

Taxation and Morality

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Introduction

- The title “Taxation and Morality” can evoke a number of varying responses and expectations on what might be covered.
- So let me start with a few examples of topics that, although extremely important and interesting with significant literatures, I will not be taking up.
 - Religious Taxes eg Tithes in Christianity, Zakat in Islam, modern day Church taxes in some European countries.
 - Sin Taxes eg taxes on tobacco, alcohol, drugs.
 - Morality of tax avoidance; more generally, immorality as opposed to illegality, of tax compliance.

- Rather, in this talk I will be taking up a set of issues which perhaps better fall under the title of Taxation and Moral Philosophy.
- In particular, I want to talk about the moral philosophical roots of what I sense is a strong intellectual and policy drift away from the post war “social democratic consensus” on redistribution of market incomes through taxation to achieve egalitarian goals.
- And I want to argue for a resistance to this drift.

- Let me start with a collection of statements to motivate what I have in mind as the topic for discussion.

- “Taxation of earnings is on par with forced labor.”

Robert Nozick, 1974.

- “He did not have a curmudgeon’s feelings about his own taxes. A secretary who exclaimed ‘Don’t you hate to pay taxes!’ was rebuked with the hot response, ‘No, young feller. I like to pay taxes. With them I buy civilization.’”

Felix Frankfurter on Oliver Wendell Holmes, 1938.

- “The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state....”

Adam Smith, 1776

- “But it is important to remember that taxes, even including negative ones in the form of cash benefits, are only one weapon in the policy arsenal for addressing vertical equity, and may not even be the most effective of them. One of the most powerful ways in which governments support the poor—especially in low income countries—is by providing basic education and health care. By enabling such spending, a not-very progressive tax that raises a lot of revenue such as VAT, can do more for the poor than a very progressive one that raises little.”

Michael Keen and Joel Slemrod, 2021

- It is the perspectives in these statements, and these sorts of statements, that I wish to address in this talk, with a focus on the moral philosophical rationale for the drift away from income redistribution through taxation.

- Some ground clearing. OECD definition:
- “Taxes are compulsory, unrequited payments to general government. They are unrequited in the sense that benefits provided by government to taxpayers are not normally in proportion to their payments. The OECD methodology classifies a tax according to its base: income, profits and capital gains; payroll; property; goods and services; and other taxes. Compulsory social security contributions paid to general government are also treated as taxes, and are classified under a separate heading.”

- Of course all sorts of issues:
 - Cross-country comparability of statistical procedures
 - “Negative Taxes” eg cash transfers?
 - Conditional cash transfers?
 - Targeted subsidies in kind?
 - General food/fuel subsidies?
- I won't belabor these sorts of points here. I will rely on a generous and expansive notion of taxation.

Optimal Income Taxation: The Mirrlees Framework

- I believe the essence of the economic analysis of income taxation is present in James Mirrlees's 1971 Nobel prize winning paper, "An Exploration in the Theory of Optimum Income Taxation."
- In the Mirrlees model individuals bring different degrees of innate ability to the market place and translate it into market income through their choice of labor supply.
- The government implements an income tax regime. This changes post tax incomes, but it also changes labor supply and hence pre tax market incomes.
- The government chooses a tax regime to maximize an objective function defined on individual wellbeings, subject to the constraint of respecting individual choices and the constraint of raising a given amount of revenue (presumably at least for the needs of a state to be able to actually implement the tax regime).
- (More on the minimalist state presently).

- This classic paper has all the ingredients to make it a quintessentially economic analysis.
 - It has individual choices in response to taxation, thus bringing in incentive effects.
 - It has a clear statement of the government's constraints.
 - It has a clear statement of the government's objective function.
 - It has optimization of the objective function subject to the constraints.

- Here my focus is on the government's objective function.
- The Mirrleesian objective function is Utilitarian--an aggregate of individual utilities.
- “The greatest happiness of the greatest number is the foundation of morals and legislation” (Jeremy Bentham).
- The Mirrleesian twist is that inequality in wellbeing is also part of the objective function. The Mirrlees framework allows a formalization which provides a range of possibilities from simple Benthamite summation of utilities to Rawlsian focus only on the worst off.
- (More on Rawls presently).

