Critical Tax Thinking

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Abstract

This presentation considers the aims of critical tax studies and offers three suggestions. First, critical tax papers too often fixate on taxes as both the problem and the solution. In many cases, in particular when progressivity is the aim, public spending is the better policy lever. Second, one should not concede that taxation imposes an inexorable tradeoff between efficiency and equity goals. This again understates the importance of the spending side of things. Taxes are a necessary cost of funding spending, and spending in turn, by reaching places where markets are incomplete, can have efficiency payoffs greater than the deadweight loss of taxation. That is, even a leaky bucket can extinguish a fire. To this end, recent research has pointed to the role of well-designed government spending in encouraging an “inclusive economy,” in which growth is both faster and more broadly shared than would otherwise be the case. Finally, the presentation urges that more work be done on the rhetoric of public finance economics. Both the structure and the vocabulary of standard presentations contained unexamined biases that color the outcomes of policy debates.
Critical Tax Thinking: It’s Not Just About Taxes

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Critical Tax Studies: What is the Agenda?
Critical Tax Studies

• No single consensus definition

• But in general an emphasis on social justice concerns not captured by standard tax work
  • Economic inequality
  • Stagnant incomes of middle class
  • Gender and other systemic biases

• An ‘outsider’s’ view of tax scholarship, not limited to usual concerns, boundaries or modes of thought

• But is even this broader view asking the right questions?
You’re Still Barking Up the Wrong Tree

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Spending is What Moves the Needle

- **Government exists to spend, not to tax**
  - Taxes just fund our (hopefully well-directed) spending
  - Spending side includes tax expenditures

- **We should** focus on *net* effects of government spending and taxing on our welfare
  - Returns to spending in broadest sense, net of their costs

- Spending and taxing thus are *two levers* by which to affect welfare – *there are two levers of progressivity*

- Within reasonable parameters, distributional consequences of spending dominate tax distribution
Unfortunately, Tax Law is More Fun

• Tax law is intellectually challenging, self-contained, largely conceptually coherent and internally consistent
  • At least the federal income tax is
  • And with interesting interactions among legislators, regulators, taxpayers and courts

• Spending is just a bunch of, well, spending programs

• But we have to decide, for whose benefit do we work?

• We must ultimately engage broad audiences
  • Change comes through the political process; talking to ourselves abdicates policy to agenda-driven think tanks and the like
If Inequality is the Concern (As it should be . . .)

• The left’s preoccupation with progressive income tax (higher marginal rates) is self-limiting and self-defeating

• *Well-designed public spending by itself is progressive in practice* – the benefits are broadly shared

• Because spending dominates, mildly regressive taxes can fund progressive *net fiscal systems* (the net of spending and taxing) – *If revenues are large enough*

• Steeply progressive tax rates thus are **not** necessary to finance progressive fiscal systems
  - Germany or the Nordics have more regressive tax structures, but more progressive *net fiscal systems*, because their commitments to public investment and insurance are larger.
U.S. Fiscal Intervention Modulates Pre-Tax Results, But Not as Much as in Other Countries

Income Distribution - Gini Measure (2014)

U.S. Does Little “Redistribution”

- Comparing the Gini coefficient of *market incomes* to the Gini of *disposable incomes*, yields a rough picture of effect of tax + transfer system on inequality remediation
  - Market income = cash income + ESI + employer share payroll taxes
  - Disposable income = After-tax, After-transfer income
- By this measure US does little redistribution
- Example: US and Germany have similar market income inequality, but very different disposable income inequality:

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<tr>
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<tr>
<td>Germany</td>
<td>0.500</td>
<td>0.289</td>
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How Does Germany Do More “Redistribution”?

