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Book Review

WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY

by Edward D. Kleinbard

(Oxford University Press, 2014, Oxford, UK, 509 pages)

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According to an old joke, a statistician whose head was on fire, while his feet were encased in a block of ice, reported that, on average, he was very comfortable. Less well-known, however, is the kinship of a sort between this poor fellow and the Italian statistician Corrado Gini, who not only devised the famous Gini coefficient, but urged its use in measuring a given society's aggregate income or wealth inequality.

The problem Gini missed relates to interpretation, rather than to measurement. Under the Gini coefficient, extreme inequality at both the top and the bottom of the social scale will not statistically offset each other, giving us a false reading of zero aggregate inequality, along the lines of the fire-and-ice example. Instead, each will raise the quantum of inequality that the measure detects. However, the coefficient still has the defect of amalgamating two normatively distinct phenomena in a single measure.

Low-end inequality matters because it indicates that some people are worse-off than the rest of us. Basic human beneficence implies we should try to help such individuals. To be similarly concerned about high-end inequality, from the standpoint of beneficence — which would oppose making those at the top worse-off as an end in itself — one needs to make the case that it is bad for everyone else. I myself am among those who believe that the extraordinary increase in recent decades of the income and wealth of the top 0.1 percent has indeed had harmful effects on the remaining 99.9 percent (Shaviro, 2015). Yet whether those of us who believe this are right or wrong, both the main issues raised by high-end inequality and the main fiscal policy (and other) instruments that one might use to address it, are very different from those associated with addressing low-end inequality.

A number of important recent books have brought broad public attention to rising high-end inequality. Thomas Piketty's *Capital in the Twenty-First Century,* while the

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best-known, is merely one entry in this genre.[1] However, until the 2014 publication of Edward Kleinbard's *We Are Better Than This: How Government Should Spend Our Money*, there had been no comparably prominent and important recent contributions within the tax law or public economics realms addressing low-end inequality.

Kleinbard's book is a tour de force, lucidly explaining a broad range of fiscal, economic, and moral issues in a way that both enriches and informs public discourse. It deserves to be both widely-read and influential. Nonetheless, since purely laudatory reviews are boring, I will emphasize here my own 5 percent disagreement with the book, more than my 95 percent agreement. This disagreement pertains to high-end inequality, which, again, is not the book's main focus.

We Are Better Than This is at least three books in one — perhaps more. It includes, in particular, a book about substantive policy analysis, one about morals and rhetoric, and one about political economy. Kleinbard has the most to say about the first of these three topics, and the least about the last, but all are essential to his diagnosis of how best to address low-end inequality. As it happens, I also disagree the least with the first of these three books-within-the-book, and the most with the last.

Book 1: Substantive Policy Analysis. Which is more important to distributional policy, taxes or spending? Suppose you can't just answer "both." For many decades, people with tax expertise have often at least acted as if tax policy is all that matters. It was long accepted that, for example, as argued by Blum and Kalven (1952, p. 517), a meaningful distributional analysis of tax policy could be conducted in complete isolation from thinking about the spending side, and indeed "as though the tax money once collected were thrown into the sea."

We now, however, know better than this. Indeed, more recent writers, even if emphasizing the tax side for reasons of personal interest and expertise, have often suggested that the conventional divide between taxes and spending lacks any coherent conceptual underpinning. Consider tax expenditure analysis, now a widely accepted fiscal tool despite its controversial origins (Shaviro, 2004).

Bradford (2003) helped to make the usefulness of the tax expenditure concept hard to deny, even if the category remains hard to define, by offering the hypothetical example of a "weapons supplier tax credit" (WSTC). In his example, a company that supplied particular weapons to the Pentagon, rather than being paid directly, would instead get a 100 percent tax credit for the same amount.[2] Voilà, "taxes" and "spending" (as officially measured) would both decline relative to the case of paying the suppliers directly. If taxes and spending were meaningful terms in the commonly assumed way, this seemingly would indicate that switching to the WSTC had made the government "smaller."

[1] Recent books that address high-end inequality for a general audience include not only Piketty (2014), but also — just to name a few — Fraser (2015), Stiglitz (2013), Frank (2013), Noah (2012), and Wilkinson and Pickett (2010).

[2] Bradford notes that the WSTC would not have to be refundable (potentially converting it into "spending," as a matter of official nomenclature) in order to ensure that weapons suppliers received full value. Instead, the credits could simply be made transferable to other taxpayers through market transactions.

In fact, however, absolutely nothing would have changed. The government would still get the same weapons, the company would have the same incentives and end up in the same economic position, and the net federal budgetary impact would be the same as under the "spending" form of the weapons program.