- It should be noted that the Mirrleesian Utilitarian framework does not necessarily lead to highly progressive tax regimes.
- Incentive effects can militate against progressivity.
- Indeed, the late Tony Atkinson (2015) drew a direct line from the Mirrleesian framework of 1971, to the 2010 Mirrlees Review in the UK which was chaired by Mirrlees, to the 2013 cut of the top rate of income tax in the UK from 50% to 45% by then Chancellor of the Exchequer George Osborne. (Atkinson was critical of the decision.)
- [And then, in October 2022, in the budget statement of the ill-fated Liz Truss Prime Ministership (49 days), Chancellor of the Exchequer Kwasi Kwarteng said to Parliament: “Mr. Speaker, I am not cutting the top rate, I am eliminating it altogether”]

- But of course the framework *could* lead to highly progressive taxation if a highly egalitarian objective function was adopted.
- The objective function matters as much as incentive effects.

Natural Rights and the Minimalist State

- It can be argued that, a la Mirrlees, Utilitarianism is the DNA of normative economic analysis, explicitly or implicitly.
- However, congenial though it may be to economist sensibilities, Utilitarianism has of course been attacked from various quarters.
- Amartya Sen and Bernard Williams (1982) highlighted what they saw as the three enduring critiques of Utilitarianism: consequentialism, welfarism and sum-ranking.
 - Consequentialism refers to the characteristic that what matters in evaluation are consequences and only consequences.
 - Welfarism refers to the characteristic that what matters among consequences is the wellbeing, or utility, of individuals as perceived by individuals themselves.
 - Sum-ranking refers to the characteristic that what matters in social evaluation is the sum of utilities across individuals

- Now we have seen that the third of these can be addressed in a Mirrleesian framework. It is the first two critiques, singly or in combination, which are associated with alternative normative traditions.
- Two famous departures from Utilitarianism are captured in the work of Rawls (1971) and Nozick (1974).
- Of Rawls's two principles of justice the second, the "difference principle" which states that policy should be targeted towards the wellbeing of the worst off, the "maxi-min", was argued early on by Arrow to be consistent with fairly standard economics distributional principles and indeed a special case of them. This is shown by the Mirrleesian framework being able to range between Benthamite sum of utilities to the utility of the worst off as the objective function.

- What really sets Rawls apart from Utilitarianism is his first and dominant prior principle on “basic liberties” (“freedom of thought and liberty of conscience; the political liberties and freedom of association, as well as the freedoms specified by the liberty and integrity of the person; and finally, the rights and liberties covered by the rule of law.”)
- But this does not seem to have impacted economists’ analysis of optimal taxation along the second principle. For the economist, it seems as though the two principles inhabit separate worlds, and we can carry on our business with reference to the second (and that too as a special case).

- The Nozickian paradigm is not quite so conducive to optimal tax theory since it holds that NO taxation is legitimate (beyond that needed for a minimalist state).
- The paradigm draws from earlier traditions of natural rights going back at least as far as John Locke.
- Nozick famously asserts: “Individuals have rights, and there are things no person or group may do to them (without violating their rights)”
- These rights emerge from the initial state of nature from which individuals develop mechanisms to enforce contracts, and to prevent theft and fraud. Individuals then have rights to hold and dispose of property justly acquired.
- Going beyond the minimalist state functions, in particular redistribution of property or returns to property, is to violate these rights.

- Thus Rawls's first level principle does not preclude redistribution through his second principle.
- But Nozick's first level principle leaves no room for a second principle: "Any more extensive state will violate persons' rights not to be forced to do certain things, and is unjustified."
- Hence it follows that "Taxation of earnings is on par with forced labor."

- There are many questions that can be posed to the Nozickian paradigm. Among other things:
 - The exact specification of the minimalist state is not clear. Presumably public goods like parks are not included. A standing army presumably is, as is a police force, as is a functioning justice system. But how big and what exact functions?
 - Whatever the resources needed for the minimalist state, the question of how they are to be raised is still left open. Who should pay how much? Equal amounts? In proportion to market income (a la Smith)? Or some other notion of leaving the market distribution intact? Or in a manner which has least efficiency costs in the economic sense, thus minimizing the costs of the minimal state? The Mirrleesian framework can help with the last of these for sure!
 - There is also Nozick's "rectification principle", that property unjustly acquired must be corrected. Leaving to one side the identification of such injustice, its rectification surely once again raises question of optimal income taxation as economists understand it.
 - Further, if inequality itself could be a threat to society functioning, could restricting inequality below the critical level be part of a minimalist state?

