. Although various studies have validated these concerns, the credits have survived numerous termination dates. The last section ends with a discussion of possible explanations for their survival.

#### *A. Overview: Employment Tax Credits as Expiring Tax Expenditures*

Although expiring tax provisions constitute a relatively small part of the income tax code as a whole, their use by Congress illuminates the budgetary and programmatic role played by tax expenditures. Unlike other tax provisions, time-limited "expiring" tax provisions automatically terminate unless they are extended by Congress. The periodic extension of "expiring" tax provisions has become an established feature of the tax legislative process.<sup>228</sup>

226. See *infra* Part III.D.

227. See generally Zelinsky, *supra* note 170 (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).

228. See, e.g., The Tax Relief Extension Act of 1999, Pub. L. No. 106-170, §§ 500-512, 113 Stat. 1861 (extending many expiring tax provisions through December 31, 2001, including the Work Opportunity Tax Credit, the Welfare-to-

Due in part to revenue offset requirements under congressionally self-imposed paygo restrictions,<sup>229</sup> the expiration and renewal of these provisions have shared some of the characteristics of appropriations.<sup>230</sup> Expiring provisions may also be utilized for reasons unrelated to budget reforms. They can be adopted as "pilot" programs to test their effectiveness or feasibility.<sup>231</sup> They may be used to cap or otherwise limit the provision's scope, to phase out a subsidy, or, as one commentator has argued, they may signal congressional commitment to provide a tax subsidy for a certain minimum length of time.<sup>232</sup> Despite these similarities to discretionary spending

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Work Tax Credit, the credit for electricity produced from wind and closed-loop biomass facilities, expanded to include energy produced from poultry waste, a credit for holders of qualified zone academy bonds to help finance construction and repair of public schools, the \$5000 tax credit for first-time home buyers in the District of Columbia, the exclusion for employer-provided undergraduate educational assistance, the brownfields remediation expense deduction, a provision allowing nonrefundable personal tax credits to count against the alternative minimum tax, an exemption from Subpart F for certain active financing income, a taxable income limit on percentage depletion for marginal production; as well as extending the research and development credit through June 30, 2004); The Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277, §§ 1001-04, 112 Stat. 2681-886 (extending many expiring provisions until June 30, 1999).

229. See *supra* Part II.C (describing paygo requirements).

230. Employment tax credits are revenue-losing, expiring tax provisions. Some expiring tax provisions, by contrast, are revenue-raising provisions. For example, the overall limitation on certain itemized deductions of upper income taxpayers, see I.R.C. § 68 (1994 & Supp. 1998), represented a tax increase when it was adopted as part of the 1990 Budget Act, Pub. L. No. 101-508, § 11103(a), 104 Stat. 1388-406. Although § 68 was originally scheduled to expire after December 31, 1995, the § 68 limitation on itemized deductions became a more permanent part of the tax code in 1993. I.R.C. § 68(f), *repealed by* Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13204, 107 Stat. 462. For a discussion how the budget rules make use of such temporary tax increases, see *Paint-by-Numbers*, *supra* note 51, at 676:

Budget scorekeeping rules, along with revenue estimating conventions, allow Congress to enact 'temporary' tax increase provisions and then to count as revenue gains subsequent extensions of the temporary provision. This occurs because the 'baseline' estimate of receipts does not include revenues from the expiring tax increase. As long as the temporary provision does not fund a special budgetary 'trust fund,' the revenue loss from the expiration of the tax does not 'score' for revenue estimating purposes and the additional revenues from the extension can thus be spent on other revenue losing enactments.

*Id.*

231. See Heidi Glenn, *Expiring Provisions Never Die, They Just Become 'Extenders'*, 73 TAX NOTES 1009, 1010 (1996) (noting that "[t]ypically, the House aide said, lack of revenue is the main reason a provision is given temporary status, but in some cases, lawmakers want to 'test' a provision.")

232. See Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129, 1194 (1996) (arguing that explicit termination dates serve "as a guaranteed grandfathered effective date in the event the provision is not extended" and are a way "of decreasing the likelihood of retroactive repeal").

funded through the appropriations process, expiring tax provisions remain under the jurisdiction of the congressional tax-writing committees<sup>233</sup> and otherwise represent a subset of tax system issues closely related to budget process reforms.<sup>234</sup>

Thus, under the current budgetary and political environment, these tax provisions import many features of the discretionary expenditure process into the tax legislative process, resulting in greater transparency of the budgetary and programmatic consequences of new tax legislation. Although greater transparency represents a step toward reform, the adoption of an appropriations-type model, in supplying new tax expenditure legislation or in extending expiring provisions, has not led to more comprehensive reforms.

The Work Opportunity Tax Credit ("WOTC")<sup>235</sup> and the Welfare-to-Work Tax Credit ("WWTC"),<sup>236</sup> like their predecessors the Targeted Jobs Tax Credit and the former credit for welfare-related Work Incentive ("WIN") Program expenses, periodically expire and then are extended, sometimes retroactively, by Congress. Although modified somewhat from the design of their sharply criticized predecessors, the WOTC and WWTC share essential similarities with the prior tax credits. They provide time-limited employer wage subsidies for certain low wage or difficult-to-place workers.<sup>237</sup>

233. The House Ways and Means and Senate Finance Committees have jurisdiction over tax provisions as well as major entitlement programs, including social security, medicare and numerous other programs providing social welfare benefits. See COMM. ON WAYS AND MEANS, 1998 GREENBOOK, *supra* note 30, at vi.

234. See *supra* note 51.

235. The Work Opportunity Tax Credit, I.R.C. § 51 (1994 & Supp. 1998), enacted by the Small Business Job Protection Act of 1996, replaced the targeted jobs tax credit. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1201, 110 Stat. 1755, 1768-72 (applying to individuals who begin work for the employer after September 30, 1996 and before October 1, 1997). It was extended by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 603, 111 Stat. 788, 862 (applying to individuals who begin work for the employer after September 30, 1997 and before July 1, 1998), by the Tax and Trade Relief Act of 1998, Pub. L. No. 105-277, § 1002, 112 Stat. 2681-888 (applying to individuals who begin work for the employer after June 30, 1998 and before July 1, 1999), and again by the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 505, 113 Stat. 1860 (applying to individuals who begin work after June 30, 1999, and before January 1, 2002).

236. The Welfare-to-Work Tax Credit, I.R.C. § 51A (Supp. 1998), was enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 801(a), 111 Stat. 788, 869-71 (applying to individuals who begin work for the employer after December 31, 1997 and before May 1, 1999). It was extended by the Tax and Trade Relief Act of 1998, Pub. L. No. 105-277, § 1003, 112 Stat. 2681-888 (applying to individuals who begin work for the employer after December 31, 1997, and before July 1, 1999), and extended again by the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 505, 113 Stat. 1860 (applying to individuals who begin work after June 30, 1999, and before January 1, 2002).

237. This analysis focuses on the WOTC and the WWTC. Other employer

The WOTC, enacted in 1996, targets eight categories of difficult-to-place or low skilled workers such as high risk or summer youths living in empowerment zones or enterprise communities, ex-felons, vocational rehabilitation referrals, food stamp recipients, qualified veterans, SSI recipients, and families eligible to receive welfare

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tax credits provide targeted wage subsidies for more geographically restricted worker populations, including the Empowerment Zone Employment Credit, I.R.C. § 1396 (1994 & Supp. 1998), and the Indian Employment Credit, I.R.C. § 45A (1994 & Supp. 1998), which is currently scheduled to expire after December 31, 2003, *see* I.R.C. § 45A(f) (1994 & Supp. 1998). Both credits are part of the general business credit. *See* I.R.C. § 38(b)(9), (10) (1994 & Supp. 1998). *See generally* BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS*, ¶ 27.3.3, at 27-39 to -40 (3d ed. 1999) (describing employment credits).

The Empowerment Zone Employment Credit provides a credit for portions of wages of employees who live and work in "empowerment zones," areas designated by the Secretary of Housing and Urban Development (urban areas) or the Secretary of Agriculture (rural areas) to have high levels of poverty, unemployment, and distress, and which meet certain other requirements. *See* I.R.C. §§ 1391, 1392 (1994 & Supp. 1998). *See generally, e.g., EZ Gazette* (EZ project web site) (visited Sept. 9, 2000) <<http://www.richmond.edu/~ezproj/>> (providing resources and links to other web sites). In 1993, the Secretaries were authorized to designate six urban and three rural areas as empowerment zones. *See* Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13301, 107 Stat. 312, 543 (1993). In 1997, two additional urban areas were authorized. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 951(a)(1)-(3), 111 Stat. 788, 885 (1997) (stating that the designation is not to take effect before January 1, 2000). For the original empowerment zones, the credit is 20% of the first \$15,000 of the wages of each qualifying employee for the calendar years 1994 through 2001, 15% for 2002, 10% for 2003, 5% for 2004, and zero thereafter. For the two additional zones designated under the 1997 authorization, the applicable percentages are 20% for 2000 through 2004, 15% for 2005, 10% for 2006, 5% for 2007, and zero thereafter. *See* I.R.C. § 1396(b) (1994 & Supp. 1998). *See generally* Ellen P. Aprill, *Caution: Enterprise Zones*, 66 S. CAL. L. REV. 1341 (1993) (discussing pre-1993 proposals and design issues); Michael Allan Wolf, *Dangerous Crossing: State Brownfields Recycling and Federal Enterprise Zoning*, 9 FORDHAM ENVTL. L.J. 495, 498-503 (1998) (describing two decades of state and federal enterprise zones).

