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Tax Incentives and the War on Drugs

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“TAX INCENTIVES AND THE WAR ON DRUGS”

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   Introduction

   The American “war on drugs” has failed to achieve its stated goal to reduce drug use. Over the nearly forty years of failed drug control policy commentators have put forth a voluminous body of scholarly literature criticizing the strategy. The impetus for this body of literature is the unambiguous and continuing reality that traditional drug control strategies are ineffective. In 2005, the percentage of “current drug users” in the U.S. was 8.1 percent, a figure that is 2 percent higher than the number of “current drug users” in 1995. Out of this voluminous body of literature, no commentator has yet to suggest integration of the tax code into the “war on drugs” as a monitoring device to

1 See infra notes 40-59 and accompanying text.
3 Results from the 2005 National Survey on Drug Use and Health National Findings, U.S. Department of Health and Human Services, 13 (2005). A “current drug user” is an individual who used an illicit drug during the month prior to the survey interview. Id.; see discussion infra Parts I.C-D.
change and influence the consumption choices of citizens with respect to illegal drugs.
This silence is surprising because the tax code is a proven and highly effective tool in modifying the after-tax cost of engaging in market activity. Moreover, the tax system could easily be extended to influence the consumption choices of citizens with respect to illegal substances.

A properly structured tax statute could create an immediate economic incentive for drug users to conform their behavior to the criminal code. In contrast, current drug control strategies only indirectly utilize economic deterrence, and for drug users any thought of economic loss from choosing to consume illegal drugs is heavily discounted by the probability of being caught, which is low. These monitoring deficiencies associated with criminal enforcement can be overcome through the tax code. Under this proposal, deterrence of drug use is achieved through the tax code and the economic incentives therein, as opposed to the traditional, costly, and ineffective criminal method.

Currently the tax code is utilized to influence the consumption choices for a whole range of “socially desired” behavior. This Article argues that state governments should extend the use of tax incentives to the “war on drugs.” This Article will explore this novel policy recommendation in detail.

Part I below offers a general overview of the “war on drugs” and the principle reasons the strategies employed to combat drug use have failed. This section presents

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4 See discussion infra Part II.
5 See discussion infra Part III.
6 See discussion infra Part III.B.i-ii.
9 See infra Part I.A-C., III.B.
10 See infra Part II.
the argument that the current strategies employed in the “war on drugs” are ineffective and that the government therefore needs to explore alternative strategies.

The integration of tax incentives into the “war on drugs” is the alternative strategy this Article argues would be most effective at reducing drug use. Part II provides background into how the government currently employs tax incentives to influence the consumption choices of taxpayers. This section is intended to provide the reader with insight into the scope of governmental influence on everyday consumption decisions. The topics here include tax incentives as well as tax disincentives.

Part III shifts to an analysis of the proposal to integrate tax incentives into the “war on drugs.”11 The introduction to this Part puts forth the specific proposal to condition the availability of tax incentives on a clean drug test. Part III.A explores the constitutional issues that such a proposal may face. The conclusion here is that the drug tests must be voluntary, and that the information collected from the drug tests must be confidential and not shared with law enforcement agencies.12

Part III.B of this Article will examine how the proposal withstands both traditional and behavioral economic analysis. The topics here include the concept of “hyperbolic discounting,” which is explored in Part III.B.iii.3. Flowing from this concept is the conclusion that any statutory codification of the proposal, in order to be most effective, should contain staggered penalties and rewards. Finally, in Part III.C the Article examines the different structural decisions facing the policymaker. In the first instance, the nature of the tax benefit conditioned on the passing of a clean drug test

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11 See infra Part III.
12 See infra Part III.A.
would depend on the character of drug users in the community at issue.\textsuperscript{13} This section explores this concept. Lastly, the Article, in Part III.C.iii., ends with a prudent proposition. That whatever the statutory scheme enacted, the policymaker should include a safe-harbor provision in the statute whereby citizens who pass the drug test on consecutive occasions qualify for a safe-harbor from future testing.\textsuperscript{14}

I. Overview of the “War on Drugs”

A. Spending: Growth in the Function of Drug Control within the Government

In 1969, shortly after taking office, President Richard Nixon declared that one problem in the United States stood out among all others, “The problem of narcotics.”\textsuperscript{15} The policies that followed during his administration are generally referred to as the beginning of the “war on drugs.”\textsuperscript{16} Over the last forty years the federal government has continued the strict policy of drug control initiated during the Nixon administration, increasing the function of drug control within the federal government. For example, according to the Office of National Drug Control Policy the total federal appropriations for drug control related activities increased from $7.0 billion in 1995 to $12.1 billion in

\begin{flushleft}
\textsuperscript{13} See infra Part III.C.i-ii. \\
\textsuperscript{14} See infra Part III.C.iii. \\
\textsuperscript{15} See Dan Baum, Smoke and Mirrors The War on Drugs and the Politics of Failure 11-12 (1996). \\
\textsuperscript{16} See Judge James P. Gray, Why Our Drug Laws Have Failed and What we Can do About It A Judicial Indictment of the War on Drugs 27 (2001). Under the Nixon administration federal drug control expenditures increased from $86 million in 1969 to nearly $800 million in 1974. See David Musto, The American Disease Origins of Narcotic Control 248-257 (3rd ed. 1999). These expenditures were directed primarily at “demand reduction” programs, where individuals in trouble with drugs could seek help if they wanted; however, “supply reduction” programs were also given substantial increases in funding. See id. at 250-251. The perceived drug threat during the Nixon administration was heroin, especially among Vietnam veterans returning from the war. Id. “Supply reduction” spending over this period increased from $43 million in 1970 to $292 million in ’74. Id. In contrast spending on “demand reduction” programs increased nearly twice as much, from $59 million in 1970 to $462 million in 1974. Id.
\end{flushleft}
2005, a staggering 73 percent increase in federal funding over the ten-year period. Over this same period, drug control expenditures increased relative to gross domestic product (GDP), indicating growth in the function of drug control within the federal government.

In addition to the federal direct expenditures outlined above, the “war on drugs” has led to substantial state and local expenditures. The exact amount of these expenditures is difficult to quantify due to the fragmented nature of the data. Most recently, in 1991 a study estimated that local governments’ drug control expenditures totaled $8.5 billion.

The current drug control programs employed by the government categorically fall under either “demand reduction” or “supply reduction” programs. As a matter of background, “demand reduction” refers to programs and research related to drug abuse intervention and drug treatment designed to reduce the demand for drugs; whereas, “supply reduction” refers to law enforcement activities designed to reduce the supply of drugs through an interdiction strategy.

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18 A common way to express the size and growth of government functions is the ratio of expenditures to the GDP or percent GDP. The percent of gross domestic product spent on federal drug control from 1995 to 2005 increased 2.67 percent. In 1995 the GDP was $7397.7 billion dollars, this figured increased to $12445.8 billions dollars in 2005. See Bureau of Labor Statistics, Gross Domestic Product, available at www.bls.gov. Thus, it can be said that the function of drug control within the federal government has increased over the last decade. In other words, a greater percentage of tax dollars are being spent on the “war on drugs” today than was spent on the “war on drugs” in 1995.

19 See One Judge’s Attempt at a Rational Discussion of the So-Called War on Drugs, 6 B.U. Pub. Int. L.J. 1, 8 (1996).

20 See infra text accompanying notes 23-25.
The effectiveness of a “supply reduction” strategy has been debated since the Nixon administration began to implement the tactic in the 1960’s. 21 “Supply reduction” has historically been, 22 and currently is the preferred strategy of the federal government. 23 Academics attribute the government’s historical trend towards a “supply reduction” strategy to its more easily measurable results as opposed to the “demand reduction” strategy. 24 Though leading to powerful political messages, these measurable results overstate the effectiveness of the “supply reduction” strategy. Instead, the “supply

21 Milton Friedman, criticizing the “supply reduction” strategy, has this to say, “To the extent that authorities curtail supplies of marijuana, cocaine and heroin coming into the U.S. market, the retail price of these substances goes up, making the trade immensely profitable – tax-free, of course. The more the U.S. spends on interdiction, the more incentive it creates for taking the risk of running drugs.” Global View: Musings About the War on Drugs, Wall Street Journal, 02/21/2006. See also Philip M. Boffey, U.S. Attacks Drug Suppliers But Loses Battle of the Users, N.Y. Times, April 12, 1988, at A1 (quoting President Reagan in a speech he gave on Feb. 29, 1988 to the White House Conference for a Drug-Free America, “as significant as stopping smugglers and pushers is, ending the demand for drugs is how, in the end, we’ll win”).

22 See Musto, supra note 16, at 267 (explaining the allocation of federal drug control funding during the Regan administration).

