Economists are from Mars, Lawyers are from Venus: The Tax Policy Implications of Communication Failure

Draft for Discussion Purposes – Please do not quote with author's permission

It is curious how often you humans manage to obtain that which you do not want[1]*.*

Men are from Mars, Women are from Venus is a book about communication between different types of people in a relationship.[2] Lawyers and economists are different types of people who come together in the legislative and policymaking realm. Although legislators come from many backgrounds, law has been the most common profession of both House members and Senators since 1945.[3] As economist Richard Thaler wrote, "as a general rule, the United States Government is run by lawyers who occasionally take advice from economists."[4] Accordingly, this article uses the terms lawyer, policymaker, and legislator interchangeably. Sometimes policymakers rely on economic analysis to make decisions. Sometimes policymakers use economic analysis to support decisions already made. In particular, economic analysis has played a large role in the formation of tax and budgetary policy. To paraphrase author John Gray, not only do economists and lawyers communicate differently, they think, perceive, react and respond differently. They almost seem to be from different planets, speaking different languages.

---

[1] Spock, in Errand of Mercy, Star Trek (Original Series), first aired March 23, 1967. Mr. Spock, a character on the television series Star Trek, was famously logical.
[2] John Gray, Men Are From Mars, Women are from Venus (HarperCollins 1992).
[3] R. Eric Petersen, Representatives and Senators: Trends in Member Characteristics Since 1945, Cong. Res. Serv. Rep. 42365 (Feb. 17, 2012), pp. 10 -11.
[4] Richard H. Thaler, Watching Behavior Before Writing the Rules, New York Times (July 7, 2012), www.nytimes.com.

While both lawyers and economists use "stories" to persuade,[5] economic analysis cloaks the story in a complex mathematical model, opaque to those without training in economic theory. The seemingly objective results, stated in terms of dollar figures or percentages, may mislead consumers of such information to invest the conclusions with greater certainty than they represent. The results of economic modeling can obscure the decisions that policymakers and the public need to make—about the direction of the tax system, the nation, and the economy.

This article will first explore the development of the relationship between lawyers and economists by briefly examining the "law and economics" movement. The next section will contrast the training of economists with the training of lawyers. The following section will focus on the income tax system and the role economists and lawyers play in its development and implementation, including options for tax reform and its effect on inequality. Finally, the article will delve into behavioral research and the psychology of "numbers," and the implications for the tax and fiscal systems.

I. The marriage of law and economics

[5] Adam Davidson, God Save the British Economy, NY Times (Dec. 19, 2012) "Economics often appears to be an exercise in number-crunching, but it actually resembles storytelling more than mathematics."

Paul Krugman writes "the birth of economics as a discipline is usually credited to Adam Smith, who published 'The Wealth of Nations' in 1776." While Smith lectured on law from an economics perspective, the law and economics movement "flowered" in the mid 1900s.[6] This article is not about the law and economics movement, but the development of law and economics can shed some light on the communication styles of economists and lawyers.

Before law and economics, legal scholars searched for patterns in cases, statutes and regulations, with the goal of explaining past decisions and predicting future legal trends.[7] Law and economics moved beyond patterns and looked for the intended purposes served by legal rules, determining those purposes by analyzing incentive effects and price effects.[8] Law and economics takes an *instrumentalist* view of law, viewing law as the instrument for solving social problems and trying to determine how the law operates.[9] Instrumentalism begins with the notion of *detachment*; that the law should be justifiable to a detached spectator who is not committed to maintaining some set of perceived logical connections among legal doctrines. [10]

[6] Pioneers of Law and Economics, Lloyd R. Cohen and Joshua D. Wright, eds. (Elgar 2009). P. 226, viii.
[7] Katherine V. Litvak, Easterbrook and Fischel, in Pioneers, supra note 6, at 246.
[8] Litvak, supra note 7, at 246.
[9] Keith N. Hylton, Calabresi's Influence on Law and Economics, in Pioneers of Law and Economics (Lloyd R. Cohen & Joshua D. Wright, eds. Elgar 2009), 224 – 245, 225 (referencing Jeremy Bentham).
[10] Hylton, supra note 9, at 227.

Judge Richard Posner described economics as "the science of rational choice."[11] Economic theory assumes that people respond to incentives by altering behavior because they are "rational maximizers" of their own self-interest.[12] Joseph Stiglitz notes that "belief in rationality is deeply ingrained in economics."[13] This belief in rationality led to two important economic ideas that continue to inform legal analysis: Pareto efficiency and the Coase theorem. The Coase theorem, developed by law professor Ronald Coase, posits that, in absence of transaction costs, private bargaining will lead to most efficient use of resources.[14] Pareto efficiency holds that an allocation is efficient if someone is made better off but no one is made worse off.[15] The Kaldor-Hicks concept of efficiency modifies Pareto efficiency by finding an outcome more efficient if those that are made better off could *in theory* compensate those that are made worse off.[16] No actual compensation need be made. Kaldor-Hicks efficiency is an underlying rationale for cost-benefit analysis.

Law and economics is often criticized for adhering too strongly to the rational actor model. The rational actor always weighs the costs and benefits of anticipated action, and always chooses the act with the greatest net benefit. In economic analysis, the benefits and costs are reduced to dollars so that an apple-to-apple comparison can

---

[11] Richard A. Posner, Economic Analysis of Law 3 (6th ed., Aspen 2003).
[12] Posner, supra note 11, at 4.
[13] Joseph E. Stiglitz, Freefall: America, Free Markets, and the Sinking of the World Economy 248 (W.W. Norton & Co. 2010).
[14] Ronald H. Coase, The Problem of Social Cost, 3 J. Law & Econ. 1, 15 (1960).
[15] Neil H. Buchanan, The Role of Economics in Tax Scholarship 3, in Beyond Efficiency, David A. Brennan, Karen B. Brown, and Darryl Jones, eds, (forthcoming 2013, Aspen).
[16] Posner, supra note 11, at 13.

be made. Critics of law and economics have argued that people do not always behave as rational actors, that they do not carefully and accurately weigh the costs and benefits of their anticipated actions.[17] Stiglitz is a major critic of the rationality assumption, and indeed notes that his economist colleagues are "irrationally committed to the assumption of rationality."[18] In the end, whether an analyst wants to modify the rationality assumption to better reflect realistic human behavior is a question of the detail the analyst wants to build into his model.[19] The model is an essential part of the economist's analytic process. Economist Kenneth Arrow described any decision problem as having four parts:

> (1) an *objective function* which indicates the relative desirability of different possible outcomes; (2) a range of policy alternatives, or *instruments* . . . among which the decision maker must choose; (3) the *model*, which specifies the empirical relations connecting the instruments, the variables entering into the objective function, and other relevant variables; and (4) the *computational methods* by which the decision maker chooses the values of the instruments so as to maximize the objective function subject to conditions specified by the model.[20]