I have written that, when people discuss "taxes" and "spending," what they often have in mind, only to get muddled if they rely on formalism, is Musgrave's (1959) famous conceptual distinction between the government's distributional and allocative branches (Shaviro, 2004). Hence, the WSTC, even though it has been structured to look like a tax cut rather than like spending, in fact emanates from the allocative branch. By contrast, the idea of taxing income emanates from the distribution branch, even when it is funding the activities of the allocative branch, given the likely lack of an allocative reason for using an "ability to pay" metric and thereby discouraging work and saving via the income tax.[3]

As Kleinbard (2010a) himself has elsewhere noted, Bradford's WSTC example can no longer be dismissed as fanciful. Congress has recently matched or even surpassed it. Tax provisions, as a matter of legal classification, are indeed often primarily "spending," in the sense of mainly relating to allocative, rather than distributional, policy rationales. In addition, on the other side of the ledger, much "spending" mainly reflects the distribution branch at work, rather than being akin to buying weapons or building roads and bridges. Cash and cash-like transfers are the clearest examples, but healthcare and education spending, especially if targeted towards poorer individuals, may also be meant to advance distributional as well as allocative objectives.

Now along comes Kleinbard in *We Are Better Than This* (pp. xxi–xxii), concluding, to his confessed "embarrassment … as I have spent 35 years meditating on federal tax matters," that "[t]ax policy is the handmaiden, and spending policy the sovereign ... [As] a longtime tax geek ... I, like many others, have elevated the tactical issues of tax system design beyond their ultimate importance to our society," relative to the "real question," to be answered primarily on the spending side, of "what we think our government is good for."

Kleinbard, of course understands, and indeed has written extensively about, the conceptual interchangeability of "taxes" and "spending" (Kleinbard 2010a, b). His main point in *We Are Better Than This* is twofold. First, greater outlays for public investment, such as education and infrastructure, and also more generous social insurance, have the potential to yield large social returns, not only greatly exceeding the fiscal interest cost (and the societal opportunity cost insofar as there is crowd-out), but also directly addressing the gaps in what markets can provide. While this is principally an efficiency argument, the benefits from such spending, if well-designed, might inure particularly to poorer individuals, and empower them to improve their circumstances.[4]

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3 Frank (2013) argues that market consumption, unlike leisure, has negative positional externalities, potentially supporting the taxation of work on efficiency grounds. Under this view, the allocative branch as well as the distribution branch might advance its aims via an income tax and/or a consumption tax.

4 Kleinbard (p. 294) notes, however, how crazy it is that the United States, like Slovenia and Turkey but unlike nearly other OECD country, spends more public funds per capita to educate rich children than poor ones.

Second, even if the benefits from increased government spending are merely enjoyed equally, as if they were a uniform cash demogrant, the net effect of financing them with any tax instrument that causes the rich to pay more in absolute terms (whether or not as a percentage of income) is to reduce low-end inequality. As the Europeans well know, even a relatively regressive tax instrument, such as a flat-rate valued-added tax, can contribute to an overall fiscal system that has a far greater distributional impact at the bottom of the income distribution than the U.S. model of more progressive taxation plus stingier social insurance benefits.

I view this argument from Kleinbard's Book 1 — which is indeed the central argument in the book is a whole — as correct, important, and widely under-appreciated by policymakers and members of the general public (albeit generally well-known to readers of the *National Tax Journal*). If one is concerned about seriously addressing low-end inequality, and with broadening both opportunity and risk mitigation at the bottom of the social scale, then changes to tax rules, even if they are permitted to include a smattering of refundable credits, cannot achieve nearly as much as the expanded government activism, on the "spending" side, that Kleinbard spiritedly and effectively urges.

This is a debate that we may be increasingly having in Washington, as the debacle of 2013 budget sequestration recedes (one hopes) into the past. *We Are Better Than This* offers a valuable explanation of both the principles and many of the details that ought to receive attention from policymakers, going into the 2016 elections and beyond.

Book 2: Morals and Rhetoric. The second book in *We Are Better Than This* addresses morals and rhetoric, which are linked because appealing to people's underlying moral convictions is crucial to persuasion. Three different audiences get an earful from Kleinbard, in his guise as a self-styled "Dutch uncle" (2014, p. xxiii). First, those who share his commitment to helping worse-off individuals are urged to do a better job of conveying the link between their views and widely held moral convictions. Kleinbard urges them, for example, to focus more on the old-fashioned virtues, including basic human decency, and to advocate expanding "social insurance," rather than engaging in "redistribution." The term "redistribution" not only raises hackles from much of the general public, but mistakenly treats the end state that a less progressive set of policies might produce as if it were a natural distributional baseline.

Second, Kleinbard seeks to appeal to the better natures of those in the broad middle. He offers devastating critiques both of Ayn Randian selfishness and of "market triumphalism," which moralizes market outcomes (even when produced by rent-seeking) and pretends that markets are perfect. He thoroughly explains, as perhaps should not have been necessary but evidently is in today's political environment, that there actually are things that governments both can do effectively, and should do if we have any concern for people who face blighted opportunities or have bad luck.