23 In 1997 “demand reduction” funding was 47.7 percent of the total drug control budget, whereas in 2006 the budget request for “demand reduction” programs is only 38.7 percent of the total budget. See Executive Office of the President, Office of Drug Control Policy, National Drug Control Strategy: FY2006 Budget Summary, 9 (Washington, DC, Executive Office of the President 2006), http://www.whitehousedrugpolicy.gov/publications/policy/07budget. Along these lines, the total dollars request for drug abuse prevention programs have been on a declining trend, from a high of $1.6 billion in 2002 to $1.1 billion in the 2006. Id.

24 Compare Ted Gest, Crime and Politics: Big Governments Erratic Campaign for Law and Order 124, 130-131 (Oxford University Press, 2001) (discussing common political arguments put forth against a “demand reduction” strategy such as, the ineffectiveness of treatment programs, and the mixed results of television advertisements) with Juan Forero, Cocaine Prices Rise and Quality Declines, White House Says, N.Y. Times, Nov. 18, 2005, at A12 (citing the Director of the White House Office of National Drug Control Policy discussing recent “supply reduction” statistics, “These numbers confirm that the levels of interdiction, the levels of eradication, have reduced the availability of cocaine in the United States. There’s a change in availability. The policy is working.”).
reduction” strategy has proven ineffective, and has little influence on the consumption choices of drug users. For example, while the funding for “supply reduction” programs has increased substantially over the last ten years, the number of current drug users in the U.S. has also increased, suggesting that illegal drugs are as readily available today as they were ever before.

B. Regulation: Mandatory Minimum Sentences and Overcrowded Prisons

In many respects the direct expenditures identified above do not wholly account for government spending on the “war on drugs.” Rather, a true quantification must include indirect government corrections spending arising from the enactment of “get tough” legislation. The federal government, as part of the “war on drugs,” has employed a strategy of broadening the penal code through the enactment of “get tough” legislation. This strategy has not been an exclusive federal phenomenon as many state

25 For years Commentators have criticized the “supply reduction” strategy as wholly ineffective. See supra note 21 and accompanying text. C.f. Orlando Patterson, The Other Losing War, N.Y. Times, Jan. 13, 2007, at A15 (“recent surveys indicate a steady increase in the use of illicit drugs: more than 40 percent of Americans over 12 have used them at some point”), Philip M. Boffey, U.S. Attacks Drug Suppliers But Loses Battle of the Users, N.Y. Times, April 12, 1988, at A1 (“only a small percentage of the cocaine and a somewhat larger percentage of the marijuana coming into the country in recent years have been seized”).

26 Despite the historical increases in funding for “supply” reduction strategies, the demand for illegal drugs remains strong. See infra Part I.C.

27 See supra note 23.

28 See infra Part I.C.

29 For example, in 1994 Congress passed the Crime Bill, which created capital punishment for some types of drug selling, and instituted criminal enterprise statutes that called for mandatory sentences from twenty years to life. See Gray, supra note 16, at 27-28. Also, in 1998 Congress passed the Drug Free Student Loans Act. Id. This statute denies aid to college students who have a misdemeanor conviction under any Federal or State law involving the possession or sale of a controlled substance. Id. For a discussion on growing global opposition to punitive drug policies see Jefferson M. Fish, Drugs and Society: U.S. Public Policy 66-67 (citing the Single Convention on Narcotic Drugs of 1961 as a baseline legal regime inhibiting greater global relaxation of drug policies).
legislatures have pursued a similar course of action by enacting “get tough” laws. The specific component of “get tough” legislation that academics cite as causing the increase in the correction population is the inclusion of mandatory minimum sentencing guidelines for judges. The effect of these statutes is that judicial discretion in sentencing is limited, has become formulaic, and results in greater incarceration rates.

The U.S. prison population has exploded over the last twenty years. A significant amount of this growth is attributable to “get tough” laws for drug offenses. For example, according to the United State Bureau of Justice Statistics, between 1995 and 2003, drug offenders represented 49 percent of the growth in the federal inmate population. The


32 Recently the issue of mandatory minimum sentencing is subject to increasing political scrutiny at both the federal and state level. See Lynette Clemetson, Judges Look to New Congress For Changes in Mandatory Sentencing Laws, N.Y. Times, Jan. 9, 2007, at A12 (explaining optimism among judges that the new congress may consider reforming mandatory minimum sentencing laws), Jennifer Warren, Democratic lawmakers propose creating a panel with power to set prison sentences, LA Times, Jan. 19, 2007 (discussing California’s growing prison population and efforts to reform sentencing laws).

most recent data available for 2003 indicates that 55 percent of federal inmates, and 20 percent of state inmates are drug offenders.\textsuperscript{34}

Not surprisingly, government spending on corrections has been historically increasing at both federal and state levels. According to the most recent data published by the National Institute of Justice total federal spending on correction increased from $408 million in 1980 to $5.4 billion in 2003.\textsuperscript{35} For this same period, aggregate state spending on corrections increased from $4.54 billion in 1980 to $39.18 billion in 2003.\textsuperscript{36} Over the last ten years alone, total government spending on corrections increased 53 percent from $20.8 billion in 1993 to $39.18 billion in 2003.\textsuperscript{37}

C. Demand For Illegal Drugs Remains High

The overarching goal of the “war on drugs” is to reduce drug use.\textsuperscript{38} The following discussion highlights the inability of current drug control strategies to meet this goal or effectively control the market for drugs.\textsuperscript{39} The purpose of this section is to

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\item \textsuperscript{36} Id.
\item \textsuperscript{37} Id.
\item \textsuperscript{38} Consider the following quote from President George W. Bush: "We must reduce drug use for one great moral reason: Over time, drugs rob men, women, and children of their dignity and of their character. Illegal drugs are the enemies of ambition and hope. When we fight against drugs, we fight for the souls of our fellow Americans." See Executive Office of the President, Office of Drug Control Policy, National Drug Control Strategy: FY2002 Budget Summary, 3 (Washington, DC, Executive Office of the President 2002), http://www.whitehousedrugpolicy.gov/publications/policy/02budget.
\item \textsuperscript{39} See Steven Duke, Americas Longest War: Rethinking Our Tragic Crusade Against Drugs 200 (Putnam, 1993) (detailing the inherent limitations of specific “supply” and “demand” reductions strategies, and concluding that the goal of a “drug free” society is impossible); See also Gray, supra note 16, at 48 (“Under our current policy, drugs are
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highlight the continued demand for drugs, and to provide background on the characteristics (e.g., income and age) of the illegal drug consumer at the national level, and how these characteristics vary when the drug problem is focused on a local level. Along these lines, the discussion first considers the continued demand for illegal drugs at the national level, and then examines the drug problem plaguing the state of Hawaii.

i. **National Demand for Illegal Drugs**

Despite increases in spending on drug control as well as the enactment of increased criminal penalties the demand for illegal drugs in the United States remains strong. According to the U.S. Department of Health and Human Services, in 2005 an estimated 19.7 million Americans aged 12 or older, or 8.1 percent, had used an illicit drug during the past month.\(^{40}\) Over the past decade the rate of current illicit drug use among persons aged 12 or older has been trending upward, rising 2 percent over the period, up from 6.1 percent in 1995.\(^{41}\) Of the 8.1 percent of Americans who are current drug users, the majority of the past month drug abuse is clustered among individuals aged 16-25 years old. The breakdown of past month drug users is detailed in “Graph 1.”\(^{42}\)

**Graph 1:**

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\(^{42}\) See supra note 40.
One of the primary measuring sticks of the success of the “war on drugs” over the last twenty years has been the use of drugs among teenagers and young adults.\(^{43}\) Despite this emphasis, over the past decade the rate of current illicit drug use among persons aged 18-25 has increased nearly 6 percent, rising from 14.2 percent in 1995 to 20.1 percent in 2005.\(^{44}\) This increase is illustrated in “Graph 2.”\(^{45}\)

**GRAPH 2:**

\(^{43}\) See Executive Office of the President, Office of Drug Control Policy, National Drug Control Strategy: FY2006 Budget Summary, Introduction (Washington, DC, Executive Office of the President 2006), http://www.whitehousedrugpolicy.gov/publications/policy/06budget (citing “drug use” among young people as a primary measuring proxy of the American drug problem); see also Gray, supra note 16, at 49 (“Our current system is completely unable to keep illicit drugs out of our communities and away from our children.”); Cf. Mike Males, Dad, This is Your Brain on Drugs, N.Y. times, Jan. 3, 2007, at A21 (arguing for policy makers to “end the obsession” with teenage drug use).


\(^{45}\) Id.
The trend of increasing current drug users among teenagers and young adults aged 18-25 can be explained by the fact that drugs are as readily available today as they were before the beginning of the “war on drugs.” For example, the latest University of Michigan Monitoring the Future survey of youth drug use concluded that for 12th-graders the availability of marijuana and cocaine are at levels relatively on par or higher than those reported in 1977, before the government significantly escalated the “war on drugs.”

Likewise, the proportion of 12th-grade students saying they could get heroin fairly easily if they wanted has stabilized at approximately 30 percent since 2000, up from around 20 percent through the mid-1980s.