A simple model is often described as "elegant," perhaps because "abstraction is the essence of scientific inquiry, and economics aspires to be scientific."[21] Arrow describes simplification of the "original" problem as a universal technique.[22] An economic theory's lack of realism is a "precondition of the theory."[23] Of course, not all economists follow the strong rational actor model, and careful economists note

[17] Hylton, supra note 9, at 238.
[18] Stiglitz, supra note 13, at 248.
[19] Hylton, supra note 9, at 242.
[20] Kenneth J. Arrow, Collected Papers of Kenneth J. Arrow: The Economics of Information 44 (Belknap Press 1984).
[21] Posner, supra note 11, at 17.
[22] Arrow, supra note 20, at 64.
[23] Posner, supra note 11, at 17.

the scope of their assumptions and what is included and left out of the model used. Economists must resist putting too much realism in the model, because when an economic model becomes more complex, it may become so flexible that no empirical observation can either refute or support it.[24] Arrow notes that uncertainty is a fundamental characteristic of government economic policy, which means that no model of government economic policy can achieve perfect predictability.[25]

Legal theory and economics theory share two major branches: positive and normative.[26] Positive legal theory seeks to explain why the law is the way it is. Positive economic theory seeks to explain why the economy reacts the way it does. Normative legal theory describes how the law should be. Normative economic theory describes how the economy should be designed. One of the goals of tax legislation is improving the economy, thus normative law and economics theory would seem to marry the best of both worlds from the perspective of a tax legislator.

It may seem strange that in a book called Pioneers of Law and Economics, there is only one mention of tax law.[27] Perhaps that is because of the three oft cited criteria for evaluating tax rules, only one, efficiency, implicates neoclassical economic theory.[28] The other criteria, equity and ease of administration, arguably do not.

---

24 Posner, supra note 11, at 17.
25 Arrow, supra note 20, at 44.
26 Hylton, supra note 9, at 232.
27 Pioneers, supra note 6, at 289.
28 Stanley Surrey & Gerard M. Brannon, Simplification and Equity as Goals of Tax Policy, 9 Wm. & Mary L. Rev. 915, 915 (1968); Buchanan, supra note 15, at 1; Anthony C. Infanti, Tax ~~Equity~~, 55 Buffalo L. Rev. 1101, 1191 (2008); Cheryl D. Block,

Equity requires moral judgment about fairness, which, as noted, is foreign to economic theory. Scholars have complained that the goal of efficiency has predominated in tax policy, at the cost of equity. [29] Section III of this article will return to the discussion of economic theory in tax policy. But first, the article will examine the differences in the training of economists and lawyers.

B. The Training of Economists in contrast to the Training of Lawyers

Anyone who has attempted to read an article containing economic analysis will have noticed the prevalence of mathematical equations.[30] Doctoral candidates in economics must take higher-level mathematics courses before enrolling in the most basic economics courses. The University of Michigan website notes "training in calculus, linear algebra, differential equations, and probability and statistics is . . . essential."[31] The Berkeley Department of Economics requires doctoral applicants to know multivariate calculus, basic matrix algebra, and differential equations and complete a two-year math sequence, which emphasizes proofs and derivations.[32] The Massachusetts Institute of Technology program cites proficiency in calculus and

Pathologies at the Intersection of the Budget and Tax Legislative Processes, 43 B.C. L. Rev. 863, 911 (2002).

[29] See, e.g., Buchanan, supra note 15; Linda Sugin, A Philosophical Objection to the Optimal Tax Model, 64 Tax L. Rev. 229 (2011).

[30] See, e.g., J.A. Mirrlees, An Exploration in the Theory of Optimum Income Taxation, 38 Rev. Econ. Stud. 175 (1971).

[31] University of Michigan Economics Doctoral Program, http://www.lsa.umich.edu/econ/graduatestudy/doctoralprogram.

[32] Department of Economics, University of California Berkeley, https://econ.berkeley.edu/grad/admissions/preparation.

linear algebra as the minimal level of mathematics necessary for success.[33] Economists need mathematical expertise to develop economic models, which specify empirical relations between policy alternatives, the variables entering into determining the desirability of possible outcomes, and other relevant variables.[34]

In contrast, there are no prerequisites for the study of law. Law schools evaluate prospective law students on their undergraduate grades, in any discipline, and on their performance on the Law School Admission Test (LSAT). According to the Law School Admission Council, which administers the LSAT, the LSAT is

> designed to measure skills that are considered essential for success in law school: the reading and comprehension of complex texts with accuracy and insight; the organization and management of information and the ability to draw reasonable inferences from it; the ability to think critically; and the analysis and evaluation of the reasoning and arguments of others.[35]

"Critical thinking" skills include drawing well-supported conclusions, reasoning by analogy, determining how additional evidence affects an argument, applying principles or rules, and identifying argument flaws.[36] No calculus or linear algebra required.

In most law schools, like most graduate economics programs, the first year curriculum focuses on required courses. Those courses typically include a number of doctrinal law subjects, such as property, torts, civil procedure, constitutional law,

---

33 MIT Economics, http://economics.mit.edu/graduate/ph.d./graduate.
34 Arrow, supra note 20, at 44.
35 LSAC, About the LSAT, http://www.lsac.org/jd/lsat/about-the-lsat.asp#types.
36 LSAC, supra note 35.

contracts, and criminal law. First year law students invariably take a legal writing course. Legal writing can be objective analysis, like a memo from a law clerk to a judge. More often, legal writing is designed to persuade. An excellent way to persuade is to tell a story. A persuasive legal brief weaves facts and legal precedent together in a way that tells a story. Communications expert Walter Fisher wrote about the "narrative paradigm," which holds that humans are essentially storytellers, and that stories resonate with their audience when the stories are "rational."[37] A rational story provides good reasons for its conclusions.

Thus, both legal and economic reasoning require rationality and logic to persuade. However, without advanced training in econometrics, lawyers cannot think critically about economic models. They cannot evaluate the reasoning and arguments, hidden as they are by the economic model. Even if the lawyer understands the economist's simplifying assumptions and what variable are included or left out of the model, she is ill-equipped to assess the robustness of the results. This is no fault of the model or its designer, but rather a factor of the different skills possessed by the economist and the lawyer. At best, the traditionally trained lawyer can read the conclusions of an economic paper and, if those conclusions match the lawyer's desired outcome, use them to persuade other similarly unsophisticated persons.

III. Economics and Taxes

The art of taxation consists in so plucking the goose as to obtain the largest possible

[37] Walter R. Fisher, Human Communication as Narration: Toward a Philosophy of Reason, Value and Action 64 (Univ. S. Carolina Press 1987).

amount of feathers with the least possible amount of hissing.[38]

A. The Players

In considering the role of economic analysis of tax law, there are several important players. Federal tax law is, of course, created by Congress, a legislative body dominated by lawyers who are advised by economists. Congress gets advice from both government and private sector economists. The economists at the Joint Committee on Taxation (JCT) specifically advise the tax-writing committees of Congress. The Congressional Budget Office (CBO),[39] the Government Accountability Office (GAO)[40] and the Congressional Research Service (CRS)[41] all employ economists who provide Congress with analysis of tax issues, as well as other legislative issues. In addition, many organizations of a variety of political persuasions, such as the Heritage Foundation[42] and the Urban-Brookings Tax Policy Center, publish economic analysis of tax issues.[43] Accounting firms[44] and lobbying firms[45] use the services of economists in furtherance of their clients' goals.

