tax reform = economic growth

This simple equation captures both the essence of, and the essential problem with, recent debates over tax reform. Notwithstanding that “[t]ax systems are primarily aimed at financing public expenditures,” debates over reforming our tax system tend to focus not on the public good—that is, on advancing our development—but narrowly on facilitating economic growth. Although economic growth may be important to human development, it is far from all that there is to development.\(^3\)

Indeed, Emmanuel Saez and Thomas Piketty have shown how recent periods of economic growth have actually redounded primarily to the benefit of the privileged few at the top of the income scale. During the period from 1993–2008, the “top 1 percent incomes captured slightly more than half of the overall economic growth.”\(^4\) During the period from 2002–2007, “the top 1 percent captured two thirds of income growth.”\(^5\) As Saez has explained, “[t]hose results may help explain the disconnect between the economic

\(^1\) Associate Dean for Academic Affairs and Professor of Law, University of Pittsburgh School of Law.

\(^2\) ORG. FOR ECON. CO-OPERATION & DEV., OECD TAX POLICY STUDIES NO. 20, TAX POLICY REFORM AND ECONOMIC GROWTH 18 (2010); see also Letter from the President’s Advisory Panel on Fed. Tax Reform to John W. Snow, Sec’y of the Treasury, in PRESIDENT’S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA’S TAX SYSTEM (2005) (“But the interests of a few should not stand in the way of the tax code’s primary goal: to raise funds efficiently for the common defense, vital social programs, and other goals of shared purpose.”).

\(^3\) UNITED NATIONS DEV. PROGRAM, HUMAN DEVELOPMENT REPORT 2010: THE REAL WEALTH OF NATIONS: PATHWAYS TO HUMAN DEVELOPMENT 5 (2010) (“human development is different from economic growth and ... substantial achievements are possible even without fast growth”).

\(^4\) Emmanuel Saez, Striking It Richer: The Evolution of Top Incomes in the United States (Updated with 2008 Estimates) 3 (July 17, 2010), available at http://elsa.berkeley.edu/~saez/saez-UStopincomes-2008.pdf (note that this quote appears on what is actually the fourth page of this document; however that page is numbered three in the top left corner). This article builds upon and updates Thomas Piketty & Emmanuel Saez, Income Inequality in the United States, 1913–1998, 118 Q.J. ECON. 1 (2003).

\(^5\) Saez, supra note 4, at 3.
experiences of the public and the solid macroeconomic growth posted by the U.S. economy from 2002 to 2007." This trend has set off alarm bells in some quarters, leading to calls for reform that encourages “broad-based” economic growth.⁷

In this essay, I propose shifting the tax reform discourse away from a nearly unwavering focus on economic growth to a broader focus on people, and, more particularly, on those in our society who are most disadvantaged.

I. THE MANTRA OF ECONOMIC GROWTH

In the introduction to their book Fundamental Tax Reform, John Diamond and George Zodrow observe:

The current tax reform discussion in the United States and around the world differs to some extent from earlier debates on tax reform, in that much of the current interest in changing the tax structure focuses on improving the tax climate for business in order to stimulate additional saving, investment, employment, wages, and economic growth.⁸

A few examples will help to underscore Diamond and Zodrow’s point.

A. THE AMERICAN EXPERIENCE

---

⁶ Id.

⁷ ROGER C. ALTMAN ET AL., BROOKINGS INST., THE HAMILTON PROJECT, FROM RECESSION TO RECOVERY TO RENEWAL: AN ECONOMIC STRATEGY TO ACHIEVE BROADLY SHARED GROWTH passim (2010), available at http://www.brookings.edu/papers/2010/04_economic_recovery_greenstone.aspx; see Floyd Norris, As Corporate Profits Rise, Workers’ Income Declines, N.Y. TIMES, Aug. 6, 2011, at B3 (indicating that “corporate profits accounted for 14 percent of the total national income in 2010, the highest proportion ever recorded,” while, in that same year, employees received less than half of total national income for the first time, which “may help explain the economic worries of many Americans who have jobs but still fear they are falling behind”); Richard v. Burkhauser et al., A “Second Opinion” on the Economic Health of the American Middle Class 2 (Nat’l Bureau Econ. Research, Working Paper No. 17164, 2011), available at http://www.nber.org/papers/w17164 (in the context of calling the approach of Piketty and Saez’s research into question, discussing how the narrow sharing of economic growth has gained the attention of the popular press and led to calls for more broad-based sharing of economic growth).