The above statistics demonstrate that current illicit drug use remains strong for a significant portion of young adults and teenagers. These findings are further

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46 Lloyd D. Johnson Et Al., Monitoring the Future 12, (University of Michigan News and Information Services, 2006). Since the study began in 1975, between 83 percent and 90 percent of every senior class have said that they could get marijuana fairly easily or very easily if they wanted some. Id. at 18. Likewise, the proportion of 12th graders saying that it would be fairly easy or very easy for them to get cocaine if they wanted some was 33 percent in 1977, while in 2005 this figure was 45 percent. Id.

47 Id. at 26.
corroborated by the National Center on Addiction and Substance Abuse at Columbia University, which since 1996 has conducted a yearly survey of teenagers asking, among other things, “What is the most important problem facing people your age?” The issue of “drugs” has ranked as the number one concern for surveyed teenagers every year.

The above statistics indicate that the strategies employed by the government to combat drug use have been largely ineffective at meeting their goal. Although drug use has not exploded over the last twenty years, it is apparent that demand has remained relatively constant. This is true despite the increase in drug control spending and the enactment of more stringent criminal penalties.

ii. Case Study: The “Ice” Problem in Hawaii

Although national interest in drug control policy may have waned in recent years, some localities are fighting the drug problem harder than ever. The following case study, detailing the recent drug control problems in the state of Hawaii is intended to present a local view of the drug control problem.

Over the last few years, the issue of drug abuse in Hawaii has gained increasing political and public visibility. The drug of primary concern is “Ice,” or

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48 National Center on Addiction and Drug Abuse at Columbia University, National Survey of American Attitudes on Substance Abuse: Teens and Parents 8 (2005). Available online at http://www.casacolumbia.org/Absolutenm/articlefiles/Teen_Survey_Report_2005.pdf. In 2005, 29 percent of teens cited drugs as their number one concern, social pressures such as fitting in was second at 22 percent. The study also concluded that 62 percent of the nation’s high school students attend schools where drugs are used, kept, or sold, a 41 percent increase since 2002. Id. at 9.

49 Id.
methamphetamine in crystalline form. In 2003, it was estimated that up to ten percent of the local population were current “Ice” users. Researchers believe that the primary drug users in Hawaii are low-income individuals. One study found that 49 percent of individuals who seek “Ice” related treatment in Hawaii were unemployed, with an average income of $220 per week.

In response to the growing drug problem, the State of Hawaii and the local municipalities have pursued a broad-based strategy to reduce the demand for illegal drugs through increased enforcement and interdiction activity, the enactment of “get tough”

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50 See e.g. In the Throes of an Ice Age: How One Prosecutor Fights Methamphetamine, 38-Oct Prosc 37 (2004) (“Hawaii has the nation’s highest rate of adults who have tried ice”).


53 Id.

legislation targeted at drug traffickers, and increased funding for treatment and education programs. Despite these efforts the drug abuse problem remains a serious issue in Hawaii. The drug trafficking market has shifted to cheaper and less risky imports, such as cocaine and marijuana. Meanwhile, a large percentage of the population is still estimated to be current users of “Ice.”

D. Why Current Drug Control Strategies are Ineffective: Inelastic Demand, Market Substitutes, and the Low Behavioral Elasticity towards Increasing Criminal Liability

It has long been recognized that the strategies by which the government conducts the “war on drugs” have been ineffective at achieving the stated goal of reduced drug

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58 See Big Island Police see Cocaine Making Comeback, Hon. Star. Bull., May 8, 2006, at A1. (quoting a Big Island officer who says ICE is becoming more expensive to purchase and therefore drug dealers are switching to cocaine as a less risky substitute).

59 See Nelson Daranciang, 2% Test Positive For ‘Ice’ Use: Job Seekers and Workers Screened Knew They Were Going to be Tested, Aug. 11, 2005, available at http://www.starbulletin.com/2005/08/11/news/story8.html. The scientific director for the company conducting the drug test of the 9,419 prospective and current employees screened estimated the number of ice users in Hawaii is probably higher than the 2 percent figure in the sample because the subjects knew they were going to be tested and because ice does not stay in people’s systems for a very long time. Id.
use. A common explanation for this result is that the market for illegal drugs is inelastic, meaning that the quantity demanded of illegal drugs is relatively unresponsive to changes in the price per unit. Moreover, this market characteristic is aggravated by the availability of low-cost substitutes (e.g., a cocaine user can save money by shifting consumption habits to a lower-cost illegal drug such as crack). These two characteristics of the drug market tend to undermine the effectiveness of currently employed drug control strategies.

The effectiveness of the current drug control strategy is further undermined by the low behavioral elasticity that citizens have towards increasing criminal liability. For example, the history of the “war on drugs” indicates that the enactment of “get tough” statutes, which subsequently increased the cost and risk of criminal apprehension and conviction, did not result in a decrease in illegal drug use. Lending support to this

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60 See supra Part I.C. In addition, the strategies employed have created tangent social costs for which taxpayers have increasingly footed the bill. For example, government spending on corrections has increased substantially as a result of “get tough” legislation enacted as part of the “war on drugs.” See supra text accompanying notes 29-34.

61 See supra Part I.C.

62 See Gary M. Anderson, Taxing Choice: Bureaucratic Incentives and the Transition from Taxes to Prohibition 149-150 (William F. Shughart II, Ed. 1997). The inelasticity of demand for illegal drugs forms the basis of a compelling argument that legalization of illegal drugs could be coupled with the enactment of a corrective tax on their purchase and in this regard the social costs associated with their consumption could be borne by the consumer, rather than the current situation where the social cost of illegal drugs are borne by the taxpayer. Id. The policy proposed in this Article achieves the same “internalization of social costs” advocated by Shughart but does so without expensing the illegalization policy. See infra text accompanying note 128.

63 See Anderson, supra note 62, at 149-150.

64 Despite the strength of this historical causal argument, which indicates that increasing criminal liability does not influence the demand for illegal drugs, see supra notes 39-42, 49-63 and accompanying text, economists have found it difficult to measure the deterrent, or behavioral elasticity, of the criminal code. See e.g. Foundations of the Economic Approach to Law: Crime and Punishment: An Economic Approach 129-130 (explaining the difficulty of learning about the elasticities of fines and criminal liability).
causal argument, numerous studies of drug users show that legal sanctions exert a relatively insignificant deterrent effect relative to the persuasive force of the expected reactions of friends and family.\textsuperscript{65} Thus, any proposed alternative to the failed current drug control strategies should harness these findings by creating social costs on the drug user’s family in a manner where its persuasive force can be harnessed without imposing costly, and ineffective criminal sanctions.

The proposed policy is consistent with these empirical findings.\textsuperscript{66} For example, suppose one adult family member is a drug user, and that the family as a unit qualifies for a refundable tax credit only if all members of the household pass a drug test. If the family as a unit (i.e. head of household) decides to qualify for the tax credit then all members would need to pass the drug test. In this regard, it would become apparent that one member of the household is a non-qualifier who is keeping the family from receiving the full economic benefit. Thus, the drug problem is identified and the family can seek rehabilitation or education on how best to help the other family member quit the potentially deadly habit.

One possible explanation for the low deterrent elasticity of criminal liability is that drug users are discounting any increase in the cost of criminal liability by the perceived probability of being caught, and penalized for engaging in the activity in question.\textsuperscript{67} Thus, any increase in criminal liability, in order to have an effect on the

\textsuperscript{65} See The Rational Underenforcement of Vice Laws, 54 Rutgers L. Rev. 423, 468 (2002) (citing numerous empirical studies in support of the proposition that the deterrent effect of family support, moral beliefs, and social attachments to peers and community far exceeds the deterrent effect of legal sanctions).

\textsuperscript{66} See infra Part III.B.

\textsuperscript{67} Experimental literature suggests that individuals facing a recurring choice do not behave in a manner that maximizes their payoff (as conventional legal scholarship has
opportunity cost of consuming illegal drugs, must account for the probability discounting of the drug consumer. That is, the difference between the actual criminal penalty and the expected penalty.

The discussion above demonstrates that the effectiveness of the current drug control strategy is undermined by the market characteristics of illegal drugs (e.g., inelasticity and substitution effect), and the inherent deficiencies of the criminal code (e.g., low behavioral elasticity towards increasing criminal liability and probability matching).

Two conclusions from this discussion should be emphasized: First, the government cannot effectively regulate prices on the illegal drug market, and, second that seeking to reduce demand for illegal drugs by increasing criminal liability is ineffective because it only nominally effects the demand for illegal drugs. These conclusions lend support to proposals for increased emphasis on treatment and education programs as federal funding on these programs over the past decade has decreased. In fact, at the state level treatment and rehabilitation programs have gained increasing political traction.

long assumed); rather, individuals under such circumstances often follow the strategy of “probability matching.” See e.g. Ehud Guttel, Alon Harel, Matching Probabilities: The Behavioral Law and Economics of Repeated Behavior, 72 U. Chi. L. Rev. 1197 (2005) (defining “probability matching” as “the tendency to adopt a mixed strategy dictated by the relative frequency of events, even when the utility-maximizing strategy would be to always behave in a way that presupposes that the most probable event would occur.”).