Third, Kleinbard directly calls out by name some people in the market triumphalist camp who have written especially aggressively and/or tendentiously on their side of the distributional debate. We hear, for example, of the "base canard" dispensed by a leading economist who thinks rich people are just smarter than everyone else, the ill-founded "extraordinary" claims of a leading law professor who celebrates inequality as a good thing and believes that any attempt to address it would be both unwise and unconstitutional, and the "arrogance" of a prominent and extremely wealthy former CEO who feels outraged by the idea that he might have to pay more taxes than other people. In my view, these people deserve what they get from Kleinbard — and his critiques are purely on the intellectual merits of their arguments rather than name-calling — but he is unlikely to end up on their Christmas card lists.

Unfortunately, I am not as sure as Kleinbard is that "we are better than this." For example, our country's racial history makes it difficult to motivate general concern for people at the bottom. He directly appeals to altruism, and to the satisfaction one may derive from being a "mensch," (Kleinbard 2014, p. 31) rather than a "jerk" (p. xix). However, altruism often takes the form of loyalty to one's own social group, with an accompanying lack of compassion for, or even hatred of, other groups. In addition, politics is importantly (even if not exclusively) driven by economic interests, and people with political power may simply not care about low-end inequality.

Bernstein (2014), in a review of *We Are Better Than This* that was extremely favorable, nonetheless made the following comment: "Just who is this 'We' that he keeps talking about? More than any time in our recent history, we are balkanized by income, class, ideology, religion, politics, race, and pretty much every other dimension you can think of. And if there is no coherent 'we' then there can be no clear path for 'us' to take together that will make us 'better than this.'"

Book 3: Political Economy. Again, *We Are Better Than This* is a book about low-end inequality, not high-end inequality. Even just on its merits, Kleinbard expresses skepticism that the case for addressing the rise of the top 0.1 percent is as strong as that for helping people at the bottom. I happen to take a different view than he does of the independent importance and undesirability of runaway high-end inequality, but that is a topic for another day.

In addition, Kleinbard strongly counsels, on prudential grounds, against too aggressively addressing such inequality, at least while so much still remains to be done in addressing low-end inequality more effectively. He urges people who sympathize with his aims to avoid not only a "class-warfare," zero-sum rhetorical framework, but also any advocacy of certain policy tools, such as highly graduated income tax rates, that might stimulate influential opposition to his entire project. An example of what he has in mind (pp. 352–354) might be recent work by Diamond and Saez (2011) that advocates high-end income tax rates in the neighborhood of 70 percent.

While Kleinbard does favor such steps as strengthening the estate and gift tax (pp. 379–380), and broadening the income tax base in ways that may have special impact at the top of the income distribution (pp. 258–261), he believes that, to an extent, angering the rich will merely ensure their opposition to helping the poor.[5] By contrast, he hopes that holding them relatively harmless might induce them to tolerate or even support expanding opportunity and strengthening social insurance at the bottom.

[5] Kleinbard does not explain in detail why strengthening the estate and gift tax, and increasing the impact of the income tax on wealthy individuals via base-broadening, might not guarantee their opposition to the same degree as sharply raising income tax rates at the top.

This is a political economy theory, the truth of which as is frequently the case with such theories — is hard to evaluate. Consider the opposing view that one needs to weaken the grip of plutocracy at the top before one can achieve anything significant at the bottom. Stiglitz (2013), for example, argues that the rise and power of the top 0.1 percent has much to do with Washington's tepid macroeconomic response to the unemployment catastrophe of the Great Recession. In his view (Stiglitz, 2013, p. 298), the change at the top has yielded "macroeconomic policy and a central bank by and for the 1 percent" — which we certainly did not have for many decades after the Great Depression. More generally, the unequal political access that arises when the top 0.1 percent are so far above everyone else, and when they face no campaign finance limitations of any significance, importantly affects what candidates and government officials from both parties even hear about, much less care about (Bartels, 2010; Gilens, 2012).

In short, while Kleinbard views addressing low-end inequality and addressing high-end inequality as substitutes, one could alternatively argue that they are complements. Who is right in this debate remains unknown, but *We Are Better Than This* takes one side without offering much to convince those who are on the other side.

For this reason, the correctness of the prudential choice that Kleinbard advocates — addressing low-end inequality in lieu of, rather than along with, high-end inequality — remains unclear, at least to me. However, evaluating who is right about this would take a full book of its own, or perhaps many books. In any event, this is but a tepid criticism on my part of *We Are Better Than This*, which clearly makes a major contribution to public political discourse regarding inequality and the role of government.

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