The Indian Employment Credit provides a credit for certain employers who employ a "qualified employee," defined generally as an enrolled member of an Indian tribe (or a spouse of an enrolled member) who lives and works on or near the reservation and receives wages not in excess of \$30,000 (adjusted for inflation after 1994) for the taxable year. *See* I.R.C. § 45A(c) (1994 & Supp. 1998). The amount of the credit is equal to 20% of the amount by which the sum of wages and health insurance costs for all qualified employees for the taxable year exceed the sum of wages and health insurance costs for such employees for the calendar year 1993 (the year before the effective date of the credit). *See* I.R.C. § 45A(a) (1994 & Supp. 1998); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13322(b), 107 Stat. 559, 563 (1994) (applying to wages paid or incurred after December 31, 1993). The aggregate amount of wages and health insurance costs taken into account for any employee cannot exceed \$20,000, for either the taxable year or the 1993 base period year. *See* I.R.C. § 45A(b)(3) (1994 & Supp. 1998).

benefits.<sup>238</sup> The WWTC, enacted in 1997, more narrowly targets workers who have received welfare benefits during the previous two-year period.<sup>239</sup> Employers receive a tax credit for hiring former welfare recipients who have left welfare for work under time limits established by welfare reform legislation adopted by Congress in 1996.<sup>240</sup>

As noted above, the WOTC replaced the Targeted Jobs Tax Credit ("TJTC"), which was enacted in 1978, and periodically lapsed and renewed until it was finally allowed to expire in 1994.<sup>241</sup> The Targeted Jobs Tax Credit replaced the New Jobs Credit, which was enacted in 1977 and allowed to expire in 1978.<sup>242</sup> The WWTC descends from a former tax credit, terminated in the early eighties, for

238. See I.R.C. § 51(d) (1994 & Supp. IV 1998).

239. The credits do not provide duplicate benefits. If an employer receives a WWTC for an employee for a particular taxable year, no WOTC credit may be taken for the employee for that year. See I.R.C. §51A(e) (Supp. 1998).

240. See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, § 103, 110 Stat. 2105, 2112-13, 2137 (repealing the individual entitlement to welfare and imposing a twenty-four month limit on welfare benefits without work and a sixty month lifetime cap on benefits).

241. See Revenue Act of 1978, Pub. L. No. 95-600, § 321, § 554, 92 Stat. 2763, 2830, 2892 (enacting the targeted jobs tax credit and requiring the Secretaries of Labor and the Treasury to report to Congress by June 30, 1981, on its effectiveness in improving employment of the targeted groups). The TJTC was extended by Congress in 1981, 1982, 1984, 1986, 1988, 1989, 1990, and 1991. See Tax Extension Act of 1991, Pub. L. No. 102-227, § 105, 105 Stat. 1686, 1687; Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, §§ 11001, 11405, 104 Stat. 1388, 1388-473; Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, § 7103, 103 Stat. 2106, 2305; Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 4010, 102 Stat. 3342, 3655; Tax Reform Act of 1986, Pub. L. No. 99-514, § 1701, 100 Stat. 2085, 2772; Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 1041, 98 Stat. 494, 1042; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 233, 96 Stat. 324, 501; Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 261, 95 Stat. 172, 260. In 1993, the targeted jobs tax credit was retroactively renewed after expiring again on June 30, 1992, and was extended through December 31, 1994. See Revenue Reconciliation Act of 1993, Pub. L. No. 103-66, § 13102, 107 Stat. 312, 420.

242. See Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126; see also Revenue Act of 1978, Pub. Law. No. 95-600, 92 Stat. 2763; H.R. CONF. REP. NO. 95-1800, at 231-34 (1978), reprinted in 1978 U.S.C.C.A.N. 6761, 7231-35 (1978) (describing the new targeted job credit adopted in 1978 and the discontinuation of the new jobs credit); H.R. CONF. REP. NO. 95-263, at 26-27 (1977), reprinted in 1977 U.S.C.C.A.N. 185, 291-92 (describing the new jobs credit, adopted in 1977, of 50% of the increase in each employer's unemployment insurance wage base above 102% of that wage base in the previous year, as limited by various caps, and an additional credit equal to 10% of the first \$4200 of unemployment insurance wages paid to handicapped individuals, including handicapped veterans, who receive vocational rehabilitation). For a description of the political origins of the New Jobs Tax Credit and its replacement by the Targeted Jobs Tax Credit, see HOWARD, *supra* note 33, at 75-82, and Emil M. Sunley, *A Tax Preference Is Born: A Legislative History of the New Jobs Tax Credit*, in *THE ECONOMICS OF TAXATION* 391-408 (Henry J. Aaron & Michael J. Boskin eds., 1980).

wages paid welfare recipients under the Work Incentive ("WIN") Program.<sup>243</sup> Congress established WIN in 1967<sup>244</sup> and modified it during the early seventies to place certain welfare recipients in jobs.<sup>245</sup> For the ten-year period from 1972 through 1981, the WIN-welfare recipient tax credit allowed an employer a tax credit for wages paid to eligible employees up to specified percentages of their compensation during the first two years of employment.<sup>246</sup> After

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243. See HOWARD, *supra* note 33, at 190 (explaining that the WIN tax credit was initiated by conservative Democrat Senator Herman Talmadge of Georgia as an alternative to increased spending for the Job Corps and other Great Society job-training programs).

244. Pub. L. No. 90-248, § 204, 81 Stat. 884. Work requirements were imposed on AFDC recipients under WIN, but were not very effective due to weak funding and enforcement. See, e.g., JOEL F. HANDLER & YEHESKEL HASENFELD, *THE MORAL CONSTRUCTION OF POVERTY: WELFARE REFORM IN AMERICA* 141-42 (WIN I), 156-58 (WIN II).

245. Although potentially subject to the original WIN work requirements, mothers with preschool children were determined by many states to be "inappropriate" for job training or work and thus as exempt from the work requirement. See MIMI ABRAMOVITZ, *REGULATING THE LIVES OF WOMEN: SOCIAL WELFARE POLICY FROM COLONIAL TIMES TO THE PRESENT* 341 (1988) (attributing the exemption to limited funding, a lack of child care, and an excess of welfare recipients over WIN slots). As amended in 1971, WIN II required participation by mothers with children six years of age or older. See HANDLER & HASENFELD, *supra* note 244, at 154. The WIN program was replaced by the JOBS program, enacted as part of the revision of the AFDC program by the Family Support Act of 1988 to assist parents in obtaining education, training, and employment needed to avoid long-term welfare dependence. See H.R. CONF. REP. NO. 100-998, at 91, *reprinted in* 1988 U.S.C.C.A.N. 2776, 2879 (1988). The JOBS program was eliminated in 1996, along with the federal entitlement to welfare. See *supra* note 240.

246. Former I.R.C. §§ 40, 50A, 50B (1976). The WIN tax credit was adopted by the Revenue Act of 1971, Pub. Law No. 92-178, § 601, 85 Stat. 497, 553-560 (applicable to taxable years beginning after December 31, 1971). The credit was terminated in 1981, see former I.R.C. § 50B(a)(5) (providing that the credit did not apply to amounts paid or incurred after 1981), but was not statutorily repealed until 1984. See Pub. L. No. 98-369, § 474(m)(1), (2), 98 Stat. 494, 833 (1984). Prior to its termination, the credit was for 50% of the first \$6000 of wages paid to each eligible employee during the first year of employment and 25% of the first \$6000 paid during the second year. Nonbusiness employees (household workers) qualified for the credit at a reduced rate of 35% for the first year for a maximum amount of \$12,000 wages paid, and second-year wages did not qualify for the credit. Prior to the Revenue Act of 1978, the credit was 20%, plus full deduction, for wages paid in the first year of employment to each eligible employee. See H.R. CONF. REP. NO. 95-1800, at 232-33, *reprinted in* 1978 U.S.C.C.A.N. 7198, 7233 (1978) (limiting the amount of the credit to \$50,000 of tax liability plus one-half of tax liability in excess of \$50,000, an increase over the originally enacted limits of \$25,000, and relaxing the employment duration requirements); H.R. CONF. REP. NO. 94-120, at 65 (1975), *reprinted in* 1975 U.S.C.C.A.N. 122, 130 (expanding the eligible employees to include AFDC recipients, regardless of WIN enrollment, provided they met certain specified employment duration requirements in addition to extending the credit to nonbusiness employment); H.R. CONF. REP. NO. 92-708 (1971), *reprinted in* 1971 U.S.C.C.A.N. 2053, 2074-75 (requiring the employer to retain a WIN program

1981, Congress included the WIN tax credit in modified form as part of the TJTC.<sup>247</sup> Thus, in their various permutations, these kinds of employment tax credits have been included in the tax expenditure budget since its inception.<sup>248</sup>

### B. *The Work Opportunity Tax Credit ("WOTC")*

The WOTC<sup>249</sup> is intended to "provide an important incentive for employers to undertake the expense of providing jobs and training to economically disadvantaged individuals, many of whom are underskilled and/or undereducated."<sup>250</sup> It provides the employer a

employee for at least one year after completion of the first twelve months of employment, unless the employee left voluntarily, was disabled, or was terminated for misconduct).

247. See Economic Recovery Act of 1981, Pub. L. No. 97-34, § 261, 95 Stat. 172, 260-61, 263.

248. For recent tax expenditure budgets showing the WWTC and WOTC as tax expenditures, see STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2000-2004 (JCS-13-99), December 22, 1999, *reprinted in* 86 TAX NOTES 103, 116 (2000) [hereinafter JCT TAX EXPENDITURE ESTIMATES FOR FY 2000-2004]; ANALYTICAL PERSPECTIVES, *in* BUDGET, FY 2001, *supra* note 5, at ch. 5, 107, 110 tbl.5.1 (listing Work Opportunity and Welfare-to-Work Tax Credits). For earlier tax expenditure budgets showing the credits' predecessors, see, for example, EXECUTIVE OFFICE OF THE PRESIDENT, OMB, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 1980, Part 2, Special Analysis G, 183, 203, 209 tbl.G-1 (showing the Targeted Jobs Tax Credit); EXECUTIVE OFFICE OF THE PRESIDENT, OMB, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 1979, pt. 2, Special Analysis G, 148, 159 tbl.G-1, 165 (showing the New Jobs Credit); and EXECUTIVE OFFICE OF THE PRESIDENT, OMB, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 1976, Part 1, Special Analysis F, 101, 108 tbl.F-1, 112 (showing the WIN tax credit).