All taxes (national + subnational) as percentage of GDP - 2014

Germany 36%  USA 26%

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Equity vs Efficiency is a Red Herring: Inclusive Growth Strategies
Our Largest Investment Opportunities

• Our largest asset class is *ourselves*
  • 60+% of GDP is derived from labor
  • Our lifetime incomes and satisfaction are directly tied to our investments in ourselves through our *health* and our *education*

• Government *necessarily* must be the investor here
  • Private markets do not and cannot invest directly in people
  • Yet today we are one of 4 OECD countries to spend more on public education of rich kids than poor kids

• Similar arguments for infrastructure
  • Public goods (net of financing) are a progressive move
  • Positive social spillovers (jobs with dignity) equally important
Our Largest Investment Opportunities - II

• Systematic differences in human capital investment convert income inequality into an hereditable gene
  • Equality of opportunity demands comparable investments in comparably able kids, regardless of parents’ wealth
  • Yet mediocre rich kids get into top colleges and earn more
  • Good health a prerequisite to our welfare, yet we rely heavily on private financing (taxing ourselves)

• Our mobility outcomes worse than Canada or much of Europe
  • Top and bottom of income distributions are much stickier in USA than in Canada or much of Europe
  • Both across generations and within one generation
Double Dividend of Inclusive Growth

• These investment opportunities (education, health, public infrastructure) are best exploited by government

• Government investment here yields *inclusive growth*
  • Because private returns accrue to less affluent

• And long-term faster, more sustainable, growth
  • Ostry et al, (IMF) *Redistribution, Inequality and Growth*
  • “[E]ducation and anti-discrimination policies, well-designed labour market institutions and large and/or progressive tax and transfer systems can . . . yield a double dividend in terms of boosting GDP per capita and reducing income inequality.” OECD *Going for Growth* (2012)
Drilling Down on Inclusive Growth

- Government investment and insurance complement the private sector, not compete with it
  - By responding to *necessarily* incomplete markets
- Complementary public investment:
  - Pie gets larger, *and* the servings are more broadly shared
    - Which in turn is accretive to welfare
  - The *only* instrument that ensures genuine equality of opportunity
- Government thus is not a zero-sum game
  - Large positive returns to government spending belie false narrative of makers vs. takers
  - Standard metrics don’t capture the social returns to government spending
Public Insurance = Triple Dividend

• Government insurance is economically efficient
  • Responds to adverse selection and existential fortuities that private markets cannot absorb
  • Encourages rather than discourages risk-taking
    • We worry about the beachcomber abusing public insurance, while private insurers are consumed by problem of moral hazard
• And responds to the moral implications of the irreducible role of brute luck in our material outcomes
  • Reorients us from the *denial of luck* that lies at the heart of Market Triumphalism
  • Reintroduces an *economics of empathy* at the heart of our covenantal bonds with fellow citizens
Equity vs Efficiency = False Dilemma

• Government investment and insurance throw off large positive returns – both financial and social.

• Okun’s leaky bucket expresses only the deadweight loss of taxation, not the financial and social returns that those revenues can earn.
  • It means that the true cost of financing public spending is more than nominal spending outlays.
  • But spending’s returns swamp this economic measure of cost.
  • E.G., 13% IRR from investment in early childhood education (James Heckman).

• Even a leaky bucket can extinguish a fire.
Reframing The Rhetoric of Political Economy: What’s Luck Got to Do With It?
The Forgotten Arts of Rhetoric

• “Rhetoric may be defined as the faculty of observing in any given case the available means of persuasion.” (Aristotle, The Rhetoric and Poetics, 1.2)

• Framing an argument is 90% of winning it
  • Rhetoric operates via both structure of arguments and vocabulary employed
  • Not just how question is asked, but words used to convey it

• Our political economy debates are rife with structural biases and loaded vocabularies

• All of these may be unexamined or unintentional, but they nonetheless shape outcomes
Rhetorical Biases in Public Finance

• Structural biases in public finance argumentation
  • Separating tax’s costs from goods purchased by tax
  • Pseudo-vise of inadequate tax revenues
    • Spending is not too high – revenues are too low
    • Regardless of MMT or other new views of deficits
  • As just discussed, “efficiency vs equity”
  • Systematic underappreciation of existential fortuities

• Public finance vocabulary is highly skewed
  • “Redistribution,” “spending,” “transfer payments”
  • Substitute for these, “investment” or “insurance”
Luck Has *Everything* to Do With It

- Life’s outcomes are highly contingent
  - We control less of our personal destinies that we like to admit.
  - And we do not choose the lives into which we are born – not our parents, not our personal attributes.
- Much public finance ignores the efficiency and moral implications of *adverse existential fortuities*
- Market Triumphantism = *the denial of luck*
- It misreads market outcomes as efficient outcomes
  - It ignores both fortuities and incomplete real world markets
  - It professes objective and scientific advice, but does so for the benefit of a world other than the one in which we actually live
  - And it is immature in its political philosophy, in claiming an identity between marketplace freedoms and political liberties.
Brute Luck as a Gateway to Moral Philosophy