---

[38] Jean Baptiste Colbert (attributed), in As Certain As Death: Quotations About Taxes 97 (compiled by Jeffery L. Yablon, Tax Notes 2010 Edition).
[39] See, e.g., Cong. Budget Office, Taxing Businesses Through the Individual Income Tax, Pub. 4298 (Dec. 2012).
[40] See, e.g., Gov't. Acct. Office, The Research Credit's Design and Administration Can Be Improved, GAO-10-136 (Nov. 2009).
[41] See, e.g., Thomas Hungerford, Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945, Cong. Res. Serv. Rep. 42729 (Sept. 14, 2012).
[42] See, e.g., Thomas G. West, The Economic Principles of America's Founders: Property Rights, Free Markets, and Sound Money, Heritage Foundation First Principles Series No. 32 (Aug. 10, 2010).
[43] Tax Notes named the Urban-Brookings Tax Policy Center its "Tax Person of the Year 2012," in recognition of the influence of a report it published on the tax

B. The Public

In theory, Congress represents the American people. The American public, as a whole, probably have little in common with tax economists. Public finance guru Richard Musgrave noted that "the public's perception of tax equity can hardly be expected to coincide with . . . models as conceived by philosophers and economists."[46] The public has two contradictory, yet rationally self-centered, goals for fiscal policy: (1) to pay as little taxes as possible and (2) to receive as many government services as possible.[47] In addition, Americans favor a more equal distribution of incomes that currently exist in America today.[48] This research has several implications for tax design and the role of economic analysis. First, if tax

---

proposals of presidential candidate Mitt Romney. Tax Notes Today (January 7, 2013); Samuel Brown, William Gale, Adam Looney, On the Distributional Effects of Base-Broadening Tax Reform, Urban-Brookings Tax Policy Center (Aug. 1, 2012) http://www.taxpolicycenter.org/UploadedPDF/1001628-Base-Broadening-Tax-Reform.pdf.

[44] See, e.g., Robert Carroll & Gerald Prante, Long-run Macroeconomic Impact of Increasing Tax Rates on High-Income Taxpayers in 2013, Ernst & Young (July 2012).

[45] Ernst & Young is one of Washington's top 10 lobbying firms as well. See Top Lobbying Firms, Center for Responsive Politics, http://www.opensecrets.org/lobby/top.php?indexType=l

[46] Richard Musgrave, Progressive Taxation, Equity, and Tax Design 348, in Tax Progressivity and Income Inequality, Joel Slemrod, ed. (Cambridge Press 1996). Arguably, these goals are consistent with the rational, self-interested public.

[47] Daniel Shaviro, Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s, 139 U. Penn. L. Rev. 1, 57 (1990).

[48] Michael I. Norton & Dan Ariely, Building a Better America—One Wealth Quintile at a Time, 6 Perspectives on Psychological Science 9, 10 (2011). In choosing income distributions from unlabeled pie charts, survey participants showed an overwhelming preference for the relatively equal income distribution in Sweden over the significantly skewed income distribution in the United States, where the top 1 percent of Americans hold nearly 50 percent of the wealth.

design should include equity, is a relatively equal income distribution the same as equity? Second, if income equality is the same as fairness, should the tax system be used for income redistribution? Finally, how should Congress respond to the voters' views?

1. Equality Preferences

While it is a matter of some dispute whether and how the design of the tax system impacts income equality[49], which will be discussed in some detail later, it is undisputed that inequality is increasing. Researchers Peter Diamond and Emmanuel Saez note that "the share of pre-tax income accruing to the top 1% of earners in the U.S. has more than doubled to about 20% in 2010 from less than 10% in the 1970s . . . [while] the average federal income tax rate on top earners has declined significantly."[50] The Gini coefficient (also called the Gini index) is an economic concept that illustrates income inequality.[51] The Gini coefficient has been

---

[49] *Contrast* Thomas Hungerford, Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945 (Updated), Cong. Res. Serv. Rep. 42729 (Dec. 14, 2012) *with* Carroll & Prante, supra note 44.

[50] Peter Diamond & Emmanuel Saez, High Tax Rates Won't Slow Growth, Wall St. J. (April 23, 2012).

[51] Central Intelligence Agency, Country Comparison: Distribution of Family Income – Gini Index, World Factbook (2011), available at https://www.cia.gov/library/publications/the-world-factbook/rankorder/2172rank.html. The Factbook explains

> The index is calculated from the Lorenz curve, in which cumulative family income is plotted against the number of families arranged from the poorest to the richest. The index is the ratio of (a) the area between a country's Lorenz curve and the 45 degree helping line to (b) the entire triangular area under the 45 degree line. The more nearly equal a country's income distribution, the closer its Lorenz curve to the 45 degree line and the lower

increasing in wealthy countries since the 1980s.[52] In the United States, the Gini coefficient increased from 0.34 in the 1980s to 0.38 in the 2000s.[53] The higher the Gini index, the greater the inequality in the country.[54] Sweden's Gini coefficient is 0.26.[55] In choosing income distributions from unlabeled pie charts, Americans surveyed showed an overwhelming preference for the relatively equal income distribution in Sweden over the significantly skewed income distribution in the United States, where the top 1 percent of Americans hold nearly 50 percent of the wealth.[56]

If Americans prefer a relatively equal income distribution, should Congress try to give it to them? And will voters be happy at the attempt? Cass Sunstein and Richard Thaler suggest that the government has a role in "choice architecture."[57] In their book, Nudge, Sunstein and Thaler argue for "libertarian paternalism," which refers to policies that influence "choices in a way that will make choosers better off, as judged by themselves."[58] Sunstein and Thaler reject the idea of the "rational man," instead focusing on social science research on the way real humans make

---

its Gini index, e.g., a Scandinavian country with an index of 25. The more unequal a country's income distribution, the farther its Lorenz curve from the 45 degree line and the higher its Gini index. Id.

[52] Unbottled Gini, The Economist (Jan. 20, 2011).

[53] OECD StatExtracts, Income Distribution—Inequality (Jan. 7, 2013), available at http://stats.oecd.org/Index.aspx?QueryId=26068, and on file with author.

[54] CIA, supra note 51.

[55] OECD, supra note 53.

[56] Norton & Ariely, supra note 48, at 10.

[57] Richard R. Thaler & Cass R. Sunstein, Nudge: Improving Decisions About Health, Wealth, and Happiness (Yale University Press 2008).

