

Book Symposium

Liam Murphy and Thomas Nagel

The Myth of Ownership: Taxes and Justice

Author's Introduction

LIAM MURPHY*

In the chapter on Financing Government in the Australian Labor Party's *National Platform*, there is the following paragraph, headed 'Fairness':

Labor is committed to a fair and progressive tax system characterised by:

- vertical equity, meaning that those with differing capacities to pay tax should face differing burdens, with a greater contribution from those with the greater capacity to pay; and
- horizontal equity, meaning that those with equivalent capacities to pay tax should face similar burdens.¹

The main claim in *The Myth of Ownership* is that the distribution of pretax income has no moral significance, and that therefore the distribution of burdens on pretax income can have no moral significance either. The upshot is that traditional appeals to vertical and horizontal equity in taxation are fundamentally misguided. Though contemporary American anti-egalitarian tax rhetoric is a frequent target in the book, and though in later chapters the tax implications of a range of egalitarian political views are considered, the rejection of the traditional approach to justice in taxation is entirely independent of any particular political perspective. To say that a fair tax is a progressive tax, or to the contrary a flat tax,² is to take a position

* Professor of Law and Philosophy, New York University.

¹ *ALP National Platform* (2004) Australian Labor Party <http://www.alp.org.au/platform/chapter_17.php> at 18 March 2005.

² See, eg, the policy statements of the extremely influential American lobbying group, Americans for Tax Reform: <<http://www.atr.org/>>. The scholarly source for the flat tax campaign in the United States is Robert E Hall and Alvin Rabushka, *The Flat Tax* (2nd ed, 1995). The authors

in a meaningless debate. Similarly, to say that granting a deduction for housing mortgage interest payments would be unfair because it would fail to treat like cases alike, as required by horizontal equity, is to appeal to a standard of equal treatment that has no application in the tax context.

Furthermore, justice in taxation is not an independent moral issue. A tax scheme will be just if it finds its place in a just set of economic and legal institutions. Economic and legal institutions as a system will be just depending on how well they secure political values, such as liberty, welfare, opportunity, personal responsibility, and equality — both of status, by which I mean primarily sexual and racial equality, and economic. Different political theories interpret and weigh these values differently, so abandoning the traditional way of thinking about tax justice leaves open a full range of views, from left to right, on what a just overall economic system, taxation included, will look like. In particular, it leaves open what the rate structure of the best tax scheme will be.

Behind the idea that justice in taxation is a matter of figuring out a fair distribution of burdens as measured against a baseline of pretax income may be an unexamined assumption that the distribution of pretax income is itself just. As soon as this assumption *is* examined, it is seen to be obviously untenable. Why would we believe that the pretax income distribution, affected as it is by all kinds of government decisions — concerning environmental law, trade policy, industrial relations, etc — is always just? We wouldn't, unless perhaps we had in mind not actual pretax incomes, but some hypothetical distribution of 'pure' market returns. But apart from the fact that that distribution is entirely irrelevant just because it is hypothetical, it is a highly contentious claim in political theory that idealized market returns are presumptively just. Not many enthusiasts of the free market are in fact prepared to go so far as to say that no matter how unequal, and no matter how badly off some are in absolute terms, whatever distribution results from competitive market interaction is just. The book takes for granted that such a view is extremely implausible as a matter of political philosophy. But the main point is structural: Most people who discuss taxation in terms of a fair distribution of burdens would agree.

But perhaps we have a property right to our pretax income? Would this not justify appeal to the baseline of pretax income independently of any theory of distributive justice? The book assumes that the morality of property should be understood as Hume understood it. Property rules are conventional, first in the form of social norms, and later in the form of law. We evaluate these rules by asking whether they have a place in an overall economic system that properly serves the relevant social values, such as

liberty, welfare, opportunity, personal responsibility, and equality. Hume's welfarist case in favour of having an institution of property law, under which people have legal rights to at least personal property, is by now banal; but that doesn't mean that it is not right. And we could go further and say, following Hegel, that a legal property scheme is not just a good idea because of its effects on social welfare, but also that it is something each of us has a positive moral right to, at least in favourable circumstances, and at least as far as personal property is concerned, because of the role of personal property in human freedom. Neither of these considerations provides any support for the idea that there are moral property rights antecedent to the conventional property rules established (in institutionally complex societies) by law — moral rights to which a just set of legal property rules must conform.