C.f. Christine Jolls, Cass R. Sunstein, Richard Thaler, A Behavioral Approach to Law and Economics, 50 Stan. L. Rev. 1471, 1549 (discussing the desirability of making law enforcement highly visible in efforts to hold constant the actual probability that offenders will be caught). How the proposed policy addresses probability discounting is discussed infra at Part III.B.ii.2.

See supra Part III.C.

See e.g. notes 16-20 and accompanying text.

See Erik Ekelom, Time Served: The Revolving Door: Help for the Hardest Part of Prison: Staying Out, NY Times, Aug. 12, 2006, at A1 (quoting Republican Gov. Donald L. Carcieri as saying, “The goal now is to see if you can rehabilitate lives instead of just locking them up.”). See e.g. Gest, supra note 24, at 128 (“Perhaps the most promising
This article is not arguing for repeal of the current strategy. Rather, it argues that the current strategy, when supplemented by an immediate economic incentive to engage in legal behavior, would prove much more effective at solving the demand problem. Along these lines, the tax code provides policymakers with a powerful device by which to implement this policy solution. Before considering this policy recommendation in detail the following section is presented as background for how the government currently utilizes the tax code to influence and change citizen behavior.

II. Overview of the Tax Code and Citizen Behavior

It is commonly understood that the government has three powers at its disposal: (1) regulation, (2) spending, and (3) taxation. Part I of this article introduced the “war on drugs” and outlined how federal and state governments have increasingly utilized the regulatory and spending components of government power to escalate the “war on drugs.” The section concluded with an overview of the problems with current drug control strategies; specifically their inability to control the demand for drugs. Part II of the Article will discuss how the government currently employs the tax system to influence citizen behavior in a number of non-tax related activities. This section provides a brief overview into the range of behavioral choices influenced by the tax code. The discussion will first consider tax incentives, which reflect a deliberate use of the tax approach that has been largely ignored is intensive treatment for drug users already in the justice system.”.

72 See e.g. The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy, 64 U. Chi. L. Rev. 405, 411 (1997) (discussing the interchangeability of taxes, government spending, and regulation).

73 See The Easy Case Against Tax Simplification, 22 VA. Tax Rev. 645, 654-657 (2003) (“It is no secret that [federal tax laws] also influence taxpayer behavior”); Line Drawing, Doctrine, and Efficiency in the Tax Law, 84 Cornell L. Rev. 1627, 1653 (1999) (discussing how tax changes the relative price of a unit which ultimately changes behavior by reducing utility relative to untaxed unit).
code to encourage behavior, and will then consider tax penalties, which generally discourage behavior.

A. Taxable Incentives

A taxable incentive, or “tax expenditure,” is designed to encourage a type of economic or social activity. The ultimate effect of a taxable incentive, regardless its form as a deduction, credit or other tax advantage, is to decrease the after-tax cost or benefit of engaging in an activity and consequently increase its market demand. In other words, the economic benefit of engaging in an activity is greater once the tax subsidy is in place. Although a variety of tax incentives target businesses, the discussion

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74 See Stanley S. Surrey, Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures, 83 Harv. L. Rev. 705, 711 (1970) (defining tax incentive as a “tax expenditure which induces certain activities or behavior in response to the monetary benefit available”). Some tax expenditures are related to involuntary activities of the taxpayer, and are designed to provide tax reduction in order to relieve misfortune or hardship. Id. at 713. The extra exemption for the blind and the aged are two examples cited by Prof. Surrey. Id. at 712. Commentators in an effort to harmonize the tax code with theoretical developments in disability law have argued for dramatic changes to a number of these provisions. See e.g. Tax and Disability: Ability to Pay and the Taxation of Difference, 154 UPALR 1053, 1138-1144 (2006) (arguing for a tax system based on a human variation paradigm versus the current tax system which is based on the human/charity paradigm).

75 See Congressional Budget Act of 1974 (Public Law 93-344) Tax expenditures are defined in the law 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 liability.” Id.

76 See Tax Incentive as a Device for Implementing Government Policy, 83 Harv. L. Rev at 713 (“The direct purpose [of tax expenditures] is to provide monetary assistance or benefit through the tax laws so as to make the desired course of action financially more palatable to taxpayers involved, and thereby induce them to take that action.”); See also The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy, 64 U. Chi. L. Rev. 405 (1997) (“Market demand for an item generally decreases as its price increases.”). Accord Budget of the United States Government: Analytical Perspectives, Fiscal Year 2007, available online at <>. (“Eliminating a tax expenditure may have incentive effects that alter economic behavior.”)
below focuses on those influencing an individual taxpayer’s economic and social decisions.

The federal tax code provides significant incentives, for example, for individuals to become homeowners through the allowance of deductions for home mortgage interest\textsuperscript{77} and property taxes.\textsuperscript{78} It also excludes gain from the sale on a principal residence.\textsuperscript{79} In addition to promoting home ownership, the federal tax code contains a number of provisions that create incentive for certain types of savings and investment behavior.\textsuperscript{80} These tax-favored forms of savings and investments can be said to encourage certain types of economic consumption.\textsuperscript{81}

\textsuperscript{77} Sections 163(h)(2)(D) and (h)(3) of the Internal Revenue Code permit a taxpayer to deduct qualified residence interest. I.R.C. §§ 163(h)(2)(D), (h)(3).
\textsuperscript{78} Section 164(a)(1) of the Internal Revenue Code permits a taxpayer to deduct state, local, and foreign real property taxes. I.R.C. § 164(a)(1).
\textsuperscript{79} Section 121 of the Internal Revenue Code, as amended in 1997, permits married homeowners to exclude up to $500,000 of gain on the sale of their principal residence. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 312, 111 Stat. 788, 836 (1997). Single homeowners may exclude up to $250,000 of gain. Id.
\textsuperscript{80} Examples include the incentives for long-term capital gain investment, I.R.C. §1(h), as well as the various provisions related to retirement planning. Retirement planning devices for which the federal tax code creates savings incentives include individual retirement accounts (IRA), both traditional, I.R.C. §408, and Roth, I.R.C. §408(A), qualified pension plans, I.R.C. §§ 219, 401, 402, 501, Keogh plans for self-employed individuals, I.R.C. §401(c), and 401k plans, I.R.C. §401(k); see e.g. Congress, Public Values, and the Financing of Private Choice, 65 Ohio St. L.J. 853, 895-897 (2004) (discussing how retirement provisions in the federal tax code provide incentives for individuals to save for their retirement years during their working years). Other federal tax provisions providing savings or investment incentive include investment in state and local bonds, I.R.C. §103, the preferred tax on dividends, I.R.C. §1(h)(3)(A)-(B), (h)(11), and section 529 education plans under which income from funds invested in a qualifying program are exempt from federal income tax. I.R.C. §529(e)(3).
\textsuperscript{81} The bulk of the economic benefit from the tax provisions that encourage home-ownership, and certain types of investment and saving behavior accrues to middle-income taxpayers, and in this respect Commentators argue that these provisions operate to level the progressive nature of the tax code. See Edward L. Glaeser and Jesse M. Shapiro, \textit{The Benefits of the Home Mortgage Interest Deduction} 1979 (Harvard Institute of Economic Research, 2002) available at
Another area in which the tax code influences economic behavior is through the deduction for charitable contributions. The federal tax code by allowing a taxpayer to deduct up to 50 percent of her contribution base for charitable contributions provides incentive for individuals to fund charitable organizations.\textsuperscript{82} Empirical research suggests the deduction induces taxpayers, on average, to increase contributions to charitable organizations.\textsuperscript{83} These taxable incentives can be said to encourage philanthropy, and operate similar to a direct federal subsidy of charities.

The deductions discussed above primarily benefit taxpayers in higher tax brackets with moderate-to-high income levels. These taxpayers are in a better financial position to exploit the benefits, and receive higher economic returns from the deductions.\textsuperscript{84} In contrast, low-income taxpayers derive little or no benefit from these provisions because they have no positive income to deduct, and therefore cannot capture the incentives. Moreover, when a low-income taxpayer chooses to consume one of the favored activities the economic benefit received is fractionally less than those received to taxpayers in

\textsuperscript{82} I.R.C. §170. Deductions for contributions to certain types of charitable organizations are allowed to the extent the total amount of the deductions does not exceed 50 percent of the taxpayer’s “contribution base,” which is generally defined as the taxpayer’s adjusted gross income. \textit{Id.} at 40-41.


\textsuperscript{84} Tax expenditures in the form of deductions benefit those in the higher tax brackets meaning that wealthier taxpayers essentially capture the benefit; in this regard, tax deductions are generally characterized as regressive. \textit{See} Thomas D. Griffith, \textit{Theories of Personal Deductions in the Income Tax}, 40 Hastings L.J. 343, 352-353 (1989).
higher tax brackets. In fact, a low-income taxpayer who pays no taxes would receive no 
economic benefit from any of the deductions identified above.