[58] Thaler and Sunstein, supra note 57, at 5.

decisions.[59] For example, noting that most people will take the default option rather than making an affirmative choice, Sunstein and Thaler suggest encouraging savings by having automatic enrollment in retirement plans.[60]

If income equality is good for Americans, policymakers may need to give income distributions a paternalistic nudge. Michael Norton and Dan Ariely, the researchers who conducted the study on income inequality referenced above, found that despite the strong survey results on equality preferences, Americans on the low end of the income distribution do not advocate for a greater redistribution of wealth.[61] Norton and Ariely find four reasons for this disconnect: (1) some Americans are unaware of the actual disparity in incomes; (2) other Americans have an unrealistically optimistic view about income mobility[62]; (3) those who agree on the desirability of a more equal income distribution disagree on the causes of inequality, and (4) "Americans exhibit a general disconnect between their attitudes toward economic inequality and their self-interest and public policy preferences."[63]

---

[59] Thaler & Sunstein, supra note 57, at 7.
[60] Thaler & Sunstein, supra note 57, at 109.
[61] Norton & Ariely, supra note 48, at 12.
[62] See, also, Economic Mobility Project. 2012. *Pursuing the American Dream: Economic Mobility Across Generations,* Washington, DC: Economic Mobility Project, The Pew Charitable Trusts (finding "stickiness" at both ends of the wealth ladder.)

> Sixty-six percent of those raised in the bottom of the wealth ladder remain on the bottom two rungs themselves, and 66 percent of those raised in the top of the wealth ladder remain on the top two rungs. Id. at 2.

[63] Norton & Ariely, supra note 48, at 12.

Is income equality normatively good? Stated another way, is income inequality bad? First, consider why the Central Intelligence Agency (CIA) might study the Gini index. The CIA's defines its mission as being the "Nation's first line of defense."[64] One way the CIA carries out its mission is by "producing timely analysis that provides insight, warning and opportunity to the President and decisionmakers charged with protecting and advancing American's interests."[65] Researchers have found a positive correlation between economic inequality and political instability, which probably explains the CIA's somewhat unsettling interest.[66] The World Bank is also interested in income inequality, finding that economic growth is more persistent in countries with more even income distributions.[67] The two studies mentioned above focused on developing economies and arguably might not be applicable to a developed and presumably stable democracy like the United States. However, other studies do focus on developed Western economies. One study focused on the United States and concluded that Americans were on average happier in the years with less national income inequality than in the years with more national income inequality.[68] Another study compared states within the United States and found higher mortality in states

---

[64] CIA Vision, Mission & Values, available at https://www.cia.gov/about-cia/cia-vision-mission-values/index.html.
[65] Id.
[66] At least, I was unsettled. Alberto Alesina & Roberto Perotti, Income Distribution, Political Instability, and Investment, 40 European Economic Rev. 1203 (1996).
[67] Andrew G. Berg & Jonathan D. Ostry, Inequality and Unsustainable Growth: Two Sides of the Same Coin?, Int'l Monetary Fund Staff Discussion Note (April 8, 2011).
[68] Shigehiro Oishi, Selin Kesebir, and Ed Diener, Income Inequality and Happiness, 22 Psychological Science 1095 (2011).

with greater income inequality.[69] Levels of trust between individuals were found to be lower in communities with high degrees of income disparity.[70] Trust levels are important for a functioning society because “when people trust each other transaction costs in economic activities are reduced, large organizations function better, governments are more efficient, financial development is faster: more trust may spur economic success.”[71] Lower trust levels may lead to poor health outcomes by causing chronic stress.[72] Moreover, as income disparity increases, those who enjoy affluence become less willing to share their wealth, making it less likely that affluent voters will support redistribution.[73] These reportedly adverse outcomes of inequality may well justify the application of paternalistic income redistribution.

2. Ways and Means of Redistribution

Assuming that income redistribution is an appropriate way to accomplish the desired policy outcome of income equality, with all its attendant benefits, should the tax system play a role in the redistribution? Certainly the tax system is not the only possible means of redistribution. Direct government transfers can redistribute

---

[69] Eric Backlund, Geoff Rowe, John Lynch, Michael Wolfson, George A. Kaplan & Paul D. Sorlie, Income Inequality and Mortality: A Multilevel Prospective Study of 521,248 Individuals in 50 U.S. States, 36 Int’l. J. Epidemiol. 590 (2007).
[70] Alberto Alesina & Eliana La Ferrara, Who Trusts Others, 85 J. Pub. Econ. 207 (2002).
[71] Alesina & Ferrara, supra note 70, at 207.
[72] Richard Wilkinson & Kate Pickett, The Spirit Level (2009) (need pinpoint cite).
[73] Paul K. Piff et al., Having Less, Giving More: The Influence of Social Class on Prosocial Behavior, 99 J. Pers. & Soc. Psych. 771 (2010). See also, Chrystia Freeland, Plutocrats: The Rise of the New Global Super-Rich and the Fall of Everyone Else 236 – 240 (Penguin Press 2012).

wealth, and some view that mechanism as a more appropriate and transparent means.[74] According to an OECD study, tax and transfer systems reduce overall income inequality in all countries, and on average, three quarters of the reduction in inequality is due to transfers and one quarter is due to tax policies.[75] Outside the tax and transfer systems, legal rules like strict liability can operate to redistribute wealth, albeit only between parties to a lawsuit.[76] As the tax system reaches almost every member of society, rich and poor, a progressive rate structure can accomplish almost any desired level of redistribution.[77] Unequal countries, like the United States, tend to redistribute more through taxes.[78] A progressive rate structure imposes a higher tax rate on higher income persons.[79] The 2012 presidential election and the subsequent "fiscal cliff" negotiations focused on the issue of progressivity: would increasing the tax rate on the wealthy have a beneficial or detrimental effect on the economy? The fiscal cliff referred to a two fold deadline facing the government: first, the so-called Bush tax cuts were set to expire at the end of 2012; and second, automatic spending cuts were about to be imposed on the government's discretionary budget.[80]

---

[74] See Stanley S. Surrey & Paul R. McDaniel, The Tax Expenditure Concept and the Budget Reform Act of 1974, 5 B.C.L. Rev. 679, 680 (1976).
[75] OECD 2012, "Income inequality and growth: The role of taxes and transfers" 3, *OECD Economics Department Policy Notes,* No. 9. January 2012.
[76] See Louis Kaplow & Steven Shavell, Why the Legal System is Less Efficient Than the Income Tax in Redistributing Income, 23 J. Leg. Stud. 667, 669 (1994)
[77] Kaplow & Shavell, supra note 76, at 674.
[78] OECD 2012, supra note 75, at 8.
[79] Walter J. Blum & Harry Kalven, Jr., The Uneasy Case for Progressive Taxation, 19 U. Chi. L. Rev. 417, 419 (1952).
[80] Mindy R. Levit et al., The "Fiscal Cliff" and the American Taxpayer Relief Act of 2012, Cong. Res. Serv. Rep. 42884 (Jan. 4, 2013).