249. The WOTC is structured as part of the general business credit. See I.R.C. §§ 51(a) and 38(b)(2). A number of credits are combined into the general business credit for the purpose of computing how much of each credit will be allowed in a given year and in carryback and carryover years. See I.R.C. §§ 38(c), (d), 39.

250. S. REP. NO. 104-281, at 32-33 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1474, 1506-07.

The bill creates a new program whose design will focus on individuals with poor workplace attachments, streamline administrative burdens, promote longer-term employment, and thereby reduce costs relative to the prior-law program. The Committee intends that this short-term program will provide the Congress and the Treasury and Labor Departments an opportunity to assess fully the operation and effectiveness of the new credit as a hiring incentive.

*Id.*; see also H.R. CONF. REP. NO. 104-737, at 205-07 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1677, 1697-99 (generally following the Senate amendment); Statement by President William J. Clinton upon Signing H.R. 3448, 32 WEEKLY COMP. PRES. DOC. 1475 (Aug. 26, 1996), *reprinted in* 1996 U.S.C.C.A.N. 1862, 1863 (1996).

The Act provides a significant incentive for employers to hire people from certain targeted groups most in need of jobs, such as high-risk youth. I am pleased to see improvements that address many of the

credit of forty percent of the first \$6000 of qualified first year wages<sup>251</sup> paid to an employee who completes at least 400 hours of service for the employer, with a smaller percentage applicable for fewer hours of service.<sup>252</sup> The maximum credit for each targeted employee is \$2400 (forty percent of \$6000).<sup>253</sup>

Each individual employee must be certified by the "designated local agency"<sup>254</sup> to be a member of one of the eligible targeted groups. The employer must receive a certification from a designated local agency by the time the employee begins work, or the employer must complete a "pre-screening notice" not later than the day the employee is offered employment.<sup>255</sup> The "pre-screening notice," Form 8850, signed by both the employer and the employee, must be submitted to the agency as part of a written request for certification from the agency within twenty-one days after the employee begins work.<sup>256</sup>

Certain limitations on the availability of the credit restrict its non-business use. The credit cannot be used for wages paid to an employee who is related to or a dependent of the employer or to an

concerns raised about implementation of the TJTC. For example, the minimum employment period required before an employer becomes eligible for the credit will promote longer, more meaningful work experiences for those hired.

*Id.*

251. Wages are defined by reference to the Federal Unemployment Tax Act ("FUTA"). I.R.C. § 51(c)(1) (referring to § 3306(b)). As with the WWTC, "qualified first-year wages" means wages attributable to services "rendered during the 1-year period beginning with the day the individual begins work for the employer." I.R.C. § 51(b)(2).

252. See I.R.C. §§ 51(a), (b), (i)(3). The credit percentage is reduced to 25% of those wages for employees who perform at least 120 hours, but less than 400 hours, of service for the employer. See I.R.C. § 51(i)(3)(A). No wages are taken into account unless the employee has performed at least 120 hours of service for the employer. See I.R.C. § 51(i)(3)(B).

253. No deduction is allowed for the employee's wages to the extent of the amount of the credit. See I.R.C. § 280C(a). This limitation also applies to the WWTC. See I.R.C. § 51A(d)(2) (Supp. IV 1998). This prevents the combination of the wage deduction and the credit from providing a tax benefit in excess of the amount of wages actually paid, and is similar in effect to making the tax credit taxable. See TAX EXPENDITURES, *supra* note 24, at 41, 111. For example, for each eligible worker, a corporate employer in the 35% tax bracket would gain a maximum \$2400 credit and would lose a deduction of \$2400, worth \$840 (35% x \$2400) to that employer. See I.R.C. § 280C(a). The overall effect is thus the same as making the tax credit itself taxable.

254. I.R.C. § 51(d)(11) (1994 & Supp. IV 1998) (referring to a State employment security agency).

255. *Id.* § 51(d)(12)(A).

256. *Id.* § 51(d)(12)(A)(ii)(II). If a certificate is later determined to be incorrect due to false information provided by the employee, the agency must revoke the certification, and wages paid after the employer receives notice of revocation will not be treated as qualified wages. See *id.* § 51(d)(12)(B). If the agency denies a request for certification, it must provide a written explanation of the reasons for denying the request. See *id.* § 51(d)(12)(C).

individual who is more than a fifty percent owner of the business.<sup>257</sup> More than half of the employee's work must be in the employer's trade or business for remuneration paid by the employer to the employee to be taken into account.<sup>258</sup>

If the employer previously employed the employee at any time prior to the hiring date, then the employee's wages may not be taken into account for the purpose of computing the credit.<sup>259</sup> Other limitations respond to concerns about interactions with other federally-financed job training and subsidy programs,<sup>260</sup> with hiring replacements during labor disputes,<sup>261</sup> and with preventing circumvention by employers of the credit wage ceiling and other limitations on the availability of the credit.<sup>262</sup> No credit is generally allowed for tax-exempt organizations.<sup>263</sup>

### C. *The Welfare-to-Work Tax Credit ("WWTC")*

The WWTC<sup>264</sup> is intended to "ease the transition from welfare to work for the targeted categories of individuals by increasing access to employment."<sup>265</sup> It provides the employer a credit amount of 35%

257. *See id.* § 51(i). This limitation also applies to the WWTC. *See id.* § 51A(d)(1) (cross-referencing I.R.C. § 51(i)).

258. *See id.* § 51(f). This limitation also applies to the WWTC. *See id.* § 51A(d)(1) (Supp. IV 1998) (cross-referencing I.R.C. § 51(f)).

259. *See id.* § 51(i)(2) (1994 & Supp. IV 1998), *as amended by* Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 505(b), 113 Stat. 1860, 1921 (striking "during which he was not a member of a targeted group").

260. No credit is available for wages for any period during which the employer receives federally funded payments for on-the-job training for the employee. *See* I.R.C. § 51(c)(2)(A). Wages otherwise eligible for the credit are reduced by the amount of work supplementation payments received by the employer under the Social Security Act with respect to the employee. *See id.* § 51(c)(2)(B).

261. Wages paid to employees hired to work at a plant or facility of the employer during a period when a strike or lockout involves the employees at the plant or facility are not eligible for the credit if they are paid for services "the same as, or substantially similar to, services performed by employees participating in, or affected by, the strike or lockout." I.R.C. § 51(c)(3).

262. All members of the same controlled group of corporations are treated as employed by a single employer, and the WOTC credit with respect to each member is its proportionate share of the wages giving rise to the credit. There are similar rules for unincorporated businesses under common control. *See* I.R.C. § 52 (1994 & Supp. IV 1998). Similar rules apply to the WWTC. *See id.* § 51A(d)(1) (1994 & Supp. IV 1998) (cross-referencing I.R.C. § 52).

263. *See* I.R.C. § 52(c) (excluding cooperatives described in I.R.C. § 521); *see also id.* § 51A(d)(1) (Supp. IV 1998) (noting that the rules are applicable also to WWTC).

264. Like the WOTC, the WWTC is structured as part of the general business credit. *See id.* §§ 51A(d)(2) and 38(b)(2).

265. H.R. REP. NO. 105-148, at 383 (1997), *reprinted in* 1997 U.S.C.C.A.N. 678, 777 (stating that "[i]t is also intended to provide certain employee benefits to these individuals to encourage training, health coverage, dependent care and ultimately better job attachment"); *see also* H.R. CONF. REP. NO. 105-220, at

of the first \$10,000 of "qualified first-year wages" and 50% of the first \$10,000 of "qualified second-year wages."<sup>266</sup> Employers thus may be eligible for a maximum credit per qualified employee of \$8500 over a two-year period, beginning with the employee's first day of work.<sup>267</sup> Wages are "qualified" if paid to employees who are "long-term family assistance recipients."<sup>268</sup> Eligible wages include cash wages paid to an employee plus amounts paid by the employer for certain health plan coverage,<sup>269</sup> educational assistance,<sup>270</sup> and dependent care assistance<sup>271</sup> for the employee.

Each individual employee must be certified by the designated local agency<sup>272</sup> as coming within one of the three targeted categories of "long-term family assistance recipients,"<sup>273</sup> under rules similar to those that apply to the WOTC.<sup>274</sup> The categories generally include members of families: (1) receiving temporary assistance to needy families ("TANF"—the successor program to AFDC) for at least 18 consecutive months ending on the hiring date,<sup>275</sup> (2) receiving such assistance for a total of 18 months (whether or not consecutive) beginning after the credit's enactment date (August 5, 1997) if they are hired within two years after the date that the 18-month total is reached;<sup>276</sup> or (3) ceasing to be eligible for such assistance by reason of any time limits imposed by state or federal law, and having a hiring date not more than two years after the cut-off of assistance.<sup>277</sup>

The WWTC is coordinated with the WOTC<sup>278</sup> and cross refer-

440-41 (1997), reprinted in 1997 U.S.C.C.A.N. 1129, 1252-53 (following the House bill); Statement of President William J. Clinton Upon Signing H.R. 2014, 33 WEEKLY COMP. PRES. DOC. 1192 (Aug. 11, 1997), reprinted in 1997 U.S.C.C.A.N. 1620-1, 1620-3 (stating that the WWTC "is designed to generate new job opportunities for long-term welfare recipients").

266. I.R.C. § 51A(a).

267. See *id.* § 51A(b)(2),(3).

268. *Id.* § 51A(b)(1).

