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Don't Give Up on Taxes

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Linda Sugin is a professor at Fordham Law School.

Sugin discusses professor Edward D. Kleinbard's latest book about the fiscal system and the broader implications of progressive taxation as a policy goal.

Edward D. Kleinbard has written an important book about the fiscal system, *We Are Better Than This* (2015, Oxford University Press, New York. 509 pages. $24.22.). Now a member of the faculty at the University of Southern California, Kleinbard was previously the chief of staff of the Joint Committee on Taxation and a partner at Cleary, Gottlieb, Steen & Hamilton. He is among the finest tax lawyers of his generation, and this book is an important contribution to the public debate about taxes and spending.

Kleinbard's central thesis is that progressives are mistaken in focusing on progressive taxation as a policy goal. He argues that the size of the fiscal system should be the central concern and that progressives should make greater spending their primary fiscal goal. A large fiscal system is more important than progressive taxation because public spending — by its nature — is progressive. Kleinbard asserts that more government is the best route to a "richer, more equal, and happier society."[1]

It is refreshing to see that someone who spent time as the chief of staff of the JCT is fundamentally optimistic about government. We are rarely reminded that government can be a force for good. Nevertheless, it is disappointing that Kleinbard has become a self-described tax apostate.

I am troubled by the increasing tendency of scholars to find solutions to their own problems in other people's fields. As a tax lawyer, I am distressed when everyone else thinks taxes can solve all our non-revenue problems: Tax carbon.[2] Tax guns.[3] Tax soda.[4] Tax executive pay.[5] Tax traffic.[6] This book suggests that instead of fixing the problems of our tax system, we should change the topic to spending. The grass is always greener in the other guy's backyard because we can't see the weeds from where we're standing.

By seizing on spending, the book sets up an unfair comparison. If we are asking whether taxing or spending is the more powerful tool, it's no contest — spending wins hands down. It's not just that a large fiscal system can support progressivity better than a small one, as Kleinbard points out. It's that spending is just so much more powerful than taxing. The only thing taxes can do is change prices. Spending, however, can do anything. All creative ideas for social progress require money. If you pit taxing and spending against each other as alternatives in designing public policy, taxes have to lose.

Kleinbard is clearly correct that the progressivity of the whole fiscal system is important and that the tax system, standing alone, has no independent distributional significance.[7] But that doesn't mean that the taxing side doesn't matter. It's not right to ignore spending, but it's also not right to ignore the design of the tax system. Just as progressive spending can mitigate regressive taxation, a more progressive tax system can counteract less progressive spending.

The decision whether to use taxes or spending should depend on which has more real potential for progressive effects. Kleinbard is optimistic about what we might achieve on the spending side, particularly in education and healthcare. I suspect

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[1]This language is from Kleinbard's book tour slides.

[2]There is widespread support for a carbon tax among economists. *See* N. Gregory Mankiw, "Smart Taxes: An Open Invitation to Join the Pigou Club," 35 *E. Econ. J.* 14-23 (2009).

[3]*See* Lucinda Finley and John Culhane, "Make Gun Companies Pay Blood Money," *The New York Times*, June 23, 2013.

[4]San Francisco and Berkeley, California, may be the first localities in America to adopt such a tax. *See* "War on Sugar," *available at* http://www.bloomberg.com/politics/articles/2014-10-28/berkeley-and-san-francisco-take-their-shot-at-soda-taxes.

[5]*See* David Walker, "Tax Response to the Executive Pay Problem," 93 *B.U. L. Rev.* 325 (2013).

[6]London does this. *See* https://www.tfl.gov.uk/modes/driving/congestion-charge.

[7]I have said this myself. *See* Linda Sugin, "Theories of Distributive Justice and Limitations on Taxation," 72 *Fordham L. Rev.* 1991 (2004).

the reason for that optimism is that he's a tax person. Kleinbard's proposals are so modest and politically realistic on the tax side, but so ambitious and unrealistic on the spending side. He proposes reinstating the Clinton-era rates on all taxpayers and reducing the value of some tax expenditures.[8] At the same time, he advocates a single-payer plan for health insurance. Many proponents of the Affordable Care Act would surely have preferred that option but were unable to achieve it. If there weren't substantial political economy barriers, we might already have made better progress on greater and more progressive spending.

The politics of the efforts on both the spending side and the taxing side run parallel to each other. The same forces that fight progressivity on the tax side also fight it on the spending side. Based solely on the data presented in the book, more progressive spending seems virtually impossible. Look at all the states that failed to expand Medicaid "solely for spite," as Kleinbard says. Grover Norquist wants every politician to pledge never to raise taxes,[9] but he also wants to get government small enough to drown it in a bathtub.[10]

Tax expenditures, which most tax scholars disdain,[11] seem the most promising way to attain anything like progressive spending these days. I have been a reluctant champion of tax expenditures precisely because they seem to be the best way to deliver benefits to the poor.[12] The distributional effects of tax expenditures are not what they were 40 years ago. We use the tax law for the most substantial cash transfer program we have. Many influential tax reform proposals — like the president's fiscal commission's — lump together corporate-welfare-type tax expenditures with the earned income tax credit and argue that we should get rid of all of them.[13] Given how stingy Congress has been recently, I'm not hopeful that we can get more progressive direct spending. I'm more hopeful about extending the enhanced earned income credit or the refundable piece of the education credits.[14] The only politically possible way to have big government these days is by making it look like taxes are being cut. It is either inconsistent or politically naive to argue for both bigger government and fewer tax expenditures.