The debate about raising tax rates on the wealthy began with accusations of "class warfare" from the political right[81], parried by President Obama's statement "This is not class warfare: it's math."[82] Congress got advice from government economists on the fiscal cliff and relief proposals. The economists at the CBO projected that failure to ease the fiscal cliff would send the economy into recession in 2013.[83] The economists at CRS concluded that lower tax rates on the wealthy do not stimulate the economy, but rather lead to increased inequality.[84] Senate Republicans objected to the CRS report, which was withdrawn from circulation.[85] The report was later reissued with the same conclusions.[86] A report by economists at top lobbying firm Ernst & Young, produced at the behest of clients including the U.S. Chamber of Commerce, came to a contrary conclusion, finding that "these higher marginal rates result in a smaller economy, fewer jobs, less investment, and lower wages."[87] With these contradictory results, whom should Congress believe? If the American public wants economic prosperity and income equality, what policies should they prefer?

3. Tax Preferences 1.0 – What does the public want?

---

[81] Helene Cooper, President's Plan on Deficit Mixes Cuts and Taxes, NY Times A1 (Sept. 19, 2011).
[82] Peter Roff, Obama's 'Tax the Rich' Class Warfare is Bad Economics, US News (Sept. 22, 2011).
[83] CBO, An Update to the Budget and Economic Outlook: Fiscal Years 2012 – 2011 (Aug. 21, 2012), at page 1.
[84] Hungerford, supra note 41.
[85] Jonathan Weisman, Nonpartisan Tax Report Withdrawn After G.O.P. Protest, NY Times (Nov. 1, 2012).
[86] Thomas L. Hungerford, Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945 (Updated), Cong. Res. Serv. Rep. 42729 (Dec. 12, 2012).
[87] Carroll & Prante, supra note 44, at 1.

Will voters like income redistribution via the tax system? It seems unlikely. Law professor Daniel Shaviro notes that "voters often support tax cuts without spending cuts because they are more aware of overt than actual burdens."[88] Shaviro considers whether public opinion about taxation reveals whether voters are rational and finds voters distinctly wanting.[89] Shaviro concludes that voters suffer from "fiscal illusion" and make "systematically inaccurate judgments about their self interest in evaluating a policy."[90]

In the case of an ideally rational person, information would overcome ignorance. However, political scientist Larry Bartels found strong interactions between information and ideology.[91] Bartels found that, among liberals, recognition of increasing income inequality "rose markedly with generally political awareness, to 86 percent for people of average political awareness . . . and a near unanimous 96 percent at the highest information level."[92] On the other hand, "the proportion of extreme conservatives who were willing to admit that income inequality had increased actually decreased with political information, from 80 percent among those who were generally least informed about politics to 70 percent for people of

---

88 Shaviro, supra note 47, at 52.
89 "Rational ignorance is mixed with just plain ignorance, creating rich opportunities for the enactment of bad or deceptive tax legislation." Shaviro, supra note 47, at 58. "If the public does not understand the choices it is making, relies on demonstrably false assumptions about the distributional effects of preferences, and holds internally inconsistent beliefs about desirable tax law, then the claim that it has illusions and acts irrationally can be made with some confidence." Id. at 63.
90 Shaviro, supra note 47, at 58.
91 Larry Bartels, Unequal Democracy: The Political Economy of the New Gilded Age 154 (Princeton University Press 2008).
92 Bartels, supra note 91, at 155.

average political awareness to a little less than 60 percent among those at the top of the distribution of political information."[93]

Bartels also examined views about the Bush era tax cuts, which he describes as "a massive government-engineered transfer of additional wealth from the lower and middle classes to the rich in the form of substantial reductions in federal income taxes."[94] Bartels found that people who wanted to increase government spending on programs were more likely to support tax cuts than those who did not.[95] Results of a 2003 survey on tax policy revealed that "much of the public was unclear about basic facts in the realm of tax policy; some of what the public did know was patently false; and a remarkable number of people, when offered the chance, said that they had not thought about [the Bush tax cuts] whose consequences are reckoned by experts in the trillions of dollars."[96]

Out of the mouth of babes[97]

Ignorant or not, people do have strong intuitive preferences about the tax system. Law professor Michael J. Graetz recounts an anecdote about three children in a one room schoolhouse in Montana, who were asked what would be a fair tax on a family with an income of $5,000 if a family with an income of $2,000 paid $200.

---

[93] Bartels, supra note 91, at 155-56.
[94] Bartels, supra note 91, at 163.
[95] Bartels, supra note 91, at 163.
[96] Bartels, supra note 91, at 177.
[97] Psalm 8, King James Version Holy Bible.

> The first child said, "$500," thereby showing a predisposition for proportional burdens. . . . A second child immediately disagreed, with the comment that the payment should be more than $500 because "each dollar isn't so important" to the family with the larger income. A third child agreed, but with the reservation that the additional tax over $500 shouldn't be "too much more or they won't work so hard."[98]

Children may have cultural preferences, that is, their views of fairness may reflect their upbringing. However, research on babies as young as 15 months shows an innate sense of fairness.[99] The study found that human infants "possess the rudiments of a sense of fairness in that they expect resources to be allocated equally."[100] Babies seem to be Rawlsian equalitarians, possibly operating from behind a veil of infant ignorance.[101]

People also tend to simplify complex systems, like the tax system, by using simplifying assumptions, known as heuristics.[102] Law professor Jeffrey Rachlinski asks "why do some people adopt the heuristic that a flat tax is simple and therefore sensible as opposed to the heuristic that the rich should pay more because they have more? Both are simple enough mental shortcuts for evaluating tax policy."[103] In particular, in assessing the progressivity of tax systems, people are subject to the

---

[98] Michael J. Graetz, The U.S. Income Tax: What It Is, How It Got That Way, and Where We Go from Here 225 (W.W. Norton & Co. 1999).
[99] Marco F.H. Schmidt & Jessica A. Somerville, Fairness Expectations and Altruistic Sharing in 15-Month-Old Human Infants, 6 PLoS One 1 (2011).
[100] Schmidt & Somerville, supra note 99, at 5.
[101] John Rawls, A Theory of Justice 136-37, 150 (1971). See also, Donna M. Byrne, Progressive Taxation Revisited, 37 Ariz. L. Rev. 739, 774-78 (1995).
[102] Jeffrey J. Rachlinksi, Selling Heuristics, 64 Ala. L. Rev. 389 (2012). See also, Amos Tversky & Daniel Kahneman, Judgment Under Uncertainty: Heuristics and Biases, 185 Sci. 1124 (1974).
[103] Rachlinski, supra note 102, at 392.

metric effect and progressivity illusions. Researchers Edward McCaffery and Jonathan Baron found that answers to questions about tax design varied systematically based on whether the question was asked using dollars or percents—and subjects consistently want more progressivity in percent than in dollars.[104]