In sum, the homeownership, investment-savings, and philanthropy incentives of 
the federal income tax primarily influence the economic behavior of middle-income to 
high-income taxpayers. For most of the incentives, the benefit received increases 
correspondingly with the tax bracket of the taxpayer. This is not to say that Congress has 
ignored the economic behavior of low-income taxpayers; indeed, the discussion below 
details that the contrary is true.

Through the earned income tax credit (EITC) the federal tax code subsidizes low- 
and middle-income taxpayers and thereby increases the opportunity cost of not 
working. \(^{85}\) In fact, in order to receive any benefit from the EITC, an individual must 
work and earn income. \(^{86}\) The taxpayer who receives the greatest economic benefit from 
the EITC is a married couple with two children and earnings between $11,340 (the phase-
in range) and $17,000 (the plateau). \(^{87}\) For these taxpayers the EITC provides a maximum 

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86 In his 1994 State of the Union message, President Clinton explained that the 1993 
expansion of the EITC “reward[s] work over welfare.” The Earned Income Tax Credit 
(citing transcript of President Clinton's Message on the State of the Union). In fact, 
nearly everyone is now expected to work in order to receive many types of public 
assistance such as the EITC and benefits under traditional welfare programs like 
Temporary Assistance for Needy Families (TANF) or food stamps). See The Freedom to 
Spend: The Case for Cash-Based Public Assistance, 86 Minn. L. Rev. 847, 847-848 
(2002); see e.g. Welfare to What?, 57 Hastings L.J. 1131, 1131-32 (2006) (discussing 
what constitutes “work” at the federal level with regards to the EITC and at the state-by-
state level with regards to TANF). Commentators observe that the EITC generally fails 
to help the worst off individuals who do not have jobs. See The Minimum Wage, the 
Earned Income Tax Credit, and Optimal Subsidy Policy, 64 U. Chi. L. Rev. at 461.
87 See e.g. Efficiency and Tax Incentives: The Case for Refundable Tax Credits, 59 
STNLR 23, 34-36 (2006). Empirical research has found that the EITC does increase 
work overall, especially among single mothers. Id. at 35.
credit of $4,536.88 As income increases above $17,000, the benefit of the EITC phases-out until it zeroes out at $38,000.89 Thus, for taxpayer’s in the phase-out range, the EITC creates a disincentive to earn more income because every additional dollar earned is taxed at a higher rate.90 Conversely, taxpayer’s in the phase-in range have a strong incentive to earn more income because for every dollar earned the taxpayer receives a corresponding credit.

In addition to the economic incentives identified above, the tax code provides incentives to individuals for a number of transactions of significant social consequence. Examples include the deduction for adoption expenses,91 the child tax credit,92 and a number of provisions targeting higher education.93 In addition, some couples contemplating marriage also receive an incentive to “tie the knot” through a favorable tax rate structure.94 These provisions (and rate structures in the case of marriage) arguably lower the after-tax cost of engaging in socially desirable activities.

The tax incentives discussed above can each be justified (or criticized, for that matter) on a variety of different political, policy, and philosophical levels. A comprehensive discussion of these arguments is beyond the scope of this article. Rather,

88 Id.
89 Id.
90 The Earned Income Tax Credit and the Limitations of Tax Based Welfare Reform, 108 Harv. L. Rev. 533, 539 (1995) (discussing the disincentive to work created by the EITC for individual’s approaching the “phase-out” income range).
91 I.R.C. §23 (Allowance of a deduction for adoption expenses, up to $10,000).
92 I.R.C. §24; see Efficiency and Tax Incentives, 52 STNLR at 37 (discussing the limitations on the availability of the child tax credit to low-income taxpayers).
the salient point is that Congress has historically enacted tax provisions to encourage taxpayers to engage in specific economic and social activity.

A. Taxable Disincentives

In addition to the taxable incentives detailed above, the tax code has also been used to discourage and penalize behavior considered undesirable. The two primary mechanisms by which taxable disincentives are implemented are “tax penalties,” and selective excise taxation (also known as, “user fees” or “sin taxes”).

A tax penalty is deliberate legislative use of the tax system to discourage non-tax behavior. To qualify as a tax penalty the provision must be a departure from the “normal” income tax structure and penalize a particular activity or class of persons. The typical form of a taxable penalty is through the denial of a deduction, exclusion, or exemption that would otherwise be allowed. A tax penalty, by increasing the after-tax cost of an illegal or undesirable activity, discourages taxpayers at the margin from engaging in such activities.

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95 Dep’t of Revenue v. Kurt Ranch, 511 U.S. 767, 782 (1994) (accepting implicitly the constitutionality of “mixed-motive taxes that governments impose both to deter a disfavored activity and to raise money”)
96 See Eric M. Zolt, Deterrence Via Taxation: A Critical Analysis of Tax Penalty Provisions, 37 UCLA L. Rev. 343, 344-350 (1989) (arguing tax penalty provisions are blunt instruments that are subject to challenge on both efficiency and equity grounds). The cost of tax penalties often depends on the offender’s tax bracket, expenditures incurred in conducting the activity, or general tax rate changes, rather than any estimates of harm caused, probability of enforcement, or gain to or culpability of the offender. Id. Examples of Federal income tax penalties designed to deter illegal activities include the denial of deductions for illegal bribes and kickbacks, I.R.C. §162(c), for certain government fines or penalties, I.R.C. 162(f), and for expenditures in connection with illegal drug sales. I.R.C. 280E. Also, if a taxpayer is convicted of a felony drug offense then they are unable to receive the benefit of the hope lifetime credit. I.R.C. §25(b)(2)(D).
97 See Deterrence Via Taxation, 37 UCLA L. Rev. at 344.
Tax disincentives are also employed through targeted excise taxes. These provisions are called “corrective taxes” (also called “sin taxes”) or “user fees,” depending on the activity targeted.\textsuperscript{98} Corrective taxes are levied on products whose consumption generates negative social externalities.\textsuperscript{99} Common examples include state and federal excise taxes on cigarettes and alcohol.\textsuperscript{100} The goal of corrective taxes is generally to align the private costs of a good (i.e. the cost of a product in the market) with the social costs of a good (i.e. the cost the product imposes on society) by forcing consumers to internalize the externality.\textsuperscript{101} In contrast, the policy goal of user fees is to impose the greater part of the cost of financing a public benefit on those who receive the greater part of its benefit.\textsuperscript{102} Examples of user fees include the federal excise tax on airline tickets, whose proceeds are earmarked for the Airport and Airway Trust Fund, as well as the federal excise tax on gasoline, some of whose proceeds are earmarked for the Highway Trust Fund.\textsuperscript{103}

III. Intersecting the Tax Code and the Criminal Code in the “War on Drugs”: Conditioning the Availability of Tax Incentives on a Clean Drug Test

The previous section demonstrated that the tax code influences a range of citizen behavior with economic and social consequences. Despite this fact, the tax code is rarely used to influence one’s propensity to engage in illegal conduct apart from violating the internal revenue laws, or course; the IRC contains statutes pertaining to civil and criminal

\textsuperscript{99} Id. at 20-21.
\textsuperscript{100} Id.
\textsuperscript{101} Id. at 21.
\textsuperscript{102} Id. at 18-19.
\textsuperscript{103} Id.
violations of the tax laws. The analysis below argues for an extension of the limited practice of criminal/tax code harmonization through the creation of a taxable incentive to engage in legal behavior. The specific proposal is as follows: policymakers should condition the receipt of a tax benefit on a clean drug test, where the taking of the test is completely voluntary, and the results are not shared with enforcement authorities.

A. Due to Constitutional Constraints a Tax Benefit Conditioned on a Clean Drug Test Must Be Voluntary and Information Must be Confidential

It should be emphasized that the proposed policy solution is voluntary. It is necessary to structure the program in this way so as to comply with the “unreasonable searches and seizure” protections in the Fourth Amendment of the U.S. Constitution.105 It is unlikely a voluntary drug test would violate the Fourth Amendment, because the taxpayer must necessarily consent before the test is administered.

The second defining characteristic of the proposed policy solution is confidentiality.