In 2005, President George W. Bush’s Advisory Panel on Federal Tax Reform issued its report. Three principles typically guide any tax policy inquiry: (1) efficiency, (2) equity, and (3) administrability. Put differently, when formulating tax policy, we usually “strive for a tax system that (1) minimizes interference with economic decisionmaking, (2) is fair, and (3) is easy to administer and comply with.” 9 Echoing the executive order establishing the panel, 10 the title of the panel’s report—Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System—repeats these three principles, but with one significant modification. Rather than striving for a tax system that refrains from tinkering with economic decision making to the greatest extent possible, the panel (and President Bush) saw its purpose as tilting the economic playing field to encourage “growth.” In fact, one of the two reform proposals put forward by the panel was labeled the “Growth and Investment Tax Plan.” 11 After all, as the panel counterfactually contended, 12 “great[er] economic growth should … benefit all Americans.” 13

10 The purpose of the Advisory Panel shall be to submit to the Secretary of the Treasury in accordance with this order a report with revenue neutral policy options for reforming the Federal Internal Revenue Code. These options should:

(a) simplify Federal tax laws to reduce the costs and administrative burdens of compliance with such laws;

(b) share the burdens and benefits of the Federal tax structure in an appropriately progressive manner while recognizing the importance of homeownership and charity in American society; and

(c) promote long-run economic growth and job creation, and better encourage work effort, saving, and investment, so as to strengthen the competitiveness of the United States in the global marketplace.

11 President’s Advisory Panel on Fed. Tax Reform, supra note 2, at 59. The other was the “Simplified Income Tax Plan.” Id.
12 See supra text accompanying notes 4–7.
13 President’s Advisory Panel on Fed. Tax Reform, supra note 2, at 138; see also id. at 178 (“Great[er] economic growth, which is projected to occur under the Growth and Investment Tax Plan, would also generally benefit all Americans by increasing their incomes.”).
For instance, the panel made a number of recommendations that were intended to create strong incentives for taxpayers to save or make investments—rather than to consume now. It also recommended that small businesses be permitted to immediately expense most asset purchases in order to “encourage new investment and capital formation by growing businesses.” Such generous expensing (e.g., the “bonus” depreciation provision in §168(k)) has been criticized in the past for encouraging investment in capital at the expense of investment in labor (i.e., hiring), leading to jobless economic recoveries following economic downturns. And this despite the panel’s deprecation of the inefficiencies created by our extant depreciation system, which favors investments in certain types of assets over others. Thus, far from removing the tax “thumb” from the scales, these examples illustrate tax reform proposals that either move the tax “thumb” from one side of the scales to the other or place an even heavier weight on one side over the other.

Similarly, a few years later, Professor Michael Graetz put forward his own tax reform plan. As the centerpiece of his plan, Professor Graetz suggested scaling back the income tax so that it applies only to those with higher incomes and enacting a value-added tax to make up for the loss in revenue. In the third paragraph of his book making the case for this proposal, Professor Graetz wrote the following, rather illuminating passage:

The time for fundamental reform has come. In a world immeasurably more interdependent than the world of the mid-twentieth century, when our current system of taxation took shape, a vital question for any reform proposal is: Will it make American workers and businesses more competitive in the global economy, while maintaining the progressive structure consistent with our nation’s historical insistence on fairness?