Not only is there confusion and disconnect between taxes and spending at the level of the general public, but in the structure of government itself. Economist Gene Steuerle commented that "legislatures separate their expenditure authorization and appropriations committees from their tax committees. Politicians running for office separate their advocacy for lower taxes from their support of more spending, as if the two didn't have to come into some balance."[105] Shaviro discounts politicians' adherence to voters' views, as their constitutents are neither informed nor rational. Instead, Shaviro posits that politicians "seek reelection, power, prestige, and ideological goals in a world where ill-informed voters are subject to symbolic responses . . .."[106]

4. How Will Congress Respond?

There are two public finance theories that purport to explain Congressional action: public interest theory and public choice theory. Public interest theory holds that

---

[104] Edward J. McCaffery & Jonathan Baron, Heuristics and Biases in Thinking About Tax, 12 Psychology, Public Policy, and Law 106, 113 (2006). Interestingly, the children in Graetz's anecdote do not seem to suffer from progressivity illusions.
[105] C. Eugene Steuerle, And Equal (Tax) Justice for All? 253, 267-268, in Tax Justice, Joseph J. Thorndike and Dennis J. Ventry Jr. eds. (Urban Institute Press 2002).
[106] Shaviro, supra note 47, at 104.

legislators will act in the public interest because the public interest is the sum of everyone's private interest and everyone will vote in their own self-interest.[107] Shaviro dismisses this theory as overly optimistic.[108] Public choice theory is an offshoot of law and economics that uses a free market approach to legislation—that is, legislation goes to the highest bidder.[109] Under public choice theory, the diffuse interests of the public are swamped by the pecuniarily focused attentions of interest groups that court politicians' attentions by monetary contributions.[110]

Both politicians and voters may be rent-seeking. Rent-seeking both by politicians and voters – short term benefit of tax cut ignoring broader implications, possibly as a result of human psychology. Also complexity – how can we know whether a provision is working as intended, teasing out one provisions effect from the entire economy, moreover, how can we even know the "intent" given that there could be 535 (number of legislators) different intents, not to mention compromises (not that compromise happens anymore).

5. The Optimal Tax System

Perhaps the answer is to use the tax system only to raise revenues and not to accomplish redistribution. In the author's normative judgment, it seems fair to say that if taxes must be paid, the tax system should impose a minimal burden on the payers. Thus, a major objective of tax design is minimizing deadweight loss, defined

[107] Shaviro, supra note 47, at 50.
[108] Id.
[109] Shaviro, supra note 47, at 64.
[110] Shaviro, supra note 47, at 66.

as the social cost of taxation that produces no revenue.[111] Lump sum, or head taxes, create no deadweight because taxpayer behavior cannot change the tax. However, head taxes are politically unpopular and violate any concept of distributional justice.[112] Distributional justice itself is a term that defies consistent definition, like equity. The welfare model of equity focuses on hedonic well-being, or "utility."[113] The liberal equalitarian model of equity focuses on equality of opportunity.[114]

Believing that the best way to design a tax system is to raise revenue with the fewest possible distortions, economists developed the endowment tax ideal, as exemplified by James Mirrlees "optimal income tax" model. Mirrlees's goal was to determine how progressive an income tax should be if the tax system's goal is maximization of social welfare.[115] Wealth is an attractive empirical target, because wealth, unlike social welfare, can be quantified. Mirrlees' optimal tax model was designed to create the second best tax—one that is maximally efficient with minimal distortion and still bearing some relation to ability to pay. In other words, the optimal tax model provides a mathematical tool for balancing equity and efficiency.[116] Mirrlees based the model on two assumptions: (1) that earning potential, or endowment, is

[111] See Richard Musgrave & Peggy Musgrave, Public Finance in Theory and Practice 235-36 (5th ed. 1989).
[112] In 1990, British Prime Minister Margaret Thatcher imposed a poll tax, which sparked widespread protests. Peter Passell, Furor over British Poll Tax Imperils Thatcher Ideology, NY Times (April 23, 1990). The "community charge" was repealed by the government of her successor, John Major. Craig R. Whitney, Britain will Abandon its Fiercely Disputed 'Poll Tax,' NY Times (March 22, 1991).
[113] Daniel Shaviro, Endowment and Inequality 123, 131, in Tax Justice, supra note 105.
[114] Id.
[115] Mirrlees, supra note 30.
[116] Sugin, supra note 121, at 229.

the ideal tax base, and (2) a person generally earns as much as he is potentially able to earn. Mirrlees proceeded to design his model using actual earned income as a discernible, though inexact, substitute for one's ability to earn. The economist's judgment of the efficiency of a tax focuses on substitution effects, since only substitution effects produce deadweight loss**.** Mirrlees found, somewhat to his surprise, that his optimal tax model suggested lowering tax rates on the wealthy.[117] Of course, in 1971, when Mirrlees wrote his article, the top marginal tax rate on individuals was 70 percent. The 2012 election's "class warfare/math" debate was about raising the top marginal tax rate from 35 percent to 39.6 percent. Moreover, Mirrlees prefaced his conclusion with many caveats. He admits that his "simple consumption-leisure utility function is a heroic abstract of a much more complicated situation" and that "many objections to using observed income distributions as a means of estimating the distributions of skills will spring to mind."[118]

Historian and law professor Dennis Ventry posits that the tax system's shift to "a flatter, less-progressive tax system that favored corporations and high-income individuals" was caused by changes within the economics profession and its increasing influence on the tax policymaking process.[119] Ventry theorizes that

---

[117] Mirrlees, supra note 30, at 207. "Being aware that many of the arguments used to argue in favour of low marginal tax rates for the rich are, at best, premissed [sic] on the odd assumption that any means of raising the national income is good, even if it diverts part of that income from poor to rich, I must confess that I had expected the rigorous analysis of income-taxation in the utilitarian manner to provide an argument for high tax rates. It has not done so." Id.
[118] Mirrlees, supra note 30, at 207.
[119] Dennis J. Ventry Jr., Equity versus Efficiency in Historical Perspective 52, in Tax Justice, supra note 105.

economists, perhaps uncomfortable with the messy idea of "fairness" or equity in the tax system, turned their focus on efficiency.[120] Ventry, and other scholars, bemoan the economics profession's abandonment of equity.[121] It seems possible, however, that in attempting to do good by analyzing the tax system using their empirical skills, economists reached for equity, but simplified it away.

Reading Mirrlees' careful description of his model's assumptions and his concern about its application to the real world, it is evident that he did not intend to remove equity from the tax system. The valuable contribution made by Ventry and other critics of the economic focus on efficiency is to emphasize the often hidden normative assumptions made by economic models. Legislators should begin with explicit normative assumptions, e.g., to increase equality. If lawyers blindly believe economic analysis without understanding it, whose fault is it? [weave in mars, venus here?] We have met the enemy, and he is us.[122]

IV. How Should Economic Analysis be used in evaluating the tax system?

---

[120] Economists have resisted considering equity too seriously, arguing that they "have no special competence in determining which distribution of resources is appropriate." James J. Heckman, The Intellectual Roots of the Law and Economics Movement, 15 Law and History Review 327, 327-328 (1997). In the interests of scientific rigor and gaining 'some relative advantage to non-economists', the profession has avoided decisions about equity. Ventry, supra note 119, at 60.