269. See *id.* § 51A(b)(5)(B)(i), (ii) (covering the reasonable cost of coverage for the period, but not more than the applicable premium defined under I.R.C. § 4980B(f)(4)).

270. See *id.* § 51A(b)(5)(B)(iii) (relating to educational assistance excludable from gross income under I.R.C. § 127, or that would be excludable but for the expiration date of § 127(d)).

271. See *id.* § 51A(b)(5)(B)(iv) (relating to dependent care assistance programs under I.R.C. § 129).

272. See *id.* § 51A(c)(1) (defined by reference to §51(d)(11) as a state employment security agency).

273. *Id.* § 51A(c)(1).

274. *Id.* § 51A(d)(1); see also discussion *supra* Part III.B.

275. See *id.* § 51A(c)(1)(A).

276. See *id.* § 51A(c)(1)(B).

277. See *id.* § 51A(c)(1)(C).

278. See *id.* § 51A(e) (Supp. IV 1998) (providing that if a WWTC is allowed to an employer with respect to an individual employee for the taxable year, then the employee cannot be treated as a member of a targeted group for purposes of the WOTC credit for the taxable year).

ences numerous definitions and other limitations from the WOTC.<sup>279</sup> Each year, the employer may choose the credit that provides the greater tax benefit.<sup>280</sup> For example, if the WOTC is selected for a taxable year, the WWTC may be chosen by the employer for the following taxable year if the covered period from the work beginning date for first-year or second-year wages has not yet been completed.<sup>281</sup>

#### D. Congressional Responses to Program Performance

The purpose of this subpart is not to evaluate the operation of the employment tax credit programs themselves, which has been or is being done elsewhere,<sup>282</sup> but to focus on the legislative response to the concerns and criticism generated by past evaluations. Congress has reenacted these expiring tax credits on a regular basis, adjusting and modifying them somewhat, but keeping their basic form fairly constant over the last several decades. As described below, Congress revived them again in the wake of major welfare reform legislation despite substantial criticism of the credits from public policy experts.

Under tax expenditure analysis, it is important to separate the question of whether employment subsidies should be provided at all from the question of whether, if provided, they should be delivered through the tax system or more directly through a direct expenditure program. Although the placement of a subsidy within the income tax code may mask the need for recurring policy analysis of the subsidy, Surrey argued that this would less likely be the case if the

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279. See *id.* § 51A(b)(5)(A), § 51A(b)(5)(C), § 51A(c)(1),(2), § 51A(d) (Supp. IV 1998). Like the WOTC, the WWTC is also coordinated with the empowerment zone employment credit. See *id.* §§ 51A(d)(2), 1396(c)(3) (providing that the same wages cannot be taken into account for multiple credits and that the \$15,000 per calendar year per worker limit of wages to be taken into account for purposes of the empowerment zone employment credit is reduced by the wages taken into account for the calendar year in determining the WWTC or the WOTC credit). For a description of the Empowerment Zone Employment Credit, see *supra* note 237.

280. See I.R.C. §§ 51(j), 51A(d)(1) (providing that an employer may elect out of having the credit apply for any taxable year). The election may be made (or revoked) at any time before the expiration of the three-year period beginning on the last date for filing the return for the taxable year (without regard to extensions). See *id.* § 51(j)(2).

281. See I.R.S. Notice 97-54, 1997-2 C.B. 307 (providing examples); see also I.R.S. Notice 99-51, 1999-40 I.R.B. 447 (describing the operation of the credits when an individual is employed by more than one employer in the process of moving from welfare to work).

282. The predecessor programs of WOTC and WWTC were studied and extensively criticized. Although some of the same criticisms apply to the WOTC and WWTC programs given the similarity in design, it is too early to tell whether these programs will suffer from the same low participation rates and ineffectiveness of the earlier programs. Preliminary information gives cause for concern. See *infra* text accompanying notes 311-12.

subsidy provision were enacted with a termination date because the program would automatically expire in the absence of congressional review.<sup>283</sup> Congressional review, in theory, should begin with consideration of the need for a subsidy and whether the subsidy could meet its goals in a cost-effective way.<sup>284</sup> The discussion below assumes a need for improving targeted group employment levels and wages, and focuses instead on the question of whether the subsidies meet their goals.

### 1. *Reviving Employer Wage Subsidies*

Employment subsidies are intended by proponents to raise wages and employment levels as a means of improving the welfare of low-income families and their communities.<sup>285</sup> A recent comprehensive analysis of the theoretical and empirical literature on employment subsidies concludes that such subsidies, including employment tax credits, are quite problematic, and argues that their supporters have overstated the case for new employment subsidies.<sup>286</sup> At the level of economic theory, Professor Anne L. Alstott points out that employment subsidies are risky because they "require sustained intervention in labor-market processes that are little understood."<sup>287</sup> At the level of practice, after reviewing the litera-

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283. See *Tax Incentives As a Device*, *supra* note 139, at 738.

284. See *supra* discussion Part II.B.

285. See, e.g., EDMUND S. PHELPS, *REWARDING WORK: HOW TO RESTORE PARTICIPATION AND SELF-SUPPORT TO FREE ENTERPRISE* 105-21 (1997) (proposing a graduated wage subsidy for all low-wage workers to increase employment levels and raise wages); Robert H. Haveman & John Karl Scholz, *Transfers, Taxes, and Welfare Reform*, 47 *NAT'L TAX J.* 417, 428-30 (1994) (proposing a permanent employment subsidy modeled on the New Jobs Tax Credit in effect during 1977-78); see also JOEL F. HANDLER & YEHESEKEL HASENFELD, *WE THE POOR PEOPLE: WORK, POVERTY, & WELFARE* 106-12 (1997) (discussing wage subsidies); Joel F. Handler, *Low-Wage Work "As We Know It": What's Wrong/What Can Be Done*, in *HARD LABOR: WOMEN AND WORK IN THE POST-WELFARE ERA* 3, 12-16 (Joel F. Handler & Lucie White eds., 1999) (discussing ways of increasing wages and employment levels for low-wage workers, including the earned income tax credit, wage subsidies, family allowances, and raising the minimum wage).

286. See Anne L. Alstott, *Work vs. Freedom: A Liberal Challenge to Employment Subsidies*, 108 *YALE L.J.* 967, 1019, 1056-58 (1999) (proposing instead a program of unconditional cash grants); see also BRUCE ACKERMAN & ANNE ALSTOTT, *THE STAKEHOLDER SOCIETY* 4-5 (1999) (explaining and defending their proposal of providing each citizen, upon reaching adulthood, with 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 (1988) (developing an 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).

287. Alstott, *supra* note 286, at 1019-29 (discussing the uncertain economics of employment subsidies and the problems of windfall and displacement); see also Yin et al., *supra* note 194, at 291 (stating that, "Concerns expressed about

ture on past programs (including the New Jobs Credit and its successor, the TJTC), Alstott observes that most such programs have been “notable failures,” difficult to design, and subject to interest-group capture and taxpayer manipulation and concluded that “their benefits for workers have been, by most accounts, slim to none.”<sup>288</sup>

In the face of such evidence, accumulated over long experience with such programs,<sup>289</sup> why did Congress revive these subsidies in the late nineties? Part of the answer may be found in political concerns generated by higher profile legislative initiatives aimed at welfare recipients. The Clinton administration pushed for the WOTC and the WWTC as a way of buttressing efforts to move welfare recipients into jobs under major welfare legislation signed in 1996.<sup>290</sup> They fit within the president’s (and congressional) political priorities in “ending welfare.”<sup>291</sup> In addition, in justifying its proposals, the administration’s analysis directly addressed and responded to some of the major criticism of past programs.<sup>292</sup>

Two of the major criticisms of the TJTC, the predecessor of the WOTC, were that the credit resulted in windfall gains for employers because they were subsidized for doing what they would have done anyway in the absence of the program (employ low-wage, low-skilled workers in high-turnover labor-intensive businesses),<sup>293</sup> and that it

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the TJTC include the possibility of windfall gains to the firm with little benefit obtained by workers, and the ‘substitution effect’ where subsidized workers merely replace unsubsidized workers or workers whose subsidy has expired, with little increase in overall employment”).

288. Alstott, *supra* note 286, at 1019, 1029-42 (discussing “pitfalls” in policy design of incremental and targeted subsidies, although acknowledging that an impossible degree of precision should not be demanded); *see also, e.g.*, Yin et al., *supra* note 194, at 291-93. Yin cites studies of the TJTC and concludes as follows:

[I]ts start and stop history, the limited duration of the subsidy to a portion of first year wages, the highly targeted nature of the subsidy directed towards individuals who undoubtedly are the subject of negative stereotyping, and the required participation of both the firm and the worker for the tax benefit to be available—may help to explain the program’s ineffectiveness and low participation rate.

*Id.* at 292.

289. For a description of the proponents and opponents of the TJTC and its political history in relationship to direct employment and training programs, *see* HOWARD, *supra* note 33, at 161-72.

290. *See supra* note 240 and accompanying text.

291. William J. Clinton, Remarks by President Clinton at the Welfare Reform Bill Signing (Aug. 22, 1996) (visited Sept. 15, 2000) <<http://www.acf.dhhs.gov/news/welfare/wr/822potus.htm>>.

292. *See* JOINT ECONOMIC COMM., U.S. CONGRESS, THE WELFARE-TO-WORK TAX CREDIT 1, 6-9 (Mar. 1997) [hereinafter JOINT ECONOMIC COMM. WWTC REPORT] (responding to the administration’s analysis of proposed changes).