\[^{14}\text{Id. at 89–93.}\]
\[^{15}\text{Id. at 95.}\]
\[^{16}\text{Theodore P. Seto, The Problem with Bonus Depreciation, 126 Tax Notes 782 (2010). For a more general critique of accelerated depreciation that questions its relationship to economic growth, see Yoram Margalioth, Not a Panacea for Economic Growth: The Case of Accelerated Depreciation, 26 VA. Tax Rev. 493 (2007).}\]
\[^{17}\text{President’s Advisory Panel on Fed. Tax Reform, supra note 2, at 95–98.}\]
\[^{18}\text{Michael J. Graetz, 100 Million Unnecessary Returns: A Simple, Fair, and Competitive Tax Plan for the United States (2008).}\]
\[^{19}\text{For a summary of Professor Graetz’s plan, see id. at 197–213.}\]
The proposal I offer in this book—what I will call the Competitive Tax—does just that.\textsuperscript{20}

Despite acknowledging the importance of a “progressive structure” to our tax system,\textsuperscript{21} Professor Graetz’s primary focus is on enhancing competitiveness. This is clear both from his phrasing of the “vital question” and from the fact that he denominates his plan the “Competitive Tax” rather than the

\begin{flushleft}
\textsuperscript{20} Id. at 4; see also id. at 16 (“We need a tax system that will encourage investment in the United States to create good jobs and will help make the goods and services our businesses and workers produce more affordable to consumers around the world.”).
\textsuperscript{21} To achieve a “progressive structure” in his Competitive Tax, Professor Graetz retains the income tax on higher-income earners and proposes either a “payroll adjustment” targeted at lower-income earners or the distribution of “‘smart’ cards that would be scanned by retailers to eliminate VAT on either a specified amount of purchases or on purchases of specific goods and services.” Id. at 171, 178; see id. at 170–81 (explaining both possibilities).
\end{flushleft}

Professor Graetz’s choice of words here is quite intriguing because there is a difference between a tax system with a “progressive structure” and a tax system that actually operates in a progressive fashion. As I have explained elsewhere:

The visible face of progressivity in our income tax system is the graduated rate structure, which, with nominal rates proceeding in five steps from 10% to 35%, appears to exact an increasing proportion of an individual’s income as that income rises. But ... appearances may be deceiving. As commentators have noted, “there are a number of reasons why nominal rate structures may not reflect the actual distribution of the tax burden,” not the least of which is tinkering by Congress with the tax base “to exclude many items included in most economic definitions of income.” Although it can be difficult to determine whether the tax burden is progressive in practice and not just in appearance, it has been said that “most analysts ... believe the effective federal income tax rate structure is progressive, although not as progressive as the nominal rate structure.” ... Indeed, a recent study that covered individual and corporate income taxes, estate and gift taxes, and payroll taxes documented a striking decline in the overall progressivity of the federal tax system at the highest income levels between 1960 and 2004.

“Competitive and Fair Tax” or the “Fair and Competitive Tax” or even the “Fair Competitive Tax.”

When he later opens his discussion of “[f]irst [p]rinciples of [r]esponsible [r]eform,”22 Professor Graetz describes the “traditional goals of tax reform” as: “produce adequate revenue; promote economic growth; increase international competitiveness of U.S. products, workers, and businesses; minimize interference with private decision making; streamline compliance and administration; and, finally, distribute the burden of taxation fairly in accordance with people’s ability to pay.”23 In this litany of principles, setting aside the obvious goal of producing revenue, Professor Graetz first mentions economic growth and next increasing competitiveness. He only then reiterates the three principles that typically guide tax policy inquiries, mentioning the efficiency or neutrality of the tax system first, simplification second, and fairness last of all. Again, the primary focus is on economic growth.