[121] See, e.g., Linda Sugin, A Philosophical Objection to the Optimal Tax Model, 64 Tax Law Rev. 230 (2011).

[122] Walt Kelly, Pogo (April 22, 1971).

The fiscal cliff has been averted, for now. Tax rates were raised on the top income earners.[123] However, a large budget deficit still looms[124], and the president has vowed to continue to use revenue measures as well as budget cuts to reduce the deficit.[125] Congressional Republicans are motivated to pursue tax reform, hoping to lower rates in a revenue neutral manner.[126] One can be sure that economic analysis will be deployed to support arguments on both sides. This section will begin with a discussion of the most specialized government economists, the JCT. Understanding the JCT is essential to understanding the arguments about one popular vision of tax reform, cutting loopholes.

A. JCT

The JCT plays a special role in tax legislation. Well before the changes in the economic profession cited by Ventry, JCT economists provided support to lawmakers making tax policy with their economic analyses. In 1926, Congress created the JCT to "publish from time to time for public examination and analysis proposed measures and methods for the simplification of internal revenue taxes."[127] Since 1974, the JCT has provided the official Congressional revenue estimates for all

---

[123] American Tax Relief Act of 2012, 112th Cong., 2d Sess., H.R. 8, P.L. pending.
[124] Levit et. al, supra note 80, at 2.
[125] Dave Boyer, Obama: More revenue needed after 'fiscal cliff' deal, Washington Times (Jan. 2, 2013).
[126] Bernie Becker, Tax reform more likely after 'fiscal cliff' agreement, say House Republicans, The Hill (Jan. 5, 2013).
[127] History of the Joint Committee, https://www.jct.gov/about-us/history.html, citing the Revenue Act of 1926, House Report 356 (Conference Report), 69th Cong., 1st Sess.(1926); Revenue Act of 1926, Public--No. 20--69th Congress (44 Stat. 127).

tax legislation considered by either the House or the Senate.[128] JCT revenue estimates take into account taxpayers' likely behavioral responses to proposed changes in tax law.[129] Behavioral effects can be broadly characterized as shifts in the timing of transactions and income recognition, shifts between business sectors and entity form, shifts in portfolio holdings, shifts in consumption, and tax planning and avoidance strategies. Consistent with economic theory, JCT tax models assume that taxpayers will largely behave rationally, while taking into account other behaviors as implicated by data and recent research.[130]

In addition, the JCT prepares analyses of the distributional impact of tax changes.[131] Distributional impact measures the effect of tax changes on different income groups, typically expressed as quintiles. Income quintiles represent five income groups, from lowest 20 percent of incomes to highest 20 percent of incomes. JCT uses economic income when assessing distributional impact, considering it to be the "conceptually appropriate measure of economic well-being."[132] The JCT recognizes

[128] The Congressional Budget Act of 1974, Section 201(g), as amended by the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings), P.L. 5.
[129] Joint Committee on Taxation, Summary of Economic Models and Estimating Practices of the Staff of the Joint Committee on Taxation 4, JCX-46-11 (Sept. 19, 2011).
[130] The JCT Revenue Estimating Process 13 (January 19, 2011), available at https://www.jct.gov/publications.html?func=startdown&id=3720.
[131] Joint Committee on Taxation, *Overview of the Definition of Income Used by the Staff of the Joint Committee on Taxation in Distributional Analyses* (JCX-15-12), February 8, 2012.
[132] JCT, supra note 131, at 2.

that "theoretical ambiguities and data constraints prevent the Joint Committee staff from constructing a perfect measure of economic income."[133]

The JCT also prepares an annual "tax expenditure budget."[134] Tax expenditures are defined as reductions in income tax liabilities resulting from special tax provisions that provide tax benefits to particular taxpayers.[135] Tax expenditures are analogous direct spending programs, but instead of receiving a check from the government, the beneficiary has a lower tax burden than would obtain in the absence of the special tax provision. JCT measures the amount of a tax expenditure by determining difference between tax liability under present law and the tax liability that would result from a recomputation of tax without benefit of the tax expenditure provision.[136] The JCT calculates each tax expenditure separately, assuming that all other tax expenditures remain in the Code, and unlike with revenue estimates, assumes that taxpayer behavior remains unchanged for tax expenditure estimate purposes.[137] Another unrealistic, but probably necessary, simplifying assumption made by the JCT that Congress's behavior would also remain unchanged if a tax expenditure were removed. If a tax expenditure provision were eliminated,

---

[133] JCT, supra note 131, at 2.
[134] The Congressional Budget and Impoundment Control Act of 1974 requires CBO and the Department of the Treasury ("the Treasury") to publish annually detailed lists of tax expenditures. (Pub. L. No. 93-344), sec. 3(3). The CBO has always relied on the Joint Committee staff for the production of its annual tax expenditure publication. See Pub. L. No. 99-177, sec. 273, codified at 2 USC 601(f).
[135] Joint Committee on Taxation, *Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates* 2 (JCX-15-11), February 28, 2011.
[136] JCT, supra note 135, at 10.
[137] JCT, supra note 135, at 10-11.

Congress might choose to continue financial assistance through other means rather than terminate all Federal assistance for the activity. JCT estimates of tax expenditures do not anticipate such policy responses. [138]

B. Tax Preferences 2.0: Cutting loopholes.

While the fiscal cliff compromise did increase the progressivity of the Code, further tax reform will probably focus on cutting loopholes.[139] Loopholes, formally known as tax expenditures, include such widely popular provisions as the mortgage interest deduction and the deduction for charitable contributions. As discussed in the previous section, the JCT annually tracks the magnitude of tax expenditures in the tax expenditure budget. Stanley Surrey, who served as Treasury Secretary, advocated for the tax expenditure budget as a way of curtailing expenditures through the tax system.[140] Surrey, writing with law professor Paul McDaniel, noted that "in effect, two spending processes existed in the Congress: one using traditional appropriations initiated by the legislative committees and consequent appropriations by the appropriations committees; the other using the tax system and reductions in tax liabilities initiated by the tax committees."[141] Surrey and

---

[138] JCT, supra note 135, at 11.
[139] Eduardo Porter, Loopholes to Some, Lifelines to Others, NY Times (Dec. 11, 2012). Republican presidential candidate Mitt Romney's tax plan included unspecified limits on tax expenditures. See Michael R. Strain, Romney's Tax Plan Doesn't Add Up—But It Deserves a Second Look, The Atlantic (Oct. 16, 2012).
[140] Surrey & McDaniel, supra note 74, at 715 ("There are the beginnings in some areas of efforts to shift from existing tax expenditures to direct assistance. Hopefully, this trend will continue . . .."). Id.
[141] Surrey & McDaniel, supra note 74, at 682.