293. Large employers in the restaurant, retail, hotel, nursing home, and chicken processing industries, as well as management assistance and consulting firms that helped those businesses with the necessary certifications and filings, were viewed as important lobbying forces in keeping the TJTC alive

provided little or no improvement in the long-term job prospects of the covered workers.<sup>294</sup> Some aspects of the WOTC and WWTC were explicitly designed to mitigate those criticisms, including the reformulation of some target groups, the modification of the certification process, the lengthening of the minimum employment periods for maximum credit receipt, and the increase in the subsidy amount to offset expected employer reluctance to hire long-term welfare recipients.<sup>295</sup> In addition, some administration officials suggested that combining targeted wage subsidies with a constellation of other job retention services, such as child care and transportation, would improve their effectiveness.<sup>296</sup>

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from 1978 to 1994. See HOWARD, *supra* note 33, at 164-65, 172; EDWARD C. LORENZ, NATIONAL COMM'N FOR EMPLOYMENT POLICY, THE TARGETED JOBS TAX CREDIT IN MARYLAND AND MISSOURI: 1982-1987, RESEARCH REP. NO. 88-18, at 74-75 (1988) (discussing lobbying by TJTC management assistance companies); see also *Harnessing Politics*, *supra* note 51, at 521-22 (discussing lobbying activity by companies engaged in assisting firms with TJTC administration).

294. See, e.g., TARGETED JOBS TAX CREDIT: HEARING BEFORE THE SUBCOMM. ON SELECT REVENUE MEASURES OF THE COMM. ON WAYS AND MEANS, 103d Cong. 76, 77 (1994) (containing the testimony of Robert B. Reich, Secretary, U.S. Dep't of Labor, stating that "the Administration has not sought an extension of TJTC in its present form" and summarizing the results of fourteen studies of the program over fifteen years); OFFICE OF INSPECTOR GENERAL, U.S. DEP'T OF LABOR, TARGETED JOBS TAX CREDIT PROGRAM: EMPLOYMENT INDUCEMENT OR EMPLOYER WINDFALL, REP. NO. 04-94-021-03-320, 16-32 (Aug. 1994) [hereinafter TARGETED JOBS TAX CREDIT PROGRAM REPORT] (recommending that, after an audit of program year 1991, the TJTC be discontinued after its expiration); see also U.S. DEP'TS OF LABOR & TREASURY, THE USE OF TAX SUBSIDIES FOR EMPLOYMENT 4-7 (May 1986) [hereinafter 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT] (evaluating the New Jobs Tax Credit and the initial Targeting Jobs Tax Credit in effect from 1979-81).

295. See CONGRESSIONAL RESEARCH SERVICE, EMPLOYMENT TAX CREDITS EXPIRING DURING THE 106TH CONGRESS, updated Dec. 21, 1999, reprinted in CRS Reports on Welfare-to-Work and Work Opportunity Tax Credits (Doc. 2000-828, Release Date: Jan. 04, 2000), 2000 TNT 3-27 (Jan. 5, 2000) [hereinafter CRS EMPLOYMENT TAX CREDIT REPORT]; JOINT ECONOMIC COMM. WWTC REPORT, *supra* note 292, at 6-9 (responding to the administration's analysis of proposed changes); see also Alstott, *supra* note 286, at 1036-38 (discussing the specific changes from prior law and noting some additional problems created by the changes).

296. See Robert Pear, *Clinton Will Seek Tax Break to Ease Path Off Welfare*, N.Y. TIMES, Jan. 28, 1997, at A1 (quoting senior advisers to President Clinton for the administration's view that the new tax credit would be more effective than earlier versions as "just one piece of an overall strategy to make work more attractive than welfare," with other elements including "child care, an increase in the minimum wage, health insurance for people leaving welfare and transportation to help people get to their jobs"). There is some academic support for this view. See, e.g., Lawrence F. Katz, *Wage Subsidies for the Disadvantaged?*, in GENERATING JOBS: HOW TO INCREASE DEMAND FOR LESS-SKILLED WORKERS 21, 46, 49 (Richard B. Freeman & Peter Gottschalk eds., 1998) (concluding that TJTC may have "modestly improved the employment rates of economically disadvantaged youth" and that, although "information/stigma problems" appear to limit the effectiveness of stand-alone targeted wage subsidies,

Other criticisms of the TJTC were not addressed in the new proposals<sup>297</sup> by virtue of their design as targeted or selective hiring credits rather than as general job credits.<sup>298</sup> These included problems of low-income worker displacement (replacing ineligible workers with workers eligible for the credits) or discrimination against members of the targeted groups.<sup>299</sup>

Congress, on a short-term basis, adopted the WWTC in 1997, and has since then renewed it through December 31, 2001.<sup>300</sup> Members of Congress may have: (1) been persuaded by heavy interest group lobbying to reenact the programs in the face of serious questions about their effectiveness;<sup>301</sup> (2) favored the programs as a symbolic gesture, signaling their concern about these employment

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wage subsidies for less skilled workers such as welfare recipients “are likely to be more effective when utilized in conjunction with labor market intermediaries that help provide some training, placement services, and job retention assistance”).

297. See JOINT ECONOMIC COMM. WWTC REPORT, *supra* note 292, at Executive Summary, 1 (concluding that “[i]t is unlikely that the proposed differences between the Welfare-to-Work Tax Credit and its predecessor will effectively address the shortcomings of the earlier plan” and that “the proposed plan may create other problems and inefficiencies which are common to targeted tax credits of its kind”).

298. The former New Jobs Credit was designed as an incremental credit tied to a general increase in the employer’s workforce. In contrast, the TJTC, which was a targeted or categorical hiring subsidy, was designed to provide an incentive for employers to hire from certain low-skilled, hard-to-place groups. See discussion *supra* in Part III.A; *supra* note 242 and accompanying text.

299. See Alstott, *supra* note 286, at 1038-39, 1041 (discussing problems of displacement and stigma).

300. The Welfare to Work Tax Credit (I.R.C. § 51A (Supp. IV 1998)), was enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 801(a), 111 Stat. 788, 869-71. It was extended until December 31, 2001, by the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 505, 113 Stat. 1860, 1921.

301. See generally Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 926-27 (1987) (applying a public choice model to the tax legislative process).

The primary lobbying support for the employment tax credits has been from certain large employers and management assistance companies that process the paperwork. See CRS EMPLOYMENT TAX CREDIT REPORT, *supra* note 295, at ¶ 19 (identifying sources of lobbying pressure in favor of the WOTC, including management assistance companies that help businesses “screen job applicants for credit eligibility and complete required paperwork,” which are believed to “play a considerable role” in lobbying for the credit); *id.* ¶ 19 n.19 (stating that state officials, such as the National Governors’ Association, “ended its summer 1999 annual meeting by passing a resolution to lobby the Congress for a multi-year extension of the WOTC”); Ben Wildavsky, *Taxation: Taking Credit*, 29 NAT’L J. 610 (1997) (describing the lobbying effort behind the WOTC by representatives of management assistance and consulting firms that help large companies secure the required certifications and manage the IRS and Labor Department filings, and also “by large employers in the restaurant, retail, hotel, nursing home,” and chicken processing industries).

problems and the need for some type of governmental response;<sup>302</sup> (3) determined as a policy matter that improved subsidies could provide some modest improvements in wage or employment levels for members of targeted groups and, thus, were worth enacting if combined with other job assistance programs;<sup>303</sup> or (4) viewed the credit as a tax decrease that would limit the size of government.<sup>304</sup> A combination of these reasons, and perhaps others, may have led to reenactment and extension of the subsidies despite the criticism. Certainly welfare reform politics and lobbying by employer groups played a significant role.

## 2. *Delivering the Subsidy Through the Income Tax System*

Once Congress opted to provide the subsidies, why provide them through the tax system? The answer ideally depends upon an assessment of the relative advantages and disadvantages of using the tax system as a delivery mechanism. The primary disadvantages relate to tax system complexity and other administrative concerns identified by tax expenditure theorists.<sup>305</sup> On the one hand, a tax-delivered benefit does not permit the same degree of agency discretion or supervision, for example, as a direct grant program.<sup>306</sup> On the other hand, the tax system may generally provide some advantages as a delivery mechanism for an employment subsidy, particularly if a large number of the employers are small to mid-sized businesses.<sup>307</sup> Businesses file income tax returns on an annual basis and smaller businesses generally may be more accustomed with the tax system than with special employment programs offered by the De-

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302. See Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 47-50 (1990) (stating that legislation, even if ineffective, makes people believe their needs are being met). See generally, e.g., MURRAY EDELMAN, *THE SYMBOLIC USES OF POLITICS* 43 (1967) (arguing that "political activities . . . require the most exhaustive scrutiny to ascertain whether their chief function is symbolic or substantive").

303. See *supra* note 296 and accompanying text.

304. Elimination of employment subsidies may not necessarily result in a general tax rate reduction, even a very modest one. Members of Congress might eliminate employment subsidies but substitute or expand another more popular tax expenditure. Alternatively, advocates for low-income workers and their communities might be successful in convincing Congress to adopt alternative tax or spending proposals aimed at increasing the earnings or employment of low-income workers. Nevertheless, enactment of a tax expenditure is viewed by some as a limitation on the size of government because it inhibits the growth or enactment of direct expenditure programs. On an individual taxpayer level, of course, the credit results in a tax reduction for the eligible employers.

305. See discussion *supra* in Part II.B.2.b.

306. See BUDGET OF THE U.S. GOVERNMENT FOR FISCAL 1999 (Feb. 2, 1998), reprinted in *Tax Expenditures Chapter from the President's Fiscal 1999 Budget*, 78 TAX NOTES 911, 935 (1998); see also *supra* note 200.

307. See *Efficiency and Income Taxes*, *supra* note 153, at 1033-35.

partment of Labor or other government agencies.<sup>308</sup> The administrative costs may thus be lower. In addition, business owners may be more likely to participate in a tax credit program that reduces their tax liability than in a “government subsidy” program to hire certain workers. Any of these factors might justify using the tax system as a means of delivering the subsidy to employers rather than using a grant program to provide either workers or their employers with wage subsidies. In addition, past practice and familiarity may argue for not changing the delivery mechanism that has been used in the past.<sup>309</sup>

However, the record of past programs casts doubt on these assumptions about the advantages of using the tax system in this context. Historically, employment tax credits have suffered a track record of poor participation rates.<sup>310</sup> Preliminary information on the WWTC and the WOTC suggest that the experience under the most recent version of these employment tax credits may not be much different.<sup>311</sup> Furthermore, some preliminary data from empowerment

308. *See id.* at 1011-12.