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104 See supra note 96 and accompanying text.
105 U.S. Const. amend. IV, § 1. The Supreme Court in evaluating mandatory suspicionless drug and alcohol tests employs a “special needs” analysis. See Skinner v. Railway Labor Executives Association, 489 U.S. 602 (1989) (upholding regulations requiring railroads to administer drug tests to employees involved in certain train accidents or safety violations), National Treasury Employees Union v. Von Raab, 489 U.S. 656 (1989) (upholding customs service screening program requiring drug testing of employees with direct involvement in drug interdiction). Most recently, in Vernonia School District v. Acton, the Court upheld a school district's policy authorizing random drug testing of students who participate in interscholastic athletics, 515 U.S. 646 (1995). The Court concluded that "deterring drug use by our Nation's schoolchildren is at least as important as enhancing efficient enforcement of the Nation's laws against the importation of drugs … or deterring drug use by engineers and trainmen." Id. at 661. See e.g. Individual Privacy Interest and the “Special Needs” Analysis For Involuntary Drug and HIV Tests, 86 Cal. L. Rev. 119, 120-21 (1998) (explaining that the “special needs” analysis proceeds by balancing the governmental interests served by mandatory testing against the constitutional freedoms the search invades).
Because the voluntary drug test necessarily involves the production of urine (or hair), which is personal information of possible criminal consequence, any information collected regarding a drug test must be strictly confidential, and in no way lead to self-incrimination. This requirement is necessary in order to comport with the Fifth Amendment, which protects an individual from being “compelled in any criminal case to be a witness against himself.”\textsuperscript{106} In sum, the IRS or state tax agency handling this information must not be able to divulge the information to other agencies. In this regard, a confidentiality provision must be included in any statute involving the proposed policy.

B. Decreasing Demand for Illegal Drugs Through Tax Incentive

i. Traditional Economic Analysis: A Conditioned Tax Incentive Will Increase the Cost of Consuming Illegal Drugs

Let us now consider how this solution addresses the demand problem plaguing the current drug control strategy. By conditioning the receipt of a current tax benefit on a clean drug test, the proposed policy solution will create an \textit{immediate} economic incentive for people not to consume illegal drugs. In this regard, it could be said that the form of the punishment is economic loss. This potential loss of a tax incentive will increase the

\textsuperscript{106} U.S. Const. amend. V, § 3. As set forth by the Supreme Court in \textit{Marchetti v. United States}, the standard necessary to invoke the self-incrimination privilege is whether the defendant “is confronted by substantial and ‘real,’ and not merely trifling or imaginary, hazards of incrimination.” 390 U.S. 39, 53 (1968) (citing \textit{Rogers v. United States}, 340 U.S. 367, 374 (1951)). The Court, in holding a federal wagering registration law and an occupational tax law unconstitutional, explained that “Congress intended information obtained as a consequence of registration … to be provided to interested prosecuting authorities,” \textit{Id.} at 57-58, therefore the defendant was exposed to a “substantial hazards of self-incrimination” and could rely on this theory as a defense. \textit{Id.} at 60-61.
magnitude of the economic penalty for people who choose to consume illegal drugs.\footnote{Clearly, the magnitude of the penalty, and consequently – the incentive effect -- will depend on the nature of the tax incentive whose availability is conditioned on a clean drug test.} Moreover, the government can efficiently achieve this increase in the economic penalty for drug consumers because the probability of detection rate would be high: if you pass the drug test the penalty does not apply; however, if you fail the drug test or fail to take the test the penalty will apply.\footnote{See e.g., Gary S. Becker, Crime and Punishment: An Economic Approach, 76 J. Pol Econ. 169, 176 (1968) (introducing an economic model to determine optimal public and private policies to combat illegal behavior, and the relationship between increases in penalties, probability of detection, and crime rates).} In this regard, the strength of this policy solution is its ability to address the demand problem by increasing the economic cost of consuming illegal drugs. The following is a basic traditional economic analysis of the proposed policy solution.

The foundation of traditional economics is the individual as a rational decision-maker.\footnote{See W. Kip Viscusi, Individual Rationality, Hazard Warnings, and the Foundation of Tort Law, 48 Rutgers L. Rev. 625, 636 (1996).} Under this theory, an individual faced with an otherwise equal decision will prefer a course of action that maximizes her utility, or expected payoff. Consider the following example: assume gas station X sells gas for $2 a gallon, while gas station Y, located immediately next door, sells a gallon for $1. Other things being equal, the rational individual in this situation will prefer to purchase gas from Y because the expected utility from this decision is greater than if gas was instead purchased from X.

Let us now suppose that the government, as a matter of policy, would prefer for the individual to consume gas from station X rather than station Y (e.g., gas station X is foreign owned while Y is a domestic corporation and the government wants to encourage
consumption from domestic corporations). In this scenario, the government might employ a tax incentive, where for every gallon of gas purchased from X at $2, the government will provide a tax credit of $1.50. Now, the rational individual, assuming transaction costs are nominal, will decide to consume gas from station X because the expected utility is greater. Phrased differently, the opportunity cost of choosing to consume from Y has increased, thus encouraging the rational individual, who previously consumed from Y, to change her consumption habits.

The following examples explore this relationship between rational consumption choices and tax incentives in greater detail. These examples illustrate how a tax incentive could create financial incentive for people to conform their behavior to the criminal code.

*Middle-income:* Taxpayer X and Y are twenty-nine years old and married. For the taxable year in question the couple earned $45,000, and took the standard deduction ($10,300), and two exemptions ($6,600) for a total taxable income of $28,100 and a total income tax liability of $3,464. According to the U.S. Department of Health and Human Services, 12.9 percent of individuals aged 26 to 29 engage in past month drug abuse. Taxpayer X and Y are part of this group, and engage in weekend recreational drug use. In year two, Congress enacts a bill whereby the receipt of the standard deduction is now conditioned on a clean drug test of all household occupants.

110 For a detailed discussion on the current tax incentives and tax penalties employed by the Federal government. See *supra* Part II.
113 See *supra* note 40, 43-44 and accompanying text.
The standard deduction for the household in this example is $10,300 (or $5,150 per individual), the loss of this deduction increases X and Y’s taxable income from $28,100 to $38,400. The effect of this policy on X and Y is to increase the couples income tax liability from $3,464 (with standard deduction) to $5,009 (without standard deduction),\(^{114}\) the penalty for noncompliance is real and immediate economic loss. In this regard, the economic effect of this bill on X and Y is that the continuation of the drug habit results in a forfeiture of $1,545 in potential tax savings, representing a 3.4 percent reduction in the couple’s disposable income.

**Low-income:** Z is married and lives in a government subsidized rental unit with a spouse and two children. Z’s spouse is the primary wage earner and Z primarily stays at home with the kids. The family earns exactly $17,000 per year and as a result receives the maximum allowable earned income tax credit of $4,536 for a total income per year of $21,536.\(^ {115}\) The area of the city where Z lives is notorious for its crack problem, and on many occasions Z has been approached by neighbors to purchase drugs. To this point, Z has never tried the drug; however, on a few occasions Z has considered experimenting with the drug for recreational purposes. In the second taxable year, Congress enacts a bill, whereby the availability of the earned income tax credit is conditioned on a clean drug test. The effect of this bill would be to give Z greater incentive to maintain a clean lifestyle because the cost of engaging in drug abuse has increased from a nominal amount (zero, at least economically) to $4,536 or 21 percent of the families’ income.

Both of these hypothetical situations demonstrate the potential power of the proposed solution to increase the financial cost of consuming illegal drugs. In the case of

\(^{114}\) Income Tax was calculated using 2006 tax schedules. See **supra** note 112.

\(^{115}\) See **supra** note 90-91 and accompanying text.
X and Y, the statute acts to encourage behavioral compliance with the criminal code through the increased economic cost of maintaining the illegal habit. Comparatively, for Z, the statute encourages the maintenance of a clean lifestyle. Moreover, if Z feels compelled she now has an informational tool (e.g. “Did you know that if you stop doing drugs you receive a check from the government?”) she can use to encourage her neighbors to stop consuming drugs.

Another strength of the proposed policy solution is that it is flexible, insofar as it can be easily tweaked or changed depending on the needs of the policymaker (e.g., in response to changing market conditions, or income characteristics of drug offenders). Returning briefly to the first example above, if taxpayer X and Y did not change their illegal drug consumption behavior despite the potential loss of the standard deduction then the policymaker, in an effort to compel compliance, could increase the magnitude of the penalty by conditioning the receipt of an additional tax benefit (e.g., individual exemption) on a clean drug test. This illustrates how the magnitude of the policy impact can be easily adjusted by changing (whether through a fractional increase or decrease) the available tax benefit upon which the certification of a drug test is conditioned.

