Miranda Stewart, Tax and Government in the 21st Century: Book Review and Interview with the Author

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Summary

- Book review of Miranda Stewart's *Tax and Government in the 21st Century*.
- Book is a tour of the intellectual history of the 'tax state'.
- Subsequent interview with the Author.

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Book Review

Miranda Stewart's *Tax and Government in the 21st Century* is an excellent introduction to tax policy. It lays out the major concerns of tax policy in understandable terms from a variety of angles: law, accounting, public finance and economics, and sociology and comparative studies. It draws on quantitative and qualitative data from countries around the world, though primarily focusing on English-speaking countries. While many works in the tax policy area focus primarily on individual and/or corporate income taxes, Stewart's work discusses consumption taxes, wage taxes (e.g., payroll), and wealth taxes (including inheritance, land and property, capital gains, and retirement savings), and individual and corporate income taxes, as well as other taxes that may be imposed upon corporations and businesses. Furthermore, and again unlike many introductory tax policy works, an entire chapter is devoted to issues of tax administration and compliance, in addition to discussion of these topics throughout the book. Two chapters are devoted to international tax issues.

Despite this ambitious breadth, the book is unified by a few key themes. Stewart has spent her career studying what she terms the "tax state": this book is a tour of the intellectual history of the idea. As Stewart explains in Chapter 1, "a tax state is a particular form of fiscal governmental organisation that relies on tax revenues extracted in a sustainable fiscal bargain with taxpayers ... . Tax states evolved over the last three centuries but they are fundamentally a product of the twentieth century." The definition reminds us that our current fiscal bargain is a product of history and should not be taken for granted as the best fit for the twenty-first century.

To understand how our tax system is contingent on current conditions, Chapter 2 discusses basic concepts of tax policy, some of which go back to times before economics was a separate discipline. Stewart traces the benefit theory of taxation to Thomas Hobbes, who "proposed that people should pay taxes to government in proportion to their benefit from society." Adam Smith argued that we were partners with the government in advancing society beyond a "mere 'shepherd' state," and advocated government spending the additional revenue on education and infrastructure. Stewart points out that this theory was replaced by the idea of "ability to pay." Richard Musgrave, a key public finance figure in the twentieth century, revived benefit theory by suggesting a fiscal model of government with three branches: allocation, distribution, and stabilization. The allocation branch collects taxes to pay for public goods, the distribution branch collects taxes to support the redistribution of income and/or wealth, and the stabilization branch addresses balance of payments, employment, inflation, and monetary stabilization.

Stewart's discussion of tax principles appropriately features Adam Smith's maxims. She quotes the maxims at length but distills them into equity, certainty, convenience, and efficiency. She notes that certainty is a basic requirement of what she calls the fiscal constitution, another concept discussed throughout the book. The idea is that the relationship between taxpayers and their government is a basic part of the political structure of society. She notes that convenience relates to the modern principle of simplicity and ease of administration, which she discusses in a later chapter. She then directly tackles equity and efficiency. In her discussion of equity, she admirably brings in government reports (such as the Canadian Carter Commission), critical and feminist tax scholarship, the Gini coefficient, and the views of philosophers from the 19th century (Bentham and Mill) and 20th century (Rawls, Dworkin, Murphy and Nagel, Sen, and Nussbaum). Stewart's discussion of efficiency addresses optimal tax theory, neutrality, trade-offs between efficiency and equity, Pigouvian taxes, and supply-side tax policy.

At the end of Chapter 4, she introduces the concept of tax state resilience as a fundamental principle of tax policy. Resilience is a concept from systems theory, defined by Stewart as "an ability to withstand, or respond coherently to external and internal shocks to the system. This enables the system as a whole to have capacity to return to a stable equilibrium, or alternatively to adapt to changing economic, social and legal circumstances in a way that maintains coherence and stability of the tax state." She goes on to point out that "it is not surprising that successful tax states have several major taxes that operate simultaneously across different aspects of the economy: income tax, consumption or sales taxes and social security taxes, as well as numerous specific taxes including customs and excise, real estate transaction taxes, and inheritance, wealth and land taxes." These taxes enhance the resilience of the system even if they do not raise much revenue or are inefficient or inequitable. Even though "optimising" the tax system has been a preoccupation of economists since the 1970s, Stewart explains that "[a] key observation of resilience thinking is that fully optimising a system may make it less resilient."