309. *See id.* at 1034.

310. A recent analysis of employer wage subsidies summarizes information available on participation rates for various programs. The New Jobs Tax Credit subsidized an estimated 1.1 million employees in 1977, and 2.15 million in 1978. *See, e.g.,* Katz, *supra* note 296, at 30; *see also* 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT, *supra* note 294, at 5 (estimating the total budgetary cost of the two-year NJTC as \$9.7 billion). The Targeted Jobs Tax Credit covered a peak of 622,000 workers in 1985 (approximately 0.4 percent of private employment) and then declined to 364,000 in 1992, with revenue losses of about \$500 million (in 1991 dollars) in the mid-eighties, declining to \$245 million in 1991. *See* Katz, *supra* note 296, at 32-33. Under the WIN tax credit program, which had low utilization rates, “no more than 20 percent of the WIN individuals known to have entered employment during the year were ever claimed by firms as tax credits.” *Id.* at 29. According to a study done in the seventies, the WIN tax credit was paid on only 88,000 workers in fiscal 1973-75 out of 515,000 WIN enrollees who entered the labor market in that period. About \$9 million was credited against taxes in fiscal 1973, although part of the credit was for jobs that were later decertified because the employees were not retained for the required period of time. *See* Daniel S. Hamermesh, *Subsidies for Jobs in the Private Sector*, in *CREATING JOBS: PUBLIC EMPLOYMENT PROGRAMS AND WAGE SUBSIDIES* 87, 95 (John L. Palmer ed., 1978). In 1980, WIN tax credits were claimed for less than 10% of all new WIN registrants, and the annual revenue loss attributable to the WIN credit was \$60 million in fiscal year 1981. *See* 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT, *supra* note 294, at 19.

311. *See* CRS EMPLOYMENT TAX CREDIT REPORT, *supra* note 295, at ¶¶ 29-32 (stating that, in fiscal year 1999, state employment security agencies issued 335,707 WOTC certifications to employers and 104,998 WWTC certifications and reporting that corporate employers claimed about \$138 million in WOTC credits on 1997 tax returns and individuals claimed \$15 million on 1997 returns). *Compare* JCT TAX EXPENDITURE ESTIMATES FOR FY 2000-2004, *supra* note 248, at 21 tbl.1 (projecting revenue losses of approximately \$400 million from corporations and \$100 million from individuals in 2000 for the WOTC, and revenue losses of approximately \$100 million from corporations and less than

zones show that utilization rates of employment tax credits tends to be highest among larger businesses,<sup>312</sup> suggesting that the advantage of using the tax system to reach small and mid-sized businesses may be overstated. Given the role of the employment security agencies in the certification process, the administrative costs generated by that participation,<sup>313</sup> and the greater past utilization of employment credits by large businesses, these tax credit programs may be relatively easily substituted by direct grant programs.

In sum, although the weight of evidence does not support providing employment subsidies through the tax system rather than through direct government grants, they remain in the code. As discussed in Part II.C, budget procedures tend to point advocates for subsidies toward using the tax code. Thus, given a pragmatic bottom-line objective to enact some type of subsidy rather than none, subsidies tend to remain in the code even if a direct expenditure program has design advantages.<sup>314</sup>

### 3. *Providing the Subsidy on a Time-Limited Basis*

As noted earlier, members of Congress may act for a range of reasons in providing tax expenditures on a time-limited basis.<sup>315</sup> Reasons in this case may range from a public-spirited desire to evaluate the program "improvements" before making them perma-

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\$50 million from individuals from the WWTC), *with* ANALYTICAL PERSPECTIVES, *in* BUDGET, FY 2001, *supra* note 5, at ch. 5, at 110 & tbl.5-1 (estimating total revenue losses in 2000 from corporate and individual returns of \$455 million for the WOTC and \$60 million for the WWTC).

312. A recent GAO survey of the utilization of employment tax credits (including the Empowerment Zone Employment Credit, the Work Opportunity Credit, and the Welfare-to-Work Tax Credit) and other tax incentives in nine empowerment zones found that large businesses (having 50 or more employees) had the greatest utilization rates. The GAO surveyed 2400 businesses and received responses from 48% of the large urban businesses, 32% of the small urban businesses, and 46% of the rural businesses. Of those responding, the empowerment zone employment credit was used by 42% of large urban businesses, an estimated 6% of small urban businesses, and 32% of rural businesses. Among rural businesses, about two-thirds of the large businesses and about one-third of the small businesses reported using the credit. Large urban businesses and rural businesses reported claiming \$9.1 million for tax year 1997. *See* GAO, *BUSINESSES' USE OF EMPOWERMENT ZONE TAX INCENTIVES*, GAO/RCED-99-253, at 2, 6-11 (Sept. 30, 1999). Most empowerment zone businesses did not use the WOTC or the WWTC (tax year 1997); however, those that did tended to be large businesses. Specifically, 11% of the large urban businesses and 14% of the large rural businesses used the WOTC as compared with an estimated 1% of the small urban businesses and 3% of the small rural businesses. By contrast, 3% of the large urban businesses, no small urban businesses, and 1% of the rural businesses used the WWTC. *See id.* at 18.

313. Spending by the employment security administration on the two programs has been \$20 million per fiscal year. *See* CRS *EMPLOYMENT TAX CREDIT REPORT*, *supra* note 299, at ¶33.

314. *See supra* notes 219-20 and accompanying text.

315. *See* discussion *supra* Part III.A.

nent,<sup>316</sup> to rent-extracting legislative behavior<sup>317</sup> or the realpolitik of congressional budget rules, which encourage the enactment of tax-delivered programs and make the revenue effects of time-limited provisions easier for the tax-writing committees to offset under the paygo budget process.<sup>318</sup>

The questions above, and possible alternative answers to them, loom large in considering what legislative reforms may be possible or desirable as we enter a period of nominal budget surpluses. The next part of the Article addresses the insights the employment subsidy example may provide about the prospects of reinventing the legislative reforms urged by tax expenditure analysts.

#### IV. REINVENTING CONGRESSIONAL OVERSIGHT OF FUNCTIONALLY RELATED PROGRAMS

The employment subsidy example discussed above confirms many of the problems experienced in the past with tax expenditure reforms, including the inherent limitations of relying on increased information or automatic review points.<sup>319</sup> Congress imposed termination dates on both the WOTC and the WWTC when it enacted them in 1996 and 1997, respectively, but it has already extended these credits several times for additional expiring terms.<sup>320</sup> Although the credits did not receive a performance review prior to each extension, Congress considered information about the performance of predecessor credits when the credits were enacted under their new "welfare reform" nomenclature.<sup>321</sup> In the absence of integrated procedures for review by both the tax-writing committees and the substantive committees having jurisdiction over employment programs, the automatic review points for the credits did not prompt

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316. See Glenn, *supra* note 231, at 1009-10.

317. See generally Doernberg & McChesney, *supra* note 301.

318. See *Harnessing Politics*, *supra* note 51, at 507-14.

319. See *supra* text accompanying note 184.

320. See *supra* notes 235-36 (discussing enactment and extension dates of WOTC and WWTC).

321. See *Harnessing Politics*, *supra* note 51, at 567-68 (noting the experience with the TJTC, observing that "[p]rocedural frameworks cannot dictate the content of congressional deliberation; they can only help to give members the opportunity to deliberate and to increase the chance that voters will be able to hold their representatives accountable," and arguing that the paygo procedures operate as a surrogate for institutionalized tax expenditures review). The automatic expiration dates for WOTC and WWTC have not resulted in a substantive review of the credits by the Treasury, the Department of Labor, or by Congress prior to extension. This may also reflect another trend in the tax legislative process. Professor Garrett has recently argued that a shift in power from the committees to the congressional leadership may decrease the amount of deliberation by the tax-writing committees and others. *The Congressional Budget Process*, *supra* note 203, at 726 (providing examples, including the omnibus bill enacting the 1997 budget compromise, which included a section extending a set of expiring tax provisions that had not gone through the revenue committees).

an effective comparison of the credits with alternative direct spending programs.

For the reasons discussed in Part II, an integrated programmatic review has been nearly impossible to achieve in the tax legislative process under current congressional rules and structures. Similar problems have prevented coordinated review by Congress of numerous employment programs funded through the authorization and appropriations process (involving many different committees and subcommittees) and implemented by many separate executive agencies and departments.<sup>322</sup>

The fact that termination dates do not accomplish the type of review advocated by tax expenditure theorists reflects realities of the legislative process quite difficult to alter.<sup>323</sup> This Part considers what the employment subsidies illustration tells us about prospects for more meaningful review of tax expenditures and related direct expenditure programs under emerging Results Act reforms.