From Nozick to Equality of Opportunity

- So I do not think that a Nozickian perspective can entirely banish taxation and the theory optimal income taxation.
- However, the Nozickian discourse has left an important mark on the current debates on progressive taxation of income, not necessarily in the stark and extreme sense of “taxation is slavery”, but nevertheless present.
- The Nozickian impact on current discussions of optimal income taxation is through the specification of the government’s objective function. Not through incentives, which still matter; not through constraints, which still matter; but through what it is we model the government as maximizing.

- The Nozickian position is that there is NO justification for income taxation (except for the minimalist state) to interfere with the free choices of individuals, and certainly not for redistributive purposes.
- An intermediate position is that there are RESTRICTIONS on redistribution but there is justification of taxation for SOME redistribution under SPECIFIED CONDITIONS.
- In particular, in the spirit of Nozick, variations in income attributable to individual choice and factors under the individual's control are NOT legitimate targets for redistribution.

- Roemer and Trannoy (2017):
- “In the welfarist tradition of social-choice theory, egalitarianism means equality of welfare or utility. Conservative critics of egalitarianism rightly protest that it is highly questionable that this kind of equality is ethically desirable, as it fails to hold persons responsible for their choices, or for their preferences...”
- However, variations in income attributable to factors outside the individual’s control, such as Race or Parental Wealth, ARE ethically legitimate targets for redistribution. (Perhaps this also jibes to some extent with Nozick’s rectification principle).

- This will immediately be recognized as the “inequality of opportunity” rationale for taxation to redistribute, as opposed to solely “inequality of outcomes.”
- The modern revival of this perspective in economics owes much to John Roemer (1998), who coined the terms “circumstance” and “effort” for factors respectively outside and inside the control of the individual.
- It also has a pedigree in moral and political philosophy, going back least to Ronald Dworkin (1981a,b). Indeed, Marxist philosopher Gerry Cohen (1989) lauded Ronald Dworkin for helping egalitarianism by “incorporating within it the most powerful idea in the arsenal of the anti-egalitarian right: the idea of choice and responsibility.”

- The upshot this line of argument is the position that while it is morally legitimate to redistribute the “circumstances” which individuals bring to the market, it is not legitimate to further redistribute market outcomes (incomes) which are the result of individual effort, choice and responsibility.
- I believe that this argument, apparently now conceded by many egalitarians as well, has been instrumental in the twenty first century drift away from the impulse to redistribute market incomes and to try something else—for example “redistributing” education. This is referred to as “predistribution.”

From Redistribution to Predistribution

- Recall:
- “But it is important to remember that taxes, even including negative ones in the form of cash benefits, are only one weapon in the policy arsenal for addressing vertical equity, and may not even be the most effective of them. One of the most powerful ways in which governments support the poor—especially in low income countries—is by providing basic education and health care. By enabling such spending, a not-very progressive tax that raises a lot of revenue such as VAT, can do more for the poor than a very progressive one that raises little.”

Michael Keen and Joel Slemrod, 2021

- This is an example of what I see as a drift away from income redistribution through taxation in the twenty first century.
- The mid-twentieth century consensus after the second world war, that redistribution of market incomes has to play a central and dominant role in addressing inequality, what might perhaps be termed the social democratic consensus, has frayed, even among egalitarians.

- The Keen-Slemrod quote is but one example of the current state of mind.
- Thomas Piketty et. al. (2022) say:
- “...policy discussions on inequality should pay more attention to policies affecting pre-tax inequality and should not focus exclusively on redistribution.”
- Here is Ferreira (2023) in his recent review of the post-Washington Consensus inequality literature:
- “My reading is that there is a growing consensus on “*pre-distribution*” policies, but perhaps less so on re-distribution policies. Pre-distribution refers to public investments intended to enhance the human capital accumulation of the least advantaged.....”