More recently, the topic of tax reform has surfaced in connection with discussions of deficit reduction. The need for tax reform to increase or enhance the nation’s economic growth often surfaces in these discussions. For example, Erskine Bowles and Alan Simpson, co-chairmen of the National Commission on Fiscal Responsibility and Reform, penned an op-ed piece in The New York Times on the deal to increase the debt ceiling in which they stated:

And we must address the tax code. We need new revenue to finance the increasing costs of our health care system and an aging population—but it should come from reducing or eliminating tax breaks, not from higher rates. The tax code is riddled with annual tax breaks amounting to $1 trillion—most of which are just government spending in disguise. By reforming them, we can reduce individual and corporate tax rates in a way that keeps the tax code progressive while promoting economic growth and reducing the deficit at the same time.24

In an op-ed piece published in The Wall Street Journal in the wake of the debt-ceiling debate, Kevin Warsh, a former Governor of the Federal Reserve, and Jeb Bush, former Governor of Florida, suggested that the nation’s

22 GRAETZ, supra note 18, at 52.
23 Id.
“economic grand strategy” should be, “[i]n a word: growth.”25 They explained that:

An effective growth strategy confronts tough challenges before they become intractable. The strategy is a threat to those who take refuge in our burdensome tax code, and it is a great source of encouragement to those who seek higher rates of return on physical and human capital. Hence, fundamental tax reform—dramatically lowering tax rates for individuals and companies while eliminating loopholes, deductions and credits—is critical to economic growth.26

In an op-ed piece published in The Washington Post to explain and “sell” the agreement reached to end the showdown over raising the debt ceiling, Timothy Geithner, the Secretary of the Treasury, wrote that “[t]he agreement sets up a powerful mechanism for agreement on tax reforms to strengthen growth.”27 Similarly, Pennsylvania Senator Pat Toomey, one of the members of the congressional “super committee” created as part of this agreement, reportedly stated that “his ‘guiding principles’ on the committee will be ‘the twin goals of reducing the deficit and continuing to promote economic growth.’ To that end, he hopes to reform the tax code in order to broaden the base while lowering rates and growing the economy.”28

B. INTERNATIONAL EXPERIENCE

This focus on tax reform as a potential driver of economic growth is by no means a uniquely American phenomenon. In 2010, the Organization for Economic Co-operation and Development (OECD) issued a report aptly titled Tax Policy Reform and Economic Growth.29 In this report, the OECD investigated what it described as a “key issue for tax policy making”; namely, “how tax structures could best be designed to promote economic growth.”30 Notwithstanding an acknowledgment that tax systems are used to achieve objectives other than economic growth, the OECD generally ignored these other objectives in preparing its report, “except when there is a clear trade

26 Id.
29 ORG. FOR ECON. CO-OPERATION & DEV., supra note 2.
30 Id. at 18.
off between them and tax reforms aimed at raising GDP per capita.”\textsuperscript{31} In explaining its focus on economic growth, the OECD stated that, even though “there is not necessarily a direct link between economic growth and overall well-being,” economic growth “should increase the level of public expenditure that can be regarded as ‘affordable’ and make it easier to keep public debt within sustainable bounds.”\textsuperscript{32}

In its report, the OECD considered “four broad groups of taxes—consumption, property, personal income and corporate/capital income taxes.”\textsuperscript{33} Of these four groups, the OECD concluded that taxes on corporate and capital income are the most damaging to economic growth, followed by personal income taxes.\textsuperscript{34} A pro-growth tax reform would, according to the OECD, involve “shifting the balance of taxation away from income taxes and towards a mixture of consumption taxes and taxes on immovable property, particularly on residential property.”\textsuperscript{35} Such a tax reform would be even “more effective in increasing growth if the design of the VAT were improved at the same time—by removing exemptions, zero-rating and reduced rates.”\textsuperscript{36} Similarly, to the extent that income taxes are retained in the reform, the OECD advocated in favor of broadening the income tax base and lowering the rates, particularly the top rates.\textsuperscript{37}

The OECD examined tax reform trends in its member countries to determine the extent to which they followed its “‘tax and growth’ recommendations.”\textsuperscript{38} It concluded that many OECD member states had “cut personal and corporate tax rates while broadening the tax base” and that there was a trend toward “increased use of value-added taxes,” though there was “a general trend to higher VAT rates.”\textsuperscript{39} With these trends in mind, the OECD then spent the following chapters identifying the obstacles to tax