#### A. Performance Measurement

Under the OMB framework, the performance review of tax expenditures is done by the Treasury, submitted to the OMB as part of the budget process, and then to Congress as part of the president's proposed budget.<sup>324</sup> As part of the process, both the Internal Reve-

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322. See, e.g., GAO, MULTIPLE EMPLOYMENT TRAINING PROGRAMS: INFORMATION CROSSWALK ON 163 EMPLOYMENT TRAINING PROGRAMS, GAO/HEHS-95-85FS, 1, 6-34 (Feb. 14, 1995) (reviewing 163 employment programs and funding streams, including tax credit programs, that provide about \$20 billion in employment training assistance administered by at least 14 different executive departments and independent agencies, including, among others, the Departments of Agriculture, Commerce, Defense, Education, Health and Human Services, and Housing and Urban Development, as well as the Department of Labor); GAO, MULTIPLE EMPLOYMENT TRAINING PROGRAMS: MAJOR OVERHAUL NEEDED TO REDUCE COSTS, STREAMLINE THE BUREAUCRACY, AND IMPROVE RESULTS, T-HEHS-95-53 (Jan. 10, 1995) (discussing the problems with the current "fragmented" system of federal employment training assistance and concluding that a major overhaul and consolidation of the programs is needed); GAO, MULTIPLE EMPLOYMENT TRAINING PROGRAMS: OVERLAP AMONG PROGRAMS RAISES QUESTIONS ABOUT EFFICIENCY, GAO/HEHS-94-193 (July 11, 1994) (summarizing the unsuccessful efforts made to address overlap issues). See generally Boris I. Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244, 244 n.1 (1969) (criticizing the "idealization of the appropriations process that has become so congenial to tax commentators").

323. See *supra* Parts II.B-C.

324. As part of the management mission of its five-year strategic plan, prepared as required by the Results Act, Treasury announced a goal to improve program performance, and set forth its plan of reporting on the yearly progress toward that objective in the annual budget process. See DEP'T OF THE TREASURY, STRATEGIC PLAN FOR FISCAL YEARS 1997-2002, at app. A, Treasury's Strategic Management Process, Planning, Budgeting, and Reporting Cycle (Sept. 30, 1997), available at <<http://www.ustreas.gov/gpra/strat.pdf>>. The Treasury's annual Results Act performance plans and progress reports have been pre-

nue Service ("Service") and the Treasury plan to develop and report data on the "outputs"<sup>325</sup> and "outcomes"<sup>326</sup> of various tax expenditure programs.<sup>327</sup>

Both the framework for analysis and the data needed for assessment would have to be developed for each specific tax expenditure; such a task would strain resources and staff unless done incrementally.<sup>328</sup> For some tax expenditures with social objectives, the

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sented as part of its annual budget submission since fiscal year 1997. DEP'T OF THE TREASURY, PROGRAM PERFORMANCE REPORT, FISCAL YEAR 1999, at 1, 3 (reporting in a "stand-alone" report, issued as a companion report to Treasury's FY 1999 Accountability Report, that Treasury met 121 of the 186 performance targets that were quantitative and objectively measurable at the end of the fiscal year and that it "continues to refine its measures to make them more useful in the decision making process, and continues to strive to improve the timeliness and accuracy of its information systems that capture and report performance data"). *But see* GAO, OBSERVATIONS ON THE DEPARTMENT OF THE TREASURY'S FISCAL YEAR 1999 PERFORMANCE REPORT AND FISCAL YEAR 2001 PERFORMANCE PLAN, GAO/GGD/AIMD-00-231R (June 30, 2000) (commenting, at the request of the Senate Committee on Governmental Affairs, on key outcomes identified as important mission areas for the agency).

325. In its framework for evaluating tax expenditures, OMB describes "outputs" as "quantitative or qualitative measures of goods and services, or changes in income and investment, directly produced by . . . inputs [in the case of tax expenditures, tax revenue loss is the principal input]." 1997 OMB RESULTS ACT REPORT, *supra* note 80, at IV.

326. OMB describes "outcomes" as "the changes in the economy, society, or environment that are the ultimate goals of programs." *Id.* For example, for an investment incentive, "an increase in the amount of investment might be a key output" and the "resulting production from that investment, and the associated improvements in national income, welfare, or security, could be the outcomes of interest." *Id.*

327. OMB notes that, for tax provisions intended to address a potential inequity or unintended consequence in the code, "an important performance measure might be how they change effective tax rates (the discounted present-value of taxes owed on new investments or incremental earnings) or excess burden (an economic measure of the distortions caused by taxes)." *Id.* In addition, "distributional effects" could be an important concern for some tax provisions. *See id.* *See generally, e.g.,* GAO, REPORT TO CONGRESSIONAL COMMITTEES, MANAGING FOR RESULTS: ANALYTIC CHALLENGES IN MEASURING PERFORMANCE, GAO/HEHS/GGD-97-138 at 14-18 (1997) (describing generally the difficulties in defining and measuring program-specific outcomes).

328. Difficult measurement problems can distract agencies from the overall goals of performance management. As one commentator has cautioned, the "biggest mistake in pursuing performance-based management is to conceive of performance as primarily a *measurement* problem." KETTL, *supra* note 7, at 47. He argues instead that it is about political communication, a "way to talk better about what results government programs produce and, therefore, to make better decisions about what ought to be done, how much ought to be spent in doing it, and how the work could be done better." *Id.* Performance measures "should be limited to those that relate to strategic organizational goals and objectives, and that provide timely, relevant and concise information for use by decision-makers at all levels to assess progress toward achieving predetermined goals." NATIONAL PERFORMANCE REVIEW, SERVING THE AMERICAN PUBLIC: BEST PRACTICES IN PERFORMANCE MEASUREMENT, BENCHMARKING STUDY REPORT 3

Treasury would need to consult with experts in other agencies before constructing performance measures. Although the Service compiles return statistics, it does not routinely collect program performance data. The performance review structure would require the Service to respond with "outputs" and "outcomes" along with agencies responsible for related discretionary spending programs, making the Treasury and the Service more accountable to the OMB and to Congress for the "programs" it administers.

How, if at all, would the performance measurement and reporting requirements have changed the evaluation of the employment tax credits described in Part III? First, it is not clear that there would have been a significant difference in the level of information available on program effectiveness even if the Treasury's Results Act framework for evaluation of tax expenditures had been further developed at the time that the WWTC and WOTC were enacted and extended. Because of the long history of targeted employment tax credits, the Treasury, the Department of Labor, and academic investigators have periodically studied their effectiveness. Although the data tended to focus on simple program output measures, such as program participation rates, they also included more complex measures, such as follow-up information about the longer term employment and wage levels for program participants.<sup>329</sup> Although such performance information was available for evaluation of the employment tax credit programs, comparable data would not be readily available for many other programs delivered through the tax code. The Results Act performance measurement requirements will likely produce useful program performance data on programs that have not been studied in the past.

Despite the relative availability of output data on employment subsidies,<sup>330</sup> the ability of the data to show "outcomes" has been

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(June 1997). The NPR defines performance measurement as follows:

A process of assessing progress toward achieving pre-determined goals, including information on the efficiency with which resources are transformed into goods and services (outputs), the quality of those outputs (how well they are delivered to clients and the extent to which clients are satisfied) and outcomes (the results of a program activity compared to its intended purpose), and the effectiveness of government operations in terms of their specific contributions to program objectives.

*Id.* at 6.

329. See, e.g., TARGETED JOBS TAX CREDIT PROGRAM REPORT, *supra* note 294, at 16-32.

330. In some cases, appropriate output measures for social programs can be quite difficult to determine. See Mashaw, *supra* note 16, at 411-12 (using the example of social security disability benefits and concluding that "[d]eciding who meets the eligibility criteria for disability payments is an interpretive enterprise whose quality and legitimacy must be evaluated more by the inputs—substantive standards, evidentiary rules, fact-gathering routines, justification requirements, quality checks, and appeal rights—than by the outputs").

quite limited because of certain inherent measurement problems. As discussed in Professor Alstott's analysis of the economics of employment subsidies, it is very difficult to isolate the impact of the subsidies from more generalized economic trends.<sup>331</sup> Thus, from an empirical standpoint, it may not be possible to measure "outcomes" from employment subsidy programs in any meaningful way. That type of difficulty with establishing "outcomes" will continue to be a problem under the Results Act performance review structure.

In some cases, as discussed above, the difficulty in selecting appropriate outcome measures and analyzing their results stems from an attempt to "influence complex systems or phenomena whose outcomes are largely outside government control."<sup>332</sup> In other cases, the federal agencies do not directly manage programs but instead provide funds in complex partnerships with others to provide services or programs, such as with private contractors, state agencies, or nonprofit organizations.<sup>333</sup> The outcomes of these programs may be beyond the control of federal agency managers.<sup>334</sup> The success of the employment tax credit programs, for example, depends upon complex relationships among federal agencies, including the Treasury, the Internal Revenue Service, the Department of Labor, and, with state employment offices, private employers and their employees. Determining how to hold federal employees accountable for outcomes under such circumstances will be quite difficult.

In sum, the technical and managerial problems in attempting to measure outcomes are considerable. For these reasons, other countries in the process of implementing performance-based management and budgeting systems have tended to focus primarily on "output" measures for performance review of social programs.<sup>335</sup>

### *B. Performance Management and Budgeting*

Gaps in performance data, discussed above, may also draw new attention to gaps in tax expenditure management and oversight. The reporting process could put pressure on the Treasury and the

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331. Alstott, *supra* note 286, at 1031-42.

332. GAO, *MANAGING FOR RESULTS: ANALYTIC CHALLENGES IN MEASURING PERFORMANCE*, GAO/HEHS/GGD-97-138, at 30 (1997) (suggesting in response that performance measurement data be supplemented by impact evaluation studies and systematic evaluation of how a program was implemented).

333. See KETTL, *supra* note 7, at 47-48.

334. One suggested way of addressing this dilemma is to begin by developing a system for measuring outputs (for purposes of shaping managers' behavior) and then to move toward assessment of outcomes for purposes of policymaking decisions. *See id.* at 47-49.

335. *See, e.g.*, GAO, *MANAGING FOR RESULTS: EXPERIENCES ABROAD SUGGEST INSIGHTS FOR FEDERAL MANAGEMENT REFORMS*, GAO/GGD-95-120, at 4 (1995) (describing the output-oriented approach of New Zealand and the United Kingdom, and observing that even though Australia and Canada take an outcome-oriented approach, the measures used in performance reports tend instead to focus on outputs).