The hypothetical fact patterns above are not intended to suggest that the federal government should adopt a tax solution where the availability of the standard deduction and the EITC are conditioned on a clean drug test. Rather, the examples illustrate how

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116 In fact, a broad based policy of this sort would be inconsistent with principles of equity and distributive justice because a greater proportion of the potential tax incentive lost from noncompliance would fall on lower-income taxpayers relative to higher-income taxpayers. In this respect, such a policy solution would have regressive tax rate consequences. For instance, while the middle-income couple (X and Y) stood to lose 3.4 percent of their yearly taxable income from consuming drugs (loss of standard deduction) the low-income individual (Z) stood to loss 21 percent (loss of EITC).
conditioning the receipt of tax benefits on a clean drug test will increase the financial cost of engaging in the criminal activity. Thus, in theory, the policy is consistent with principles of traditional economics, as the conditioned tax incentive will increase the cost of engaging in criminal activity, which in turn, should lead to a decrease in the demand for illegal drugs.

ii. Behavioral Economics: Why a Conditioned Tax Incentive is More Effective At Changing Behavior Than Criminal Sanctions

The heart of the proposed policy solution is the economic penalty of losing a tax benefit. Whether or not the proposed policy is effective depends largely on whether drug users will change their behavior in response to this potential economic loss. This section concludes that economic loss, especially in the form of a loss of a tax benefit, is a phenomenally powerful device in changing criminal behavior because the economic loss is real, immediate, and personal. These effects differ substantially from the current criminal regime where the effectiveness of the penalty (i.e., incarceration, fine, etc.) is undermined by the probability of apprehension and conviction.117

The body of behavioral economics literature suggests that an individual often makes decisions, and selects courses of action based on heuristics, or rules of thumb, in which the frequency of some event is estimated by judging how easy it is to recall other

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117 See supra Part III.C. Gary Becker in Crime and Punishment: An Economic Approach, 76 J. Pol Econ. at 179, explains that the cost of imprisonment, when monetized, “is the discounted sum of the earnings foregone and the value placed on the restrictions in consumption and freedom.” Thus, any economic penalty from criminal activity is “far away,” and depends largely on the probability the criminal assigns to his eventual apprehension and conviction. Id. at 176 (noting that economists generally agree that “an increase a person’s probability of conviction or punishment if convicted would generally decrease … the number of offenses he commits”).

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instances of this type.\textsuperscript{118} This literature challenges the primary assumption of traditional economics, that people behave rationally, and instead argues that people behave with bounded rationality (i.e., the cognitive abilities of people are not infinite), bounded will power (i.e., people often take actions they know are in conflict with their own long-term interests), and bounded self-interest (i.e., people care about the interest of other people, even strangers).\textsuperscript{119} This section discusses how the proposed policy solution comports with the prescriptive demands of behavioral economics. Specifically, it demonstrates that a proposed tax policy to change behavior should (i) exploit information salient to people by employing penalties tied to personal information, and (ii) exploit the tendency of people to avoid losses by framing the penalty in terms of losses rather than as a potential gains.\textsuperscript{120} Also, the proposal could be structured in a manner that capitalizes on behavioral economics findings that the most effective way to change criminal behavior is through short penalties with a high probability of occurrence.

\textit{a. Potential Loss of a Tax Benefit Is Immediate and Personal}

Taxes are a vivid, and personal part of every wage-earner’s financial condition. Along these lines, the economic consequences of losing a tax benefit is readily understood; most taxpayers will be able to calculate the financial consequences of noncompliance versus compliance immediately upon notice of the conditioned tax

\textsuperscript{118} For a detailed discussion on behavioral law and economic consider the seminal law review article written by Christine Jolls, Cass r. Sunstein, Richard Thaler, \textit{A Behavioral Approach to Law and Economics}, 50 Stan. L. Rev. 1471, 1536-37 (1998).
\textsuperscript{119} Id.
\textsuperscript{120} Id.
benefit. In this respect, the proposed policy exploits the salient nature of taxes and finances, generally.\footnote{Id. at 1518-20 (discussing the concept of salience, and how interested actors in the private and public sector generally exploit salient information to their own advantage).}

This leads to the second demand of behavioral economics: exploiting loss aversion.\footnote{Id. at 1483-84 (demonstrating a sub-set of “loss aversion” theory called the “endowment effect,” whereby individuals tends to value assigned, or sunk, property rights higher than traditional economic models predict).} Behavioral economists posit that the most effective behavior-altering policies exploit the fact that an individual tends to weight losses more heavily than gains.\footnote{Id. at 1537-38.} The proposed policy solution frames the consequence on non-compliance in terms of potential economic loss. This outcome, in many respects, is immutable. No matter which taxable benefit is conditioned on a clean drug test, the individual must naturally balance the cost and benefit of compliance within the constraints of potential financial loss.

In the case of an individual in poverty, or with low levels of income, the strength of the proposed policy to exploit the personal nature of taxes and the loss of tax benefits is arguably neutralized. The argument goes that because poor people do not have much income to begin with, and because many do not file a tax return, then they will likely not respond to a conditioned tax benefit.\footnote{See Implementing Disaster Relief Through Tax Expenditures: An Assessment of the Katrina Emergency Tax Relief Measure, N.Y.U. L. Rev. 2158 (2006).} However, these problems are merely structural and can be easily addressed by conditioning a refundable tax credit, such as the EITC, on a clean drug test.\footnote{See supra notes 86-90 and accompanying text; see infra Part III.C.ii.} This is because a tax credit, such as the EITC, does not necessarily require positive income in order to recognize an economic benefit.

b. **Probability of Detecting Drug Use under Proposal is High**
One of the major pitfalls of the current enforcement regime is that its effectiveness is undermined by the tendency of people to discount the likelihood of apprehension and conviction in determining whether to engage in criminal activity.\textsuperscript{126} Earlier in this Article it was noted that any increase in criminal liability, in order to have an effect on illegal behavior, must account for the probability discounting of the drug consumer.\textsuperscript{127} It should be emphasized that the problems of probability matching, which so readily undermine the effectiveness of the criminal code, will not undercut the effectiveness of the proposed policy. This is because the proposed policy, through the use of accurate drug tests, contains a highly effective oversight feature unlike anything constitutionally allowable under the criminal enforcement regime.\textsuperscript{128}

Under the current strategy, the economic consequences of drug abuse (e.g. lost wages, and possible lawyer fees) are distant and assigned a low probability of occurring. For example, a current drug user may believe there is only a one percent chance of being caught and prosecuted for violating the criminal law. In contrast, under the proposed policy a current drug user would likely believe there is a one-hundred-percent chance of losing the tax benefit.\textsuperscript{129} In this regard, the economic consequences would be felt

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\textsuperscript{126} See supra note 64-68 discussing the concept of probability matching.
\textsuperscript{127} See supra note 67 and accompanying text.
\textsuperscript{128} See supra Part III.A.
\textsuperscript{129} How effective the proposed policy is at deterring drug use depends largely on the number of times an individual is required to consent to a test. A hair analysis test can detect drug use for three months or more after use. \textit{The Use of Hair Analysis to Test Children for Exposure to Methamphetamine}, 10 Mich. St. U. J. Med. & L. 143, 185-87 (2006). One of the drawbacks of a hair analysis test is that they typically cost twice as much as the traditional urinalysis test. \textit{Id.} at 188. In contrast, a urine analysis test generally is only able to detect drug use for a few weeks prior to the test. \textit{See e.g. State Drug Test Statutes: Legislative Attempts to Balance Privacy and Productivity}, 14 J. Corp. L. 721, 728-31 (1989) (discussing the various methods by which drug tests can be conducted). At first glance, it appears that in order for the proposed policy to be effective
\end{flushleft}
immediately, and drug users will necessarily factor these costs into their decision to use
or refrain from drugs. In this respect, the financial losses associated with non-compliance
are personal, immediate, and measurable. Thus, the proposed policy solution is, in
theory, consistent with the prescriptive demands of behavioral economics. However,
empirical research into the area is needed. For example, a survey should be done of
current and recovering drug users to determine the magnitude of economic deterrence or
economic benefit necessary to compel them to change their prior decision to try drugs in
the first instance, and then to continue consuming drugs in the face of potential criminal
sanctions. This survey should include drug users from every social class (i.e. individuals
in poverty, as well as those in low, middle, and high income brackets).

c. “Hyperbolic Discounting” and Criminal Behavior: Why a Conditioned
Tax Benefit Should Contain Staggered Penalties and Rewards

Behavioral economists describe criminals as “impulsive” individuals who exhibit
a behavior pattern referred to as “hyperbolic discounting,” which means that impatience
is very strong for near rewards, and aversion is very strong for near punishments. The
drug tests should be conducted at least three times a year. However, a drug test
conducted twice or even once a year would still temporarily disrupt the market.
Moreover, getting the individual to quit doing drugs, even if for a few months of the year,
would be a success because this former drug user would likely avail themselves of
information on how to maintain sobriety, or seek rehabilitation.

The proposed policy forces the drug user to internalize the cost of enforcement
activity. For example, if current drug users choose to forgo taking the drug test and
instead continue their drug habit then the treasury will experience a boon in the form of
less individuals taking the conditioned deductions or credit (i.e. whatever tax benefit the
policy-maker chooses to condition). This additional revenue could then be used for
greater enforcement and interdiction activity, or alternatively for government projects of
greater social importance, such as education and health care.

A Behavioral Approach to Law and Economics, 50 Stan. L. Rev. at 1538-39
(discussing the concept of “priority of the preset,” where short punishments have much
more effect on criminal than long punishments).
proposed policy is able to address these behavioral characteristics because the policy could be structured in a manner where the reward for compliance is immediate (e.g., a check, or cash) and the penalty from noncompliance is short.\textsuperscript{132}

In order to make the reward for compliance immediate, a person who fails the drug test would receive a fraction of the tax benefit that an otherwise fully compliant individual would receive. For example, if a person who passes the drug test would receive a 25 percent state-level EITC then the person who does not pass the test would receive, say, a 10 percent credit. In order for the drug user to receive the balance of the credit, additional conditions would need to be met. These conditions should seek to rehabilitate as oppose to punish the individual.