- An honest appraisal of the role of brute luck in our lives
  - Leads to humility in place of Market Triumphalism
  - And greater empathy towards fellow citizens
    - Feeling others’ pains, understanding their motives
    - Sharing values that we believe define us as a country
- Actualized through accepting the centrality of insurance as a governmental function
- Which in turn institutionalizes an empathetic economy
- All the more urgent with 330 million Americans
  - ....with very different backgrounds
Cultivating Our Fiscal Soul

- When we choose how government should spend and tax, we open a window into our national \textit{fiscal soul}
  - Thinking about our larger obligations, and our opportunities to increase the happiness of society, in the real world – one removed from theoretical models of perfect markets and perfectly rational economic actors

- Fiscal policy thus is about \textit{applied moral philosophy} as much as it is a story of incentives and preferences

- Both conservatives and progressives get things wrong: We need more government, not less, but we do not need steeply higher top marginal income tax rates to yield a richer, more equal, and happier society

- A perfect field for critical tax studies to explore further
Appendix

A LOW-TAX SMALL GOVERNMENT COUNTRY
A Low-Tax Small-Government Country

- U.S. tax as % of GDP *lowest* of major OECD countries
  - Includes federal, state and local
  - OECD average (2016): 34.3%; USA: 26%
  - CBO Jun. 2017: federal tax revenues = 18.2% GDP next 10yrs
  - And post-TCJA federal revenues ≈ 17.5% GDP

- Those taxes are shared across all income levels
  - Total tax system is *modestly* progressive

- Government is big spender in only two areas
  - Defense: As much as next 8 countries combined
    - 36% of world spending (reflects China’s build-up)
  - Healthcare – Most inefficient system in world
    - USA – 17.2% of GDP (public and private)
    - Switzerland (#2) – 12.4% of GDP. If we spent at Dutch rate, savings >$11 trillion over decade
A Low-Tax Small Government Country II

- 70% of existing transfers go to elderly
  - And elderly as % of younger adults will almost double by 2040
  - SS + Medicare ≈ $1.6 trillion in FY 2018 (44% of tax revenues)
- USA is 23rd in OECD in total social spending (GDP %)
  - Includes Social Security & Medicare
  - And far below average in most income security programs
  - Income security spending 2018: 1.5% of GDP; in 2027: 1.3%
- Net investment in infrastructure ≈ zero
- Total nondefense discretionary spending trending towards lowest levels in modern history
Fiscal Challenges Summary

• Greatly inadequate tax base for current spending path
• No evidence that the U.S. is the drunken sailor of government spending
  • Except healthcare!
• Social costs of increasing economic inequality
• How should tax policy respond?
  • More revenue is more important than more progressivity!
  • Progressivity addressed through better capital income taxation
    • And revitalized estate tax for the very top end
• But remember tax is only half of fiscal policy
More Tax Revenues

• Carbon tax raises $1 trillion over 10 years
  • Kleinbard, WSJ, Sept. 24, 2017
• Only large economy without a national VAT
• Coherent capital income taxation!
• Many mistakes post-TCJA need rectifying
  • “Pass-through” giveaway = $415 billion/10 years
  • Corporate rate (21%) + expensing + interest deductibility is much too generous
    • Right place is 25% + expensing + no interest deductibility
  • Top individual tax rate bracket starts much too high ($600K)
  • Charitable contribution deduction has lost its mooring
    • Donor-advised funds = $85 billion in 2016
  • Estate tax riddled with easy avoidance
    • And double benefit of tax-free step-up w/o estate tax liability
New Political Economy of Capital Income Tax

- We need the eggs
  - Capital income = 40% GDP (including owner-occupied homes)
- Capital income tax addresses top-end income inequality
  - Wealth of course is highly concentrated
  - In turn, capital income tax ≈ periodic wealth tax
- Kleinbard Dual BEIT is revenue-raiser vs. Post-TCJA law
- And is a coherent and comprehensive proposal