> To achieve resilience, a system requires some redundancy, and this implies some multiplicity, inefficiency or overlap of methods of components. We should expect that we cannot fully optimise the tax system, in part because we cannot predict which elements may collapse or fail. Tax system maintenance is a dynamic and continual social and economic process—the maintenance of the tax state itself.

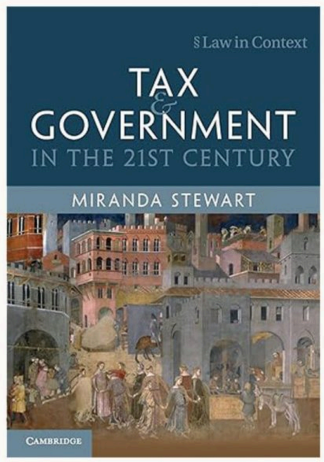
Chapter 4 also provides an excellent summary of the ongoing debate regarding the ideal tax base between a comprehensive income tax base or a consumption tax base. She directs readers to the seminal work of David Bradbury in the United States and also highlights the Meade Report in the United Kingdom. She notes the success of the value-added tax (VAT) in the European Economic Community as an impetus for considering the switch. While the income tax ultimately prevailed as the primary form of tax, she describes the tax reform push of the 1980s that resulted in a consensus for lower rates overall (and even lower rates on capital income and gains) and a broader base in the income tax. She points out that one event that has followed (without stating whether as a consequence of these policies) has been greater income and wealth inequality.

Stewart appropriately focuses on how the choice of tax unit (individual or couple/family) can have an impact on women's labor force participation. For an American, it is interesting to see that other countries struggle with this same issue. Stewart provides an in-depth analysis of means-testing of Australian welfare benefits and Australian support for childcare based on joint income, even though the income tax is levied on the individual unit. This contributes to a significant percentage (37.6%) of mothers of children under five not participating in the workforce (compared to only 6% of fathers) and 62% of mothers who are in the workforce working only part-time.

Part II of the book (Chapters 5 through 9) covers taxation at the intersection of a variety of social phenomena: work, family, gender, old age, business activity, and charity. Part III (Chapters 10 through 12) covers cross-border issues—something she characterizes as the "Global Digital Era." As

Stewart convincingly argues, these issues call the resilience of the tax state into question. “The downward pressure on revenue may make it more difficult for governments to deliver public goods or redistribution, undermining equity and reducing trust or community values,” what another scholar has called the “ ‘tragic choice’ of the tax state as it weighs the dilemmas of exit and voice, efficiency and redistribution.”

The final chapter draws together the book’s themes. Professor Stewart asks us to consider: “how well placed is the tax state for success in the twenty-first century?” Claims that the tax state is under threat are not new. When the term was coined in 1917, it was to proclaim its “crisis.” Stewart names other observers over the last century, from Joseph Schumpeter to Richard Musgrave to Christopher Hood, who have given a similar diagnosis. However, rather than dwell on the crisis, Stewart seems optimistic that we will adapt. The question is, once the next generation has done so, how much of what we take for granted will be recognizable in retrospect?



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Book Cover: Miranda Stewart, Tax and Government in the 21st Century

Interview

(Interviewers indicated as JG/AG; Interviewee as MS; and the book as TAG)

JG/AG: What did you learn from doing this project?

MS: I learned a tremendous amount! This book has taken years to write, and I worked in legal and policy academic positions during this time. There are many citations to tax scholarship from around the world in the book, including tax scholars in the United States and many other countries. In terms of thinking systemically about taxation, writing the book taught me both the expansive scope and limits of comparative analysis. I tried to make explicit many of the policy or other assumptions that tax lawyers, in academia or practice, make in our day-to-day work.