But now the argument against the role of pretax income in discussions of justice in taxation actually does not depend on taking this instrumental view about the morality of property. For whatever the truth about the morality of property, we couldn't possibly have a right to the whole of our pretax income. The point here, unusually in practical philosophy, is one of logic.

Suppose we could make sense of some theory of natural property rights. Good government would then respect the property rights people have according to this theory. If those property rights were absolute, then compulsory taxation would always be wrong. This is what Nozick argued in *Anarchy, State, and Utopia*.³ But some favour a modified libertarianism, according to which these property rights are not absolute: Compulsory taxation, so long as its burdens are fairly distributed, is legitimate for the sake of protecting individual rights and securing certain basic public goods. On this view, we should assess tax justice by looking at the distribution of burdens against a baseline of people's rightful property.⁴ But at this point the view dives into incoherence by assuming that people's rightful property includes the whole of their pretax income. We couldn't have a natural property right to all our pretax income, because our pretax income is determined by government economic policy and the entire legal apparatus of the state that makes any stability of holdings possible. Since that entire set of institutions requires taxation for its existence, we can't possibly have property rights to all our pretax income.

³ Robert Nozick, *Anarchy, State, and Utopia* (1974).

⁴ This is the view of Richard Epstein. See, eg, 'Taxation in a Lockean World' in Jules Coleman and Ellen Frankel Paul (eds), *Philosophy and Law* (1987) 49.

This logical point is entirely general: Whatever we believe we are entitled to as a matter of distributive justice or property theory, or anything else, we cannot be entitled to the whole of our pretax income.

The argument is *not* that without the state, our property rights would not be protected, and so it follows that we don't really have any property rights. It is that pretax income depends on the state, which depends on taxes, so we can't have a right to all our pretax income. This point does not itself establish that the idea of moral property rights makes no sense, just that we can't be entitled in any sense to our pretax income. The myth of ownership that ruins tax policy debate is the myth of ownership of pretax income. (Still, this is not a good result for the moralist of property, because it leaves it unclear just what, on that view, we do own.)

The case against appealing to pretax income as a morally relevant baseline against which to measure the distribution of tax burdens has been made before. And the simple logical point at its heart is not something about which there can be moral debate or reasonable disagreement of any other kind. The persistence of this clearly untenable approach to what is, from the point of view of economic justice, the most important issue of domestic institutional design clearly requires some diagnosis. *The Myth of Ownership* coins the phrase 'everyday libertarianism' to label an unreflective way of thinking about the operation of the major institutions that structure life in a capitalist economy that encourages us to believe the unbelievable — that our pretax income is really ours, that it belongs to us.

Everyday libertarianism is not genuine libertarianism. It does not accept the radically egalitarian implications of even the modified libertarianism mentioned above. It is not opposed to taxation for the sake of health care or income support for the poor, much less to the very idea of compulsory taxation. Everyday libertarianism does hold, however, that everyone has a *prima facie* moral entitlement to their pretax income. This is enough to provide the appearance of justification for the use of pretax income as a baseline for thinking about tax fairness.

Everyday libertarianism seems to be grounded in one or both of the following natural but mistaken chains of reasoning. It is natural to move from the fact that market returns depend to some extent upon effort, and the common sense idea that people who expend more effort deserve to do better, to the false conclusion that pretax incomes reflect relative levels of desert. More important, it is natural to slide from the fact that what we have a legal property right to is, legally speaking, really ours, to the thought that it is really ours in some intrinsic moral sense too. In particular, it is natural to think that the strong legal protection of our entitlement to our post tax incomes is required by some prior moral claim to just those holdings. We are then inclined to think that any tax increase, or tax levied on a transaction, such as a sales tax, is a taking away from what we are fully

entitled to, and as such requires special justification. It is then a short step to the thought that all taxes are takings from what is really ours, and that what we really are entitled to is our pretax income. This second line of thought, in particular, is very tenacious in most of us; it is actually very difficult to live and work in a capitalist economy and see pretax income for what it is — a mere accounting figure.