\textsuperscript{31} Id. The OECD did this for the sake of confining itself to a “manageable” task and because the OECD had earlier produced studies covering other objectives (e.g., equity and environmental matters). Id.
\textsuperscript{32} Id. at 9.
\textsuperscript{33} Id. at 40.
\textsuperscript{34} Id.
\textsuperscript{35} Id.
\textsuperscript{36} Id.
\textsuperscript{37} Id.; see also id. at 20–23 (discussing the points made in this paragraph in detail).
\textsuperscript{38} Id. at 21 box 1.2.
\textsuperscript{39} Id. at 26; see also id. at 40–43 (providing greater detail in summarizing these trends).
reform and providing recommendations on how to surmount them in order to implement pro-growth tax reforms.\textsuperscript{40}

II. TAX REFORM ≠ ECONOMIC GROWTH

As mentioned in the introduction to this essay, the general aim of tax systems is to finance public expenditures.\textsuperscript{41} Put differently, “[t]ax law is a basic institution that shapes society and must serve the public good.”\textsuperscript{42} Calling to mind the aphorism that “a rising tide raises all boats,” our tax reform discourse does not focus on advancing the public good directly, but on economic growth as a proxy or indirect route for achieving a public good. The problem with this proxy is that, as demonstrated by Saez and Piketty, for nearly twenty years, the rising tide has “swamped the majority of people”\textsuperscript{43} while raising the yachts of the wealthiest and most privileged among us.\textsuperscript{44}

What if, instead, we were to refocus the tax reform debate directly on advancing the public good; that is, on individuals instead of economic growth and, more particularly, on those most disadvantaged in our society (i.e., not just the poor but those who are disadvantaged along lines of race, gender, sexual orientation, disability, etc.)? What types of reform proposals would we make if people were put at the center of tax reform debates (rather than economic growth)? How would our tax system change if it were viewed not simply as a means of encouraging economic growth but as one instrument (among many) for advancing human development? What fundamental changes would be made to the tax system if we were to place those who are most disadvantaged in our society at the center of the debate?

Two perennial focuses of tax reform debates are eliminating tax expenditures (more popularly referred to as closing special interest loopholes) and the need to keep any reform revenue neutral. Often debates over tax reform rail against tax expenditures. But would valuing human development support the current (and, in the academic literature, much maligned) approach of using the tax system to further social goals, perhaps in a more coordinated and targeted fashion? Drawing on comparative legal theory, if we think of law as mirroring society, the idea of tax expenditures makes perfect sense. Why wouldn’t the tax laws mirror American quirks/priorities (e.g., privatized health insurance provision, the American dream of

\textsuperscript{40} Id. at 48–80.
\textsuperscript{41} See supra note 2 and accompany text.
\textsuperscript{44} See supra note 4–7 and accompanying text.
homeownership, and charitable giving)? But, having posed the question in this way, what does it say about American society that our tax laws do not place a central focus on human development? What of Emmanuel Levinas’s notion about the “other,” which Richard Cohen has reformulated as: “to ‘love thy neighbor is oneself.’” 45 What would the tax laws look like if we empathized with the suffering of others rather than worried about increasing economic growth (which often redounds to the benefit of those who already have rather than the outsiders/have-nots)? Would it have something to say about the level of revenue that our tax system is designed to raise in order to fund programs that aid the disadvantaged?

At bottom, debates about the distribution of the tax burden are debates about self and other. When we speak of horizontal and vertical equity, we are talking about how an individual taxpayer will view their taxation (i.e., self) as it relates to the taxation of the other who resembles them (i.e., horizontal equity) and the other who looks different from them (i.e., vertical equity), at least in terms of a mirror that reflects only the financial dimension of the individual. This is a very self-centered view of otherness, one that is all about how I am treated vis-à-vis others. A different approach would be to adopt Emmanuel Levinas’s view of self and other and to recognize that we discover our own humanity, our own self by identifying with the other and, more particularly, with the suffering of the other.