- And this brings us to the term Predistribution, which was arguably introduced to the academic literature by Yale political scientist Jacob Hacker (2011).
- Redistribution is the application of tax and transfer schemes to reduce the inequality of market incomes. Pre-distribution seeks to obtain a less unequal distribution of market incomes in the first place, so that redistribution after the event is not necessary.

- The then leader of the British Labour Party Ed Milliband put it like this in 2012 for a general audience he was addressing:
- "Think about somebody working in a call centre, a supermarket, or in an old peoples' home. Redistribution offers a top-up to their wages. Pre-distribution seeks to go further - higher skills with higher wages."
- The Keen-Slemrod quote does not thus stand in isolation but is part of the zeitgeist of the first quarter of the twenty first century on taxation and redistribution.

- There appear to be three main types of arguments why pre-distribution measures rather than direct income redistribution measures are thought to be superior.
 - First, it is argued that there are so many problems with redistributing income—informational costs, incentive effects etc, etc, that redistributing income may not in fact be the best way of even redistributing income. So even if redistributing income is the objective, it may be better to redistribute education, for example.
 - Second, it is argued that that the shift from “equality of outcomes” to “equality of opportunity” (of which equality of education is seen to be a manifestation) finds favor with the population at large and thus with politicians.
 - Third, it is argued that redistributing income is morally not the appropriate objective. The morally legitimate objective is to equalize opportunities, and let the income chips fall where they may, based as they are on effort and choice. The argument has its roots in Locke and Nozick, brought through to us via Dworkin and Roemer.

- My focus in this talk is on the third of these arguments, the moral legitimacy or otherwise of taxation to redistribute market incomes.
- But let me briefly touch on the other two arguments which, in my view, have had too easy a ride in the discourse and need to be examined more closely.

- The first argument, on the difficulties of redistributing income through taxation, incentive effects, informational costs etc, is well established. It is the bread and butter of the economic analysis of taxation.
- The narrow windows in Amsterdam, the peculiarities of tax farming in Mughal India and then the East India Company, the Cayman Islands etc etc , are very well set out in Keen and Slemrod's *Rebellion, Rascals and Revenue*.
- And the issues with targeting negative taxes, ie use of transfers for redistribution, are as severe. (Indonesia example)

- BUT, just because redistributing through income taxation is difficult does not mean that redistributing through other avenues is easy.
- It is not that there are no incentive effects in redistributing education.
- It is not that state educational expenditures are themselves particularly equally distributed.
- And the moment we model market relevant human capital as being the product of both public inputs and private parental inputs, the distribution of income is seen to play a key role in the distribution of education and human capital. Thus Predistribution Requires Redistribution (Tuomala et. al. et al 2022).
- The grass is not greener on the other side. At the very least we need to fully assess the difficulties in other channels before quite so easily advocating a shift away from income redistribution through (positive and negative) taxes.

- The second argument is at heart an empirical one. Does the population at large in fact evidence support for “opportunity” rather than “outcome”?
- I think a fair read of the experimental literature suggests that BOTH elements are present in normative evaluations:
- “...individuals are more willing to accept income differences which are due to effort and preferences... Yet, in spite of its wide acceptance, the notion of individual responsibility is insufficient to define fairness. For example, when an outcome is such that it brings deep deprivation to an individual, questions of how it came about seem secondary to the moral imperative of addressing the extremity of the outcome, be it hunger, homelessness, violence or insecurity.” (Hufe, Kanbur and Peichl, 2022).

- Going beyond the empirical, however, philosopher Christine Sydnovich (2023) considers the contention from political progressives that:
- “....a focus on outcomes could be political suicide. Given the popular appeal of ideas like merit, private property, and social mobility, it is only prudent for egalitarians to adopt modest goals and focus on equality of opportunity....In my view, if we heed the realists’ advice, we risk capitulating to a grudging outlook that is unwilling to remedy disadvantage that, though ostensibly the result of free choices, is mired in unchosen and unjust social conditions.”

- Let us turn finally then to the third argument, that (leaving to one side incentive effects and political economy considerations) predistribution is morally superior to redistribution because it addresses inequality due to circumstance, not effort.
- I have written elsewhere (Kanbur, 2023) about the empirical difficulties of make the distinction between circumstance and effort in practice in order calculate measures of “inequality of opportunity”.
- I have also contested the political wisdom of buying into the distinction because it gets one a “seat at the table” in policy discussions.
- But consider now some conceptual difficulties of the circumstance/effort distinction.

