And Equal (Tax) Justice for All? (Part 2 of 8)

Part Two: Horizontal and Vertical Equity

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To be equitable is to be just, while justice means lawfulness. These relationships lead me to conclude that equity is the highest of principles in both law making and law administration. Even if it were not, it undoubtedly dominates debates over the allocation of taxes and expenditures in the population, the enforcement of laws, and the extent to which government should interfere in the economy and individual lives in the first place. No one can attend legislative hearings on tax and expenditure policy, for instance, without noting the remarkable attention given to equity issues. Even other goals such as efficiency and growth are often promoted as matters of equity as well.

Beyond a broad level of abstraction however, equity must be defined in ways that can be understood and applied to public policy. Equity and equal justice do not mean equality in all things. In matters of the state, the terms refer to the way that government will treat us, not our starting point. The individuality of each person, however, not only prevents us from being boring, it makes far from dull the task of trying to ensure equity under the law. Indeed, figuring out precisely what equity requires as a matter of law is one of the most complex of all tasks, occupying philosophers and government officials as long as they have been writing about the state. Disagreements abound, generally centering on who are equals, who are not, and what to do about those differences.

Here the public finance literature, as expounded by Richard and Peggy Musgrave, among others, is extraordinarily useful. It makes the distinction between horizontal equity and vertical equity. The former refers to the way that equals are treated, the latter to adjustments made because people are not equal. If income were the only measure of a person, for instance, then two persons with equal incomes would be treated as equals. Someone with no income, on the other hand, would have trouble paying an equal amount of income tax as someone who was rich.

The easiest and often most useful way to conceptualize horizontal and vertical equity together is to imagine people along some scale. A classic scale used in the tax literature (but interestingly enough, less in the expenditure literature) is ability. Thus, we speak of taxing people according to their ability to pay.

Horizontal equity requires that those with equal status—whether measured by ability or some other appropriate scale—should be treated the same. They should pay the same amount of tax and receive the same amount of benefits. As a consequence, those who start out as equals before any governmental action would end up as equals after the government acted. For example, suppose equals are defined by ability which in turn is defined by income. In that case, those starting with the same before-tax income should end up with the same after-tax income.

Vertical equity, in turn, generally requires that those with less ability be treated favorably relative to those with greater ability. Progressivity is a term often considered synonymous with vertical equity, but, as we shall discuss in a later column, the term is not applied consistently even by economists trained in the literature of public finance.

Some believe that horizontal and vertical equity are essentially applications of the same principle—more informally, that the concern that those who have less pay less and receive more is the same concern that those with equal status be treated equally. This belief derives partly from trying to conceive of equity by putting people on a single scale so that the appropriate tax or expenditure is a simple function of what is measured on that scale. For instance, if taxes are a positive function of income and income only, then both horizontal and vertical equity fall out of the same functional form. Nonetheless, despite this functional relationship under one theoretical (almost mathematical) approach to understanding equity, I do not believe that horizontal and vertical equity should be treated as two corollaries of the same principle. Many people strongly support horizontal equity even though they reject the notion that government must adjust the position of any individual along any particular scale (for example, they may oppose redistribution). I do not think they are necessarily inconsistent in holding those two positions.

Examples abound of the application of horizontal equity to government programs. In an income tax, those with equal incomes should be made to pay equal taxes. Within a sales tax, those who purchase the same items at the same price should pay the same tax. Among those at equal levels of poverty and equal need, they are entitled—at least within their jurisdiction—to equal amounts of food stamps. Equal crimes should be made to bear the same punishment. Chemical companies should be subject to the same limitations on what chemicals can be used for agricultural purposes. Automobile companies should face the same limitations on pollution. Each citizen should have an equal right to vote. And so on. Indeed, I would challenge anyone to come up with any program that does not apply some horizontal equity standard, however imperfectly, in its allocation of government tax, expenditure, or regulation. Where the principle is not applied consistently by one person's definition, it is almost always because by another person's definition the people to whom the law applies unequally are not equals.

From one end of the political spectrum to the other, horizontal equity is a universally accepted principle. There are no sides, no division between conservatives or liberals, or between advocates of big or small government. Usually the principle is so taken for granted and understood that it is not even explicitly examined. If a person can prove that she is just like another, then almost no one will deny that she has a strong case for equality under all laws applying to the two of them. In some ways, horizontal equity is almost tautological—that is, if we are defined as equals, how can government treat us differently, thereby making us unequals? Horizontal equity is the most basic of the applications of equal justice.

When it comes to vertical equity and progressivity, on the other hand, agreement quickly breaks down. Everyone has his own version of how progressive government should be, how much it should be involved in assessing different amounts of tax on individuals with different means, or helping differentially those with different needs. The debate over progressivity at one level or another has often dominated the public debate and even led to the toppling of governments. It has been a major issue in the debate between socialism and capitalism and the resulting compromise that is sometimes called a mixed economy.

If governmental action is invoked to try to rectify some vertical inequity, then some amount of redistribution is almost inevitable. The redistribution may be in cash, in-kind services, or access to opportunities such as education. To achieve some redistribution of consumption or opportunity through the expenditure and tax systems—and usually by means of regulation as well—someone must pay and someone must receive. In both cases, government will be affecting the lives of the individuals involved. No matter what the necessity or validity of such action, therefore, it likely generates some amount of controversy and conflict. After all, any interference involves costs that in turn demand substantial justification.

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