Convincing the reader that the traditional approach to tax justice and the everyday libertarianism that lies behind it must be abandoned, and explaining the range of genuine values that do bear on economic policy, taxation included, are the primary aims of *The Myth of Ownership*. Thomas Nagel and I pursue them by offering the general arguments outlined above, along with a general introduction to economic justice in political theory, and a series of more detailed discussions of central questions in tax policy. Thus the upshot of the chapter on progressivity is that while the Labor Party may have a case for a progressive rate scheme, it cannot consist in the simple claim that it is only fair that the rich pay more. It would have to include a particular theory of economic justice as well as an account — grounded largely in economic theory and empirical information about people's sensitivity to financial incentives — that explains why the best means to the end of economic justice (so understood) would include a tax system with progressive rates. Current economic research suggests that a progressive rate structure will be part of any set of economic institutions that aim at reducing economic inequality or improving the plight of the worst off. But that is an entirely contingent, practical matter. Some economists believe that a mostly flat tax scheme coupled with a very large demogrant will better achieve egalitarian ends than progressive taxation. If this empirical claim is right, egalitarian political theory recommends such a scheme.

Other topics discussed include the taxation of gifts and bequests, the choice of tax base, and tax discrimination; and there is a chapter on the puzzling problem of how to think about an efficient determination of the level of public goods once we lose pretax income as a presumptively just distribution of private holdings (which could, therefore, be an appropriate benchmark for determining the efficient level of public provision).

The choice of tax base and tax discrimination engage, among other things, the idea of horizontal equity. Since the distribution of tax burdens has no moral significance whatsoever, the demand of horizontal equity, that like earners should pay like tax, has no merit. If the American preferential tax treatment of owner-occupied housing is to be attacked, it must be on the ground that its effects are not desirable, from the point of view of the relevant political values. So there is no general moral reason to be concerned about taxation varying with consumption preferences, though

there is, of course, ground for suspicion of differential treatment of this kind since it may just be an unjustified handout to a favoured group.

This undermines one influential argument for preferring consumption to income as the tax base, the argument that an income tax unfairly burdens savers more than like-earning current spenders.⁵ The fact that two people have the same pretax income (or income and wealth) does not in itself imply anything about what their post tax holdings should be. If the consumption tax is to be preferred to the income tax, that will have to be for reasons of efficiency, simplicity, or some other instrumental effect. There is no *direct* moral case to be made one way or the other.

The rejection of horizontal equity also undermines some claims that the tax system discriminates among various groups. If such arguments have the form that the tax system treats favourably the expenditure choices of a particular (say) racial group, relative to the typical expenditure choices of another racial group, they have no force, since there is no demand of justice that people's tax burden should not be affected by their consumption preferences even if those preferences converge around racial or sexual lines. But if the claim is that details of the tax code contribute to unequal *outcomes* of a kind that we do have reason to regard as morally significant — such as, in particular, increased inequalities of status along the lines of race, sex, religion, etc — then the argument is of the right kind. So for example the claim that the favourable American tax treatment of housing makes racial inequality worse must be taken seriously: improvement in racial equality would be a reason to change the tax law. Similarly, there is no doubt that the American practice of joint filing for married couples results in a disincentive for second earners to join the workforce; since these are mostly women, on most views of sexual equality, the tax law worsens it.

The only way to argue about tax justice is as part of an overall argument about the design of the totality of our economic and legal institutions, and this argument must appeal not to simple-minded notions of fairness but to complex and controversial theories of social and economic justice, along with a great deal of practical information about the effects of different institutional schemes. So an upshot of the book is that justice in taxation is a much tougher problem, philosophically and practically, than has traditionally been thought. But of course simplicity is no reason to think about things in a way that makes no sense at all, morally and logically. Still, it would be wrong to be too optimistic that the traditional way of pursuing the question of tax justice will die out any time soon. The real problem is that the myth of ownership of pretax income, and the everyday libertarianism that grounds it, is very hard to shake off. The thought that pretax income is just an accounting figure seems threatening,

5

See David Bradford, *Untangling the Income Tax* (1986), ch 8.

seems to rob individuals of some of their dignity and security. If these comforting illusions did no harm, we could leave them alone. But as they ruin political discussion of the most important instrument by which a society puts into practice a conception of social and economic justice, exposing them is an urgent political priority.