

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

Part Eight: Still the Standard

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This review of tax justice began with a strong endorsement of equity principles and their powerful influence on the development of policy. Equity is closely associated with justice, justice with lawmaking.

Most public laws center on efforts to improve equity, somehow defined, while even those that emphasize other concerns, such as efficiency, must pay homage to the principles of equity. From this lofty ideal we then turn to details. Different notions of equity compete—for example, progressivity and redistribution toward the needy compete with individual equity, which asserts the right of people to engage freely in transactions with others. Equity is not even defined consistently between tax and expenditure systems, so that what is sometimes called regressive tax policy and regressive expenditure policy together can still be progressive by redistributing to those who are worse off.

One also has to figure out the base or bases by which to measure who are equals and who have more or less ability to pay; this is no easy matter, and much disagreement persists among those who emphasize income, consumption, or some other measure as the base. Finally, in determining who pays taxes and who receives expenditures, attention must be paid to a variety of possible adjustments for the potential income of the individual, household size, transfers made, lifetime endowment, and many other items.

The temptation in the midst of all this complexity is to conclude that equity must merely be in the eye of beholder, that there is no reason to pay homage to the standard of justice when developing policy. Statements by many economists, such as Milton Friedman and his followers, add to this confusion. Some of these economists imply, others state, that the economics profession has nothing to say about equity. In this view, equity debates are merely about unmeasurable qualitative matters, similar to competing assessments of a work of art.

In some cases it is really progressivity that is being attacked as being unworthy of economic analysis; in other cases it is almost all aspects of equity. Economists are told to focus their efforts on the efficiency aspects of government policy and, it would seem, turn over the equity debate to lawyers and advocates. This view has become so politically correct within the economics profession that in hiring economists at Treasury, I would at times interview recent Ph.D.s who came from years of university training with almost no ability to perform even rudimentary analysis of the equity aspects of a given proposal.

Here I would like to reclaim the equity ground on which policymakers instinctively move, and on which economists from Adam Smith to Richard Musgrave found it quite natural to walk. Equity is not only a legitimate field of inquiry for economists but a necessary exercise for any would-be policymaker who must balance the benefits and costs of various public actions. Public finance without consideration of equity is like a body without a soul. One can no more ignore the equity of alternative public actions than one can protest that food is unnecessary to health because it is a matter of taste.

The attack on equity really involves two types of errors. The more general is that since there is no simple standard of equity that can be proclaimed universally and applied simply, there is no standard at all. The more specific is that there is no rigorous analytical thinking or at least economic thinking that can be applied to making equitable choices.

That one cannot necessarily proceed from the particular to the universal, of course, is well-known and exposes the logical weakness of the general attack. The presence of hard choices does not mean there are no real choices. Suppose a person has \$100. There are perhaps a million ways that she could spend the money. There are also a trillion ways she would waste the money. Certainly, we can claim that she should get more than \$80 worth of goods and services for her \$100.

Similarly, tax and expenditure choices are multiple and difficult. If they weren't, we would have less need for a democracy to sort out choices in a nonviolent manner. Nonetheless, equity principles can be applied usefully even in the midst of disagreement. As one example, during the tax reform effort at Treasury in 1984 a stalemate arose between those who favored a consumption tax and those who favored an income tax. Not knowing which type of tax would eventually be proposed made it difficult to start the internal process. The solution was simple: concentrate the initial discussions on all those aspects of tax law that were not dependent on the income/consumption debate, such as itemized deductions, employee benefits, tax credits, and other preferences. In most cases, the equity choices to be made there were the same in a consumption or an income tax.

Thus, suppose we are in conflict over whether two people with equal consumption or equal income should pay the same amount of tax. We can and should agree that any tax system on which we agree should not tax unequally those with both equal consumption and equal income.

Think of two competing principles as two points in space. There are an infinite number of points that represent a compromise between the two and that lay at a minimum distance in total from those two points: essentially the exact points themselves and all points between them on the line that they form. But there are even more points that are not on that line at all and that can then be rejected as being too far from both the principles. From these bad points, it is always possible to find a point closer to at least one principle without being further from the other. One can go on with this mathematical analogy when three legitimate principles compete. Three points form a plane, but there is even more space in the three dimensional space outside the interior part of the plane that is formed by connecting the points. By thinking rigorously about the competing principles, one can remove options not lying within the plane.

The error of the more specific attack, the one more commonly expressed by many economists, proceeds from several sources. Sure, economists are trained to understand efficiency, but that no more makes them unqualified to consider equity than does the ability of medical doctors to treat the body make them unqualified to examine the mind. But I would go further. Not only does logic disprove the proposition that training in one area disqualifies one in another, but, in fact, the training of economists is well-geared to examining equity issues because it emphasizes understanding and quantifying relationships and determining how well various measures work, such as in identifying who are equals and who are not.

Their study of efficiency also allows them to spot the inconsistencies in purported theories of equity. For example, one well-known theory asserts that all government actions must be judged first on what they do for the poor. While at first this sounds idealistic, economists recognize that it too easily dismisses the value of transactions among people, including the non-poor, that involve making the parties to the transactions better off without making any one else worse off.

This second attack on equity, of course, is concentrated particularly on progressivity itself, where qualitative judgment is necessarily involved. That people care about equity, including progressivity, however is, in the language of economists, a "revealed preference" that should not be ignored. If people want to pay for justice—for example, by preventing the poor from starving—then why should this valued service be downgraded relative to other consumption desires? Once equity is recognized as having a value toward which people are willing to sacrifice resources, then it can't be ignored on efficiency grounds, either.

Moreover, considerable effort is required to examine how efficiently different equity goals can be met—again an item where economic training serves well. For instance, governments often attempt to target programs toward the poor, and least-cost options need to be developed. In designing many programs aimed at improving equity, the efficiency aspects of both implicit and explicit tax rates need to be examined. And any government consideration of interfering in imperfect markets requires some understanding of both potential equity and efficiency consequences.

Having gone so far to oppose those iconoclasts who would remove equity as a standard, I will go one step further. There is a notion, sometimes taken from a book by Arthur Okun, that there is a "big tradeoff" between equity and efficiency. I do not believe it. What amazes me constantly is how often equity and efficiency go hand in hand. Of course, the idea of individual equity—that we are entitled to the rewards from our efforts and from the trades and transactions that we make—is not easily separated from traditional market notions of efficiency. Horizontal equity and efficiency, too, are constantly linked. The equal tax treatment of different sources of income, for instance, often leads to both equity and efficiency gains by simultaneously taxing those with equal incomes equally and removing tax-induced distortions. Finally, the pursuit of progressivity, adequately balanced against claims of individual equity and efficiency, is in the end nothing more than the pursuit of the good society, and a good society is necessarily efficient as well.

Can I prove the last point? No. From one perspective, it requires a holistic, rather than individualistic, view of humanity—a view that no part of the societal organism is totally free from the others. Of course, the pursuit of progressivity is fraught with costs and dangers, which is why it must always be balanced against other principles, in particular, individual equity. From another perspective, however, the claim that progressivity and efficiency go together is nothing more than an extension of the idea that equity is a service toward which individuals reveal a preference.

In sum, despite many sources of complexity, equity principles are the first standard against which policy is assessed and judged. It simply cannot be otherwise. True, equity might be ignored at certain times and in certain enactments. Certainly, much bad policy today derives from nothing more than an inadequate consideration of the demand for equal justice. Yet the standard simply cannot be ignored too long, or inequity pushed too far. It will always assert and reassert its rightful place in the world of government policy.

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