Kleinbard recognizes that there are fundamental moral and philosophical questions that drive tax policy and that those questions should be explicit. Judging from his proposals, it seems Kleinbard does not really want that much progressivity in the fiscal system. The ideal contemplated in the book is a fiscal system financed by the huge middle class but that mostly serves the middle class also. There's nothing wrong with wanting only a modest level of progressivity in the fiscal system. There's no principle that dictates the right level of progressivity; it is a moral choice. It is on that moral choice that I disagree with Kleinbard the most because even if we spend more and better, I still believe taxes matter.

Taxation is the most widespread and intrusive interface between individuals and the government. It involves a coercive exercise of government power. It is appropriately a test of whether we govern ourselves fairly. If the government operates the tax system unjustly, there is no direct spending that can cure those injustices. Every institution of government must operate fairly.

What does it mean to govern ourselves fairly? In general, all government institutions must respect individuals as autonomous and equal. In taxation, respecting individuals as autonomous and equal requires allowing individuals to exert dominion over what they deserve. We cannot construct a theory of fair taxation without talking about what we each deserve — as our share of the social product and as our burden of society's costs. What are individuals entitled to own exclusively, and what is justly allocated to communal resources? The most fundamental tax fairness question asks what should be treated as private property and what should be treated as social product. There is no pre-social division between private ownership and public entitlement. Pretax income is a normatively empty concept because it assumes people have entitlements to amounts they do not morally deserve.

Fair shares also depend on context. Government spending is part of that context, but the fiscal system is not enough. Other factors are also relevant to the question of fair shares. How markets allocate returns is important. We live in a society in

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[8]Kleinbard's business tax plan, the business enterprise income tax (BEIT), is admittedly more radical.

[9]Americans for Tax Reform, "Federal Taxpayer Protection Pledge Questions and Answers," *available at* http://www.atr.org/federal-taxpayer-protection-questions-answers-a6204.

[10]*See* Paul Krugman, "The Tax-Cut Con," *The New York Times Magazine*, Sept. 14, 2003, at 57.

[11]Including Kleinbard in this book and elsewhere. *See* Kleinbard, "The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes," 36 *Ohio N.U. L. Rev*. 1, 3 (2010).

[12]Sugin, "Tax Expenditures, Reform, and Distributive Justice," 3 *Col. J. Tax L.* 1 (2012).

[13]National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," at 29 (2010).

[14]Both of these enhanced refundable credits are scheduled to expire at the end of 2017. See sections 32(b)(3) and 25A(i).

which the returns to capital outstrip the returns to labor, and the top 1 percent is doing much better than everyone else.[15] Markets are part of the social structure that government institutions must account for in measuring fair shares. On the other side, the contributions individuals make to the social fabric are important, too. An individual's share should reflect whether her life is devoted to improving prospects for others. Fair shares need to account for what we contribute to society, as well as what we take from it.

Once we account for social institutions, we all deserve very little of what we have. A huge part of everyone's income and wealth is attributable to factors for which we are not responsible. Moreover, the share of income and wealth that comes from being in society increases rapidly as income and wealth go up. The benefits to high-income individuals provided by the social structure and the government extend beyond anything that looks like a transfer or even a public good. The basic infrastructure of society benefits the wealthy compared to the poor. That infrastructure includes the operation of markets and the monetary system, as well as everything else that makes America an attractive place to live, work, and invest. Social forces and social cooperation produce many tangible and intangible things that contribute to income and wealth. The advantage of being part of society is enormous for people who do well.

Let me be clear. I'm not in favor of a benefits tax, which is an incoherent idea. We all enjoy infinite benefits from social cooperation, since the baseline for comparison should be the Hobbesian world in which life is brutish and short. Instead, my point is that social investment has implications for taxation because it should make us think about what people really deserve as their fair shares of private ownership, and as a corollary, what are fair shares to contribute to communal purposes. Substantially more tax progressivity is necessary to appropriately allocate returns to private property, on the one hand, and returns to social cooperation, on the other. Given the operation of institutions in our society, more progressive taxes are necessary to make the system — as a whole — one of fair shares.

On this question of moral fairness, Kleinbard focuses primarily on the role luck plays in determining outcomes even when potential is the same. Although he mentions John Rawls, Kleinbard's philosophical lodestar seems to be Ronald Dworkin, whose "Equality of Resources"[16] largely parallels the philosophical framework of Kleinbard. In that essay, Dworkin explicitly developed the case for a progressive income tax on an insurance model, and his defining principle on moral fairness separated luck from ambition. Unlike some other scholars, I don't think government, in general, or the tax system, in particular, should have as its purpose compensating people who have suffered bad luck.

While Rawls didn't say much about taxation in particular, he did believe that the principles of justice must "specify the fair terms of social cooperation" and "regulate the division of benefits arising from social cooperation and allot the burdens necessary to sustain it."[17] Kleinbard's focus on the integrated fiscal system emulates Rawls in thinking about how the interactions of different government institutions add up. However, I think Rawls's principles of justice look at it both more narrowly and more broadly and that Rawls was more demanding of government institutions. Fairness in taxation depends on how the tax system fits into the larger social structure, taking into account institutions beyond the fiscal system. It also requires that government use the power to tax, whenever possible, to further every individual's equal right to basic liberties of citizenship, which was Rawls's first and primary principle of justice.[18] So I would suggest that taxation can do more to contribute to a just society, and I hope that smart tax people, like Kleinbard, don't give up on it.

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[15]Thomas Piketty, *Capital in the Twenty-First Century* (2014).

[16]Ronald Dworkin, "What Is Equality? Part II: Equality of Resources," 10 *Philosophy and Public Affairs* 283 (1981).

[17]John Rawls, *Justice as Fairness* 7 (2001).

[18]Rawls, *A Theory of Justice* 61 (1971).