Service to manage these programs more actively if they are formally incorporated into their performance plans. Therefore, the Results Act should, over time, prompt preparation of new information about the effectiveness of programs.

By raising the bureaucratic stakes, the expansion of tax expenditure analysis from its current role in budgetary analysis to a new management and assessment role puts additional pressure on the controversial definitional and measurement issues underlying tax expenditure theory. Categorizing a tax provision as a tax expenditure would determine the applicability of the performance-based management and budgeting requirements. Although the definitional issues were briefly mentioned in Part II, they were assumed away for purposes of this discussion. Not all definitional issues are as clearcut as they appear to be in the employment tax credit context. Some issues are very difficult to resolve and have been highly contested, for different reasons, by both tax experts and politicians.

In addition to focusing greater attention on program definition and management issues within the Treasury and the Service, the Results Act raises interagency management issues as well as potential cross-agency budgetary concerns. The missing pieces of the employment subsidy analysis in Part III that could be provided by the Results Act tax expenditure performance review framework are the "comparisons of tax expenditures with other means of addressing their main objectives or budget functions, such as spending or regulatory programs."<sup>336</sup>

This type of analysis so far has not been a prominent feature of the Treasury's performance plans. The GAO evaluation of the Treasury's fiscal year 1999 and fiscal year 2000 performance plans found that the Treasury's plans do not consistently include information about how the Treasury and the Service plan to coordinate cross-cutting agency activities that share common purposes.<sup>337</sup> Although it is possible that providing this type of cross-agency and cross-budgetary analysis could have made a difference by persuading Congress to substitute tax subsidies with a direct grant program, current congressional structures for committee consideration

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336. 1997 OMB RESULTS ACT REPORT, *supra* note 80, at IV.

337. The GAO explained its finding as follows:

[The] IRS, for example, is responsible for administering the tax code provisions relating to several billions of dollars of tax expenditures, such as the earned income tax credit, the low-income housing credit, and the research credit. However, there is no discussion of how IRS intends to coordinate with federal agencies that administer related direct expenditure programs to develop performance goals pertaining to its responsibilities.

GAO, REPORT TO THE SECRETARY, DEPARTMENT OF THE TREASURY, RESULTS ACT: OBSERVATIONS ON TREASURY'S FISCAL YEAR 1999 ANNUAL PERFORMANCE PLAN, GAO/GGD-98-149, at 4; *see also* GAO, OBSERVATIONS ON THE DEPARTMENT OF THE TREASURY'S PERFORMANCE PLAN FOR FISCAL YEAR 2000, GAO/GGD-99-114R, at 9.

and review make substitution unlikely to happen even if the information were available.

In sum, whether increased performance information leads to major changes in program design, to changes in which agency manages them, or eventually to program elimination, primarily depends upon Congress. These issues must be addressed and resolved as the performance review process matures. The next section briefly sets forth the type of congressional response that should be considered as a next-stage "reinvention" development.

### *C. Congressional Response*

Congress must eventually decide how to respond to the additional performance information provided by the Treasury about tax expenditure programs and by other executive agencies responsible for managing direct expenditure programs. Most importantly, Congress must determine whether revised congressional structures will be developed to engage in functional budgeting analysis or more systematic and integrated performance oversight of functionally related programs.

The inadequacy of the current congressional structures to deal with the type of performance information that should become increasingly available under the Results Act is illustrated by the experience with employment subsidies discussed in Part III. Unlike many other tax expenditures, the performance of these programs has been reviewed by both the executive and legislative branches. The executive agencies, at various points, recommended the termination of employment tax credit programs or otherwise questioned their effectiveness after reviewing the programs' performance.<sup>338</sup> After a temporary termination, the administration supported revised credits, and Congress passed them despite serious questions about the corrective effect of the revisions. Thus, an evaluation of the subsidy's effectiveness did occur prior to the enactment of the WWTC and WOTC.<sup>339</sup>

Despite the initial review of past performance of similar employment tax credits, Congress did not give any serious consideration to providing the subsidies directly, rather than through the tax system, or in consolidating the assistance with existing jobs programs. No current congressional structure facilitates such an analysis, even under Results Act reforms. Although the Results Act provides a reporting mechanism to support a comparative analysis of alternative program delivery vehicles, it does not address the more basic structural obstacles to reform.

As discussed in Part II.A, the GAO tax expenditure study concluded that integrated reviews of functionally related programs

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338. See *supra* note 294.

339. See discussion *supra* in Part III.D.1 (reviving employer wage subsidies).

would more likely be achieved through an executive branch coordination effort than through changes in congressional procedures.<sup>340</sup> The Results Act offers one such executive branch approach. Additional reforms, aimed at achieving more integrated analysis of alternative program funding mechanisms, could be attempted as part of the president's annual budget submission. However, if Congress ever comes to a consensus about the need to evaluate program performance and to eliminate program overlap and inefficiency, it must restructure its own procedures.

As mentioned earlier, congressional committees now review agency performance plans as part of the Results Act oversight process.<sup>341</sup> Nevertheless, existing committee structures offer little opportunity for coordinated review of cross-agency programs in related functional areas. More fundamental structural reforms are needed.

In recent testimony before the Senate Budget Committee, the U.S. Comptroller General compared the current performance oversight environment to that of the budget environment of thirty years ago, prior to the creation of the Budget Committees and the congressional budget resolution to coordinate the budgetary activities of congressional committees.<sup>342</sup> He urged Congress to "consider whether a more structured oversight mechanism is needed to permit a coordinated congressional perspective on government[-]wide performance matters," with one possible approach being a modification of the budget resolution to include such a perspective.<sup>343</sup>

This type of coordination effort and other potential responses should be explored in the coming years if Congress is to achieve a meaningful review of program management and budgetary performance. Incorporating performance review coordination instructions into the congressional budget process would increase the influence of the budget committees and further lessen the autonomy of the tax-writing and appropriations committees, continuing a shift in influence that has occurred gradually over the last twenty-five to thirty years. However, in the absence of a program management crisis analogous to the federal deficit crisis, the development of a program oversight coordination role for the budget committees could require a level of political consensus beyond the current capacity of Congress.

Without ways to achieve congressional committee coordination, however, important program oversight issues will remain unaddressed. The challenge for the future under the Results Act will be how Congress responds to the performance information provided by

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340. See *supra* notes 126-130 and accompanying text.

341. See *supra* note 96 and accompanying text.

342. See GAO, TESTIMONY BEFORE COMM. ON BUDGET, U.S. SEN., BUDGET ISSUES, GAO/T-AIMD-00-73 at 22 (Feb. 1, 2000) (statement of David M. Walker, Comptroller General of the United States).

343. *Id.*

the Treasury and other executive agencies in the budget and program oversight process.

### CONCLUSION

The Results Act creates an executive branch framework to provide Congress with information about the performance of federally-funded programs. The reporting framework could lead to more meaningful review by Congress of a broad range of functionally related government programs, whether delivered directly by government employees or indirectly through alternative delivery mechanisms. To achieve that end, however, the framework must apply to all federally-funded program activities, whether funded and implemented via direct expenditures, tax expenditures, or as regulatory programs. Ensuring comprehensive coverage is, thus, an important first step toward reform.

The Results Act framework, if comprehensively applied, provides a new opportunity to address the management and oversight problems posed by the use of tax expenditures as alternatives to direct expenditure programs. Tax expenditure theory and its progeny, a series of tax expenditure budgets issued over the last thirty years, have served an important public policy function by providing legislators with information about the budgetary role of certain revenue-losing tax provisions. Tax expenditure theorists have also provided a conceptual framework and argument for more systematic review by Congress of tax expenditures as spending programs. To accomplish such review, they have suggested the use of automatic review points (sunset provisions) and other legislative reforms. Over the years, however, the tax expenditure oversight aspects of their legislative reform agenda have encountered significant institutional obstacles. Most of these reforms were never fully implemented, and the ones that have been enacted provided little political constraint on the use of tax expenditures.

That experience provides important lessons about the prospects for more meaningful review of both tax expenditures and direct expenditures under the Results Act. The transformation of tax expenditure analysis—from primarily a budgetary information function into a program management assessment tool—will be quite difficult to accomplish, but it has already begun under the government-wide performance review process developed pursuant to the Results Act. The agency performance measurement and reporting process should, over time, generate useful information about the “output” of a broad range of programs, including previously unexamined tax expenditures. Program performance information may less likely be used as a budget dodge than mechanical rules like sunset provisions. Most importantly, once available, the information coordinated by the OMB as part of the budget process will give policymakers an opportunity to evaluate program effectiveness within the

context of other programs within the same budget function.

Recent experience with two expiring employment tax credits, the Welfare-to-Work Tax Credit ("WWTC") and the Work Opportunity Tax Credit ("WOTC"), however, highlights some of the limitations of relying exclusively on an executive branch coordination effort to accomplish more effective legislative oversight. Although the visibility, impermanence, and detailed eligibility provisions of the employment tax credits approach an appropriations-type model, periodic review and extension of these provisions by the tax-writing committees have not resulted in the type of programmatic review contemplated by reformers. The lack of integrated review in these particular cases does not derive from a lack of transparency or a dearth of data; instead, it represents, depending upon your view of the legislative process, either "business as usual" or a structural failure to consider tax system and direct spending alternatives as part of a coordinated program review process.

As we enter a period of budget surpluses and modification of the paygo budgetary regime, it is time to evaluate whether the movement toward results-oriented management and oversight of government programs could lead to more fundamental structural reforms by Congress. If fully implemented, the Results Act performance information framework could present Congress with an opportunity to develop more coordinated legislative procedures, through the budget resolution or some other procedure, to improve oversight of functionally-related government programs. Whether the executive and Congress will sustain this movement remains to be seen. If so, the question of whether Congress will create effective structures to respond to the program and budget information provided by the executive branch under the evolving Results Act framework remains a central challenge for the future.