\textit{Additional testing.} If a taxpayer fails a drug test then the taxpayer should be given the option to re-capture the tax benefit lost from failing the test. One such way would be to request the drug user to return for additional tests (e.g. bi-monthly). For each clean test passed the user would receive an additional fractional tax benefit.

\textit{Rehabilitation and Education:} A second option could be to request the taxpayer to attend rehabilitation and education programs. Such programs are already offered by many states Health and Human Services department, or are run by non-profit organizations such as Alcoholics Anonymous. For consistent attendance at these events, even if the subsequent drug test is a failure, the individual should still receive a fractional tax benefit. This is because attending the rehabilitation program demonstrates an affirmative intention to quit consuming drugs.

\textsuperscript{132}\textit{Id.} at 1539 (discussing Mark Kleiman’s “coerced abstinence” proposal where drug offenders on probation or parole would be swiftly and automatically punished but with modest sanctions, for any positive drug result).
C. Structural Choices Facing the Policymaker

The effectiveness of the proposed solution is largely a function of the amount one stands to lose from noncompliance, in this regard, it is necessary to formulate a policy determination as to how much economic benefit one must stand to lose before a behavioral change towards drug abuse is actualized. This paper will not evaluate this question. However, in determining how much economic incentive (i.e. tax benefit) to condition on a clean drug test, policymakers should first take into account the income characteristics of the primary drug abusers in the area (whether at a national, state, or municipal level), as these income characteristics will largely determine how the underlying tax policy should be structured. After determining how to structure the tax (whether as a deduction, credit, or favorable rate structure), the policymaker can determine the magnitude of the desired incentive effect. This section explores the first issue facing the policymaker, specifically, how to structure the conditioned tax.

In determining what type of taxable benefit should be conditioned on a clean drug test, the policymaker has a number of options. The options include: (i) whether to pursue a revenue-neutral strategy versus creating a new tax benefit (likely resulting in foregone revenue); (ii) whether to attach the condition of a clean drug test onto the availability of a deduction, tax credit, or favorable tax rate; and (iii) whether to include a “safe harbor” provision.

i. Choosing Between a Revenue Neutral versus a New Tax Solution

Whether to create a revenue-neutral policy versus creating a new tax benefit will largely depend on the prevailing fiscal and political climate. If the policymaker is facing budgetary constraints, a revenue neutral strategy would be desirable. In this case, the
condition of a clean drug test could be attached to a currently available tax deduction, tax credit, or favorable tax rate (e.g., capital gains). Examples at the federal level would include the home mortgage interest deduction or the EITC.\textsuperscript{133} A state with a local income tax could similarly condition the availability of its personal exemption, as well as any deductions (e.g., solar energy deduction), or tax credits (e.g., low-income refundable credits) on a clean drug test.

In contrast to a revenue neutral solution, the government could also condition a new tax credit, deduction, or favorable tax rate on a clean drug test. This type of strategy would likely face less public resentment, and would also provide the policymaker with greater flexibility in targeting the class of individuals who are the primary drug users in a given community. In either case - whether choosing a revenue neutral strategy or instead creating a new tax benefit – the policymaker must decide how to structure the incentive effect.

ii. Choosing Between a Conditioned Tax Deduction, Credit, or Favorable Tax Rate

In determining how to structure the tax benefit, the policymaker has three options: a conditioned (1) deduction, (2) credit, or (3) favorable tax rate. The income characteristics of the targeted class will generally dictate which structure will be most effective at influencing taxpayer behavior.

It is a commonly accepted principle that tax deductions are worth more to a high-income taxpayer than to a low-income taxpayer.\textsuperscript{134} In fact, tax deductions are often

\textsuperscript{133} See \textit{supra} Part II for a comprehensive list of federal tax benefits.

\textsuperscript{134} For example, a $1 deduction to taxpayer in a 35 percent tax bracket results in a tax saving of 35 cents, while this same deduction is worth only 25 cents to an individual in a 25 percent tax bracket. In this regard, the higher the tax bracket the greater the tax benefit from a given tax deduction. See \textit{e.g.}, Tax Incentives as a Device For
worth nothing to low-income individuals, because they do not itemize deductions (a taxpayer must earn more than the standard deduction and personal exemption before being able to reap the benefits of a deduction). Thus, conditioning a tax deduction on a clean drug test is likely to have no effect on low-income individuals and those in poverty, though it potentially could create a large economic incentive for middle-income and high-income individuals.

If a policy-maker is seeking to influence the behavior of low-income individuals then a refundable tax credit is the most effective mechanism available. In contrast to deduction, a refundable tax credit does not require any offsetting tax liability for the economic benefit to accrue. Conditioned refundable tax credits that target low-income individuals, such as the EITC, have been successful at achieving their underlying behavioral goals.

In addition to the structural formulations above, the policymaker could also condition the availability of a favorable tax rate on a clean drug test. For example, a

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136 See e.g. Efficiency and Tax Incentives: The Case for Refundable Tax Credits, 59 Stan. L. Rev. 23 (2006) (arguing the default for all tax incentives should be a refundable tax credit). In general, the creation of a new tax deduction will have a regressive effect on the rate structure as whole because the higher-income individuals stand to gain more than their low-income or middle-income counterparts. In contrast, a refundable tax credit operates to make the tax structure more progressive because low-income individuals stand to gain more relative to their high-income counterparts. A tax credit when taken to its extreme comes in the form of a basic cash allowance for low-income families. A version of this was the negative income tax (NIT) proposed by President Nixon in 1969. See Efficiency and Tax Incentives 59 Stan. L. Rev. at 33.

137 See supra notes 79-82 and accompanying text.
lower marginal tax rate could be made available to individuals who comply with the conditioned demand. An example from the federal income tax would be to condition the availability of the favorable tax rate on long-term capital gains. If the taxpayer fails to voluntarily certify that she had not done drugs, the long-term capital gains would instead be taxed at ordinary income rates.

In addition to being extremely flexible, the utilization of a conditioned rate structure has a potential fiscal upside. For example, a state facing both a fiscal crisis and a serious drug problem (where the demand for drugs is increasing and/or deterrence regulation is ineffective) could employ a conditioned rate structure to address both problems. In response to the fiscal problem, the state would raise tax rates; however, for political reasons, the legislature might also want to allow individuals to maintain their current rate structure if they meet the condition of a clean drug test. This tax increase would likely lead to a boon for the treasury, because current drug users would likely not seek certification and expose themselves to higher tax rates.\(^{138}\) It may also lead to a decrease in the demand for drugs if the tax increase is large enough. This type of proposal is similar to a “user fee” insofar as the drug users will be paying, ultimately, for the increased cost of enforcement necessary to combat the drug problem.\(^{139}\)

iii. Use of a Safe Harbor Provision

Because the proposed policy may be an inconvenience for non-drug using taxpayers, the policymaker may consider employing a “safe harbor” provision. Such a provision would allow a taxpayer who passes the voluntary drug test on consecutive

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\(^{138}\) The treasury may also experience a windfall from such a policy because many people may simply choose not to get certified even though they are not drug users.

\(^{139}\) See supra note 98-102 and accompanying text.
occasions (i.e., the taxpayer passes several tests during an entire year) to qualify for “safe harbor,” meaning they would not need to come verify eligibility for the tax benefit for some number of years. This type of provision would be politically appealing because it would reduce the burden on the non-drug using taxpayer while at the same time implementing policies that are tough on crime.

The discussion above introduced the various ways a criminal/tax harmonization could be formulated. The ultimate structure of the tax benefit should depend on the characteristics of the targeted class of individuals as well as any fiscal constraints facing the state or local policymakers.

IV. Conclusion

The “war on drugs” has been a failure. Because it is unlikely that the failed policy of criminalization will change anytime soon, it behooves academics, experts, and policymakers to accept its normative premise of illegalization and identify structural or strategic ways the policy could be more effective and efficient. This Article introduced a novel policy device to include in the larger “war on drugs”; specifically, it argued that the government should employ tax incentives to encourage people to comply with the criminal code. This proposal employs economic incentives to encourage criminal code compliance. The Article discussed how this proposal holds up against traditional economic analysis, and how it could be designed in a manner that capitalizes on the findings of behavioral economics with respect to changing criminal behavior. The Article also introduced the different structural formulations a tax incentive could take to be most effective at changing the targeted drug users’ behavior.
The clear advantage of introducing tax incentives into the “war on drugs” lies in the power to create immediate and measurable economic consequences for the individual. By contrast, the current direct expenditure approach only creates tangential economic costs with little demonstrated behavioral impact on the individual’s consumption decisions. In light of the models of traditional economics and the demands of behavioral economics the proposed solution provides a promising alternative to the current drug control strategy, and could lead to a reduction in the demand for illegal drugs.