- Consider first the following conundrum.
- What happens when one person's effort becomes another person's circumstance?
- The effort doctrine says that the consequences of that effort "belong" to the individual and we have no moral right to alter those consequences.
- But the circumstance doctrine says that factors outside an individual's control are a morally legitimate target.
- Both doctrines cannot be satisfied simultaneously.

- The most obvious example of such interconnection is parents and children. If free and full knowledge parental choices lead to a poor start for their children, which doctrine is to rule?
- The answer is not clear and cannot be given within the philosophical framework of the current equality of opportunity discourse.
- Biblical injunctions also reflect age old ambiguity on this question.
- “for I, the Lord your God, am a jealous God, visiting the iniquity of the fathers on the children, and on the third and the fourth generations of those who hate Me” (Deuteronomy 5:9)
- "Fathers shall not be put to death for their sons, nor shall sons be put to death for their fathers; everyone shall be put to death for his own sin."
(Deuteronomy 24: 16)

- Conceptually, any form of social connectedness leads to similar difficulties.
- An executive's freely chosen decisions lead to the circumstances for the firm's workers.
- Freely chosen housing decisions of high income individuals lead to rising house prices and rising rents for low income individuals.
- What Amartya Sen called "entitlement failure" in his study of the 1943 West Bengal Famine was the freely made market decisions of grain hoarders pushing up food prices, thereby altering the circumstances of artisans and causing famine deaths.

- But the conceptual difficulty arises even when there is no social connectedness and we consider individuals in isolation.
- Imagine yourself serving on a soup line.
- As one particular indigent approaches you and you reach out with a cup of soup, the equality of opportunity police, the circumstance/effort monitors, step in and inform you that the reason why the indigent is an indigent is not because of circumstance but because of effort and choice.
- In what moral universe would you pull away the cup of soup?

- If your moral intuition recoils from doing that then it is conceding that outcomes can matter irrespective of choice and that at the very least we have to carry with us both moral intuitions.
- Again, note that acting on the intuition by providing support to the worst outcomes will have incentive effects, but so will acting on the other moral intuition. Or any moral intuition. The point here is to specify the objective function that is to be optimized subject to incentive compatibility and other constraints.
- A formal axiomatization of accommodating or balancing both intuitions is presented in Hufe, Kanbur and Peichl, *Review of Economic Studies* 2022.

- I have argued elsewhere that these conceptual difficulties significantly undermine the circumstance/effort distinction, quite apart from the empirical difficulties in implementing the distinction in practice (Kanbur and Wagstaff, 2015).
- But here I would like to say that even if you do not come with me all the way, or significantly, at least you should question the third argument for the move away from taxation of market incomes for redistribution—that it is morally illegitimate because it interferes with the free choices which lead to those incomes.

Conclusion

- Let me conclude by retracing the narrative of this talk.
- The Nobel prize winning Mirrlees framework captures the quintessential economic approach. It has incentives, constraints, and a clear specification of the government's objectives.
- The Utilitarian foundations of the Mirrlees framework (and, I would argue, much of economic policy analysis) are much debated, leading in particular to the moral philosophical formulations of Rawls and Nozick.
- The Rawlsian framework, especially the second of his principles ("the difference principle"), can be and has been incorporated into standard economic analysis of optimal taxation.
- The Nozickian framework in its pure form is antithetical to optimal taxation exercises because it rejects altogether the moral legitimacy of taxation, except only for a minimalist state and certainly not for redistributive purposes.

- However, the Nozickian perspective has left its mark on the current discourse on redistributive taxation via the route of personal responsibility and equality of opportunity, and the illegitimacy of taxing to redistribute income inequality caused by differences in individual choice and effort.
- This moral philosophical perspective has played its part, along with presumed incentive effects and political economy considerations, in underpinning the twenty first century drift away from redistribution of market incomes through taxation, and towards predistribution.
- However, this drift needs to be closely examined on conceptual, empirical and policy grounds and, I believe, it needs to be resisted by egalitarians of all stripes.

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Thank You!