JG/AG: Your knowledge of comparative tax law is impressive. What foreign practice would you wish for the United States to adopt?

MS: I learned in writing this book that it's difficult to make tax policy prescriptions for other countries—as well as for my own! But the U.S. scholarship and policy materials about tax point to persistent tax issues that I hope that the United States can address in due course. These include the fundamental imperative to properly finance tax administration, as this is necessary for achieving fairness and due process for taxpayers, as well as collecting the revenue due under the law. From a law and policy perspective, maintaining the tax base for the income tax—removing excessive deductions or loopholes—is important (for example the home mortgage interest deduction has an unfair impact), while ensuring equal taxation of businesses through different entity forms is a constant challenge in the U.S. tax law. While the United States was ahead of many other countries in enacting the GILTI and BEAT in its corporate income tax reform of 2017, I hope that it can 'walk the talk' on global tax cooperation to support effective taxation of multinational enterprises around the world.

JG/AG: Your interests are broad. For example you have written on tax issues in estate planning, sham transactions, gender, and housing. How did you first come to study the "tax state?" Do you feel that TAG represents a departure from your other interests, or is there a common thread?

MS: I became interested in the 'tax state' when I started to research the origins of tax policy principles and sought to link this to legitimacy and the rule of law. I observed that tax ideas and new policies developed in line with the development of governmental capacity and the market economy, as well as new technologies.

JG/AG: You do not take many positions in this book. We gather that that is on purpose. You discuss a variety of theories, such as optimal tax theory, benefit theory, the tradeoff between efficiency and equity, and in the international realm theories such as capital export neutrality and capital import neutrality. Throughout the book we get the sense that you report neutrally on these views and keep your personal preferences private. In this forum, can we ask you to share which theories you think should most guide tax policymaking in the coming years and why?

MS: Your observation is quite insightful and puts me on the spot! Sometimes, I do express a view: for example, I am skeptical as to whether a tax on robots or automation will be beneficial for workers or tax systems in the longer term. On other issues, yes, I am agnostic. I suspect my biases—in favor of adequate taxation to finance public goods and of a progressive system overall with an adequate base—become clear enough in the book! But more fundamentally, I am making a case for us to think hard about these issues, and to support enhancement of democratic governance through better tax policy discourse and respect for legitimacy and accountability through the democratic system.

JG/AG: The book is not a practice guide. Still, it helped us understand many fundamental concepts which we had taken for granted. For example, you describe optimal tax theory. With its emphasis on avoiding deadweight loss by taxing inelastic activities, it seems hard to imagine an alternate view. Yet, you identify several criticisms of the theory—including the idea quoted in our review that "fully optimising a system may make it less resilient. To achieve resilience, a

system requires some redundancy." Do you think optimal tax theory should guide tax policy more or less than it currently does? What are some examples of specific policy areas where you think it should be used more or less?

MS: I do think optimal tax theory—understanding elasticity in behavioral response to taxes, both in economic activity and in tax planning or arbitrage—is one of the great tools we have available to us to understand tax systems. However, there is a tendency among economists (I dare to suggest) and inherent in optimal tax theory, to overemphasize optimizing the system. This occurs elsewhere in economics, business and government as well. We have seen this post-COVID19 in the crises in many businesses, a consequence of "just in time" supply chains. My suggestion in terms of resilience is that systems with some redundancy, some overlaps between tax bases, or in ways of administering the system, are more resilient—these are the warehouses of the tax system that can help in adapting to new challenges.

While I'm not an optimal tax theory idealist, it is crucial that the debate about tax policy take account of potential behavioral effects of every kind of tax or tax reform. The challenge is to connect this with empirical evidence about how people really behave in the tax system. In this regard, the economic empirical research on tax planning, salience and incentives is valuable in any debate. And, we need to be clear when we cannot empirically prove tax system responses, and 'think like tax lawyers' in working out the potential impact on economic or social behavior of any tax reform.

JG/AG: You write, "Taxation can be approached from disciplines of law and legal theory, economics, political science, history, psychology, sociology, accounting and philosophy. Approaching tax law through the lens of these different disciplines helps to understand the design, operation, and effects of tax law." Your multi-disciplinary approach is one reason your book is so enjoyable. Do you believe that any of these disciplines is under-appreciated?

MS: I think both historical and social science approaches to taxation are probably under-appreciated. Law and economics scholars are beginning to take the broader history and impact of tax systems more seriously, but the role of taxation as a social and therefore political process is often under-played.

JG/AG: You discuss benefit theory a lot. Benefit theory can be both progressive and regressive. How do you think governments can best use benefit theory today? Which do you think are the most appropriate uses of benefit theory?

MS: I argue that taxation, broadly, is for the benefit of government. I would like to recuperate benefit theory from its rather narrow box of levying a tax for a specific earmarked benefit, such as a road user charge. This is useful, but much more broadly we need to think about what taxes are really for—and it comes down to, what is government for? I think there is an easy connection between those who have done well in the current economy and those who benefit from taxes and have higher ability to pay. Adam Smith, in my view, accepted this approach.

There is no doubt that the combination of public delivery of goods, services and redistribution, combined with an effective and well-regulated market economy, can continue to deliver well-being for all. But we are in danger of forgetting the government part of this. Taxes remain, in my view, the most contestable, transparent, and democratically accountable way to fund government and thus must be maintained or enhanced.

JG/AG: Although the global tax system probably cannot do much for the poor in any particular country (either developed or developing), do you think that the Two-Pillars model offers possibilities for ensuring that developing countries can collect enough revenue to provide essential government services and to have tax revenue remaining that can be spent on development priorities such as improving higher education within the country or spending money to develop particular industries?

MS: The attempts to develop the Two Pillars—taxing large global multinationals in market jurisdictions and doing so with an effective minimum tax—are fundamental and truly novel. It may well be that these attempts fail, but I still think they are important. Developing countries can indeed benefit in terms of revenues from Pillar Two, though it is likely to be complex and also have unintended effects. I hope that the U.S. government carries through its initial strong commitment to global tax cooperation. More fundamentally, developed countries including the United States really need to step up and provide automatic data sharing and other tax administrative and technological support to developing countries, which still suffer from massive outflows to tax havens and struggle to tax individuals and corporations.

JG/AG: The first and last footnotes in TAG are to quotes from Joseph Schumpeter, The Crisis of the Tax State. You also emphasize Richard and Peggy Musgrave throughout. What about these authors made such a big impact on you?

MS: These public economists—Schumpeter and Richard and Peggy Musgrave—were unique in their 20th century engagement with both European and U.S. ways of thinking and writing about tax and government. They saw the big picture. Schumpeter was pessimistic, while the Musgraves were optimistic. I see these scholars as epitomizing 20th century thought about public finance and taxes. The challenge for us is to work out how much of that thought can be applied to 21st century tax systems, and this is something I try to tease out in the book.

JG/AG: You quote Christopher Hood, who asks: “Is the twentieth-century advance of the tax state in the developed countries best seen as a historical aberration, from which we might expect a reversion to more historically normal levels?” You argue that, if states do not adapt, their ability to raise taxes will erode over time, due to growing wealth inequality, demographic changes, globalization, digitalization, the gig economy, and other factors. Are you optimistic that societies will surmount these challenges? How painful will the transition be? Is there a particular country, organization, or group that you think will show the greatest leadership in this regard?

MS: People say I am optimistic, and I guess I am. But I hope that I am clear-eyed also. My point is not that government will collapse without effective tax systems. We should be careful, however, not to lose this way of financing the public good, especially in democracies. As already noted, I think this is the most contestable form of financing government, and it permits the most freedom while also sharing the benefits of economic growth. This requires careful attention to the rule of law, improved technologies, cooperation between governments, and adjusting the tax base to fit changing demographic conditions and new inequalities in societies and markets. I think these are challenges for all countries, and I would not hold out any as being leaders! But I am hopeful for all.

Authors

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