McDaniels outlined their goals and hopes for the tax expenditure budget: first, the government would learn how much it is spending and on what; second, "once knowledge exists, appropriate analysis is possible;" and third, the appropriate analysis would be to "ask whether the government would directly spend such funds for such purpose . . . , and if not, why should the money be spent through the tax system?"[142] Considering that deductions provide the greatest benefit to the wealthiest taxpayers, Surrey and McDaniel conclude that "it is clear that no direct program would be structured in such an upside-down or exclusionary fashion."[143] Finally, Surrey and McDaniel note that "the intense struggles of tax reform are over tax expenditures."[144]

Tax reform's focus on tax expenditures has not changed, but Surrey's dream of their eventual extinction is far from realized. To the contrary, the number and scope of tax expenditures has increased. The number of tax expenditures doubled from 67 to 146 between the years 1974 and 2004.[145] For the past three decades, annual revenue losses from all tax expenditures have been similar to the amount of discretionary spending each year, with aggregate revenue losses totaling an estimated $1 trillion in 2011.[146] The fiscal cliff agreement extended a number of tax expenditures that otherwise would have expired.

---

142 Surrey & McDaniel, supra note 74, at 692.
143 Surrey & McDaniel, supra note 74, at 693.
144 Surrey & McDaniel, supra note 74, at 706.
145 Edward A. Zelinsky, The Counterproductive Nature of Tax Expenditure Budgets, 137 Tax Notes 1317, 1319 (2012).
146 Government Accountability Office, ''Tax Policy: Factors for Evaluating Expiring Tax Provisions,'' GAO-12-760T, at 3-4 (June 8, 2012) (statement of James R. White).

The concept of tax expenditure budgets has been criticized for inconsistency by a number of scholars for a variety of reasons.[147] Law professor Boris Bittker, a contemporary of Surrey, argued that there is no principled way to distinguish normative tax provisions from tax expenditures.[148] Law professor Steven Dean views the tax expenditure budget as the "undead," mindlessly accounting for government spending with no conscious ability to do anything about it.[149] Law professor Edward Zelinsky finds that rather than curtailing spending through the tax system, the tax expenditure budget have highlighted the benefits and "triggered a race to obtain tax-based [government] largesse."[150] Law professor David Weisbach and co-author Jacob Nussim disagree with Surrey's normative assumption that government spending is best accomplished via direct transfers, finding that "the

---

[147] Boris I. Bittker, ''Accounting for Federal 'Tax Subsidies' in the Budget,'' 22 *Nat'l Tax J*. 244, 250 (1969) (arguing that there is no principled way to distinguish normative tax provisions from tax expenditures); Zelinsky, supra note 145, at 1323 (tax expenditure budgets have highlighted the benefits and "triggered a race to obtain tax-based largesse); Steven A. Dean, The Tax Expenditure Budget is a Zombie Accountant, 46 U.C. Davis L. Rev. ___ (forthcoming 2013) ("conceiving of tax expenditure abuse as a mere accounting deficiency—to be addressed by fine tuning the budget process—guaranteed the project's failure"); David A. Weisbach & Jacob Nussim, The Integration of Tax and Spending Programs, 113 Yale L. J. 955, 957 (2004) ("the decision to implement a 'nontax' program through the 'tax system' has little or nothing to do with tax policy", rather it is a matter of institutional design).
[148] Boris I. Bittker, ''Accounting for Federal 'Tax Subsidies' in the Budget,'' 22 *Nat'l Tax J*. 244, 250 (1969)
[149] Steven A. Dean, The Tax Expenditure Budget is a Zombie Accountant, 46 U.C. Davis L. Rev. ___ (forthcoming 2013) ("conceiving of tax expenditure abuse as a mere accounting deficiency—to be addressed by fine tuning the budget process—guaranteed the project's failure").
[150] Zelinsky, supra note 145, at 1323.

decision to implement a 'nontax' program through the 'tax system' has little or nothing to do with tax policy", rather it is a matter of institutional design.[151]

This article does not deal with the interesting question of whether tax expenditures are good, bad or ugly, but rather with whether economic analysis affects the way legislators and the public view tax expenditures. Zelinsky notes that even though "tax expenditures can be designed (and sometimes are designed) to be economically and procedurally equivalent to comparable direct outlays," for some people, policies that are unacceptable when accomplished through direct transfers become attractive when labeled as tax reductions.[152] This "framing effect" means that labels matter, even when the policies are economically identical.[153] Political scientists Brandon Bartels and Jake Haselswerdt empirically tested support for a government housing program depending on whether it was structured as a grant or as a deduction.[154] They found that "the delivery mechanism of a government program can have a dramatic effect on citizens' likelihood of supporting that program, [and] in genera, Americans seem to be much more favorably disposed towards government interventions through the tax code than through more direct

---

151 David A. Weisbach & Jacob Nussim, The Integration of Tax and Spending Programs, 113 Yale L. J. 955, 957 (2004).
152 Edward A. Zelinsky, Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditure Analysis, 24 Va. Tax Rev. 797, 799 (2005).
153 Zelinsky, Framing Effects, supra note 152, at 799.
154 Jake Haselswerdt & Brandon Bartels, Comparing Attitudes Toward Tax Breaks and Spending Programs: Evidence from a Survey Experiment (George Washington University Department of Political Science Working Paper (Jan. 9, 2012), on file with author.

channels."[155] In particular, political conservatives, generally hostile to government interventions, were much more amenable to 'spending through the tax code.'[156] Far from being swayed by economic arguments about tax expenditures, citizens appear to be largely impervious to them.

Another study, by economics doctoral candidate Jacob Goldin and law professor Yair Listokin, examined taxpayers' perceptions of two popular tax expenditures, the mortgage interest deduction and the charitable contribution deduction.[157] They found most survey participants knew about the existence of the tax expenditures, but do not have accurate knowledge about their eligibility for the provisions or the magnitude of the effect on their tax liability.[158] Taxpayers systematically underestimated the value of both the charitable deduction and the mortgage interest deduction, that is, the deductions had low salience.[159] The researchers concluded that these low salience policies were inefficient—the provisions reduced revenue without changing taxpayer behavior.[160] This seems a curious conclusion: if the eligible taxpayers do not take the deduction, then how can it reduce revenue? In any event, this study also seems to support the idea that taxpayers are not swayed by economic analysis. As Zelinsky notes, tax expenditures are probably significantly

---

[155] Haselswerdt & Bartels, supra note 155, at 21.
[156] Haselswerdt & Bartels, supra note 155, at 22.
[157] Jacob Goldin & Yair Listokin, Tax Expenditure Salience (2012), available at http://ssrn.com/abstract=2097836.
[158] Goldin & Listokin, supra note 157, at 2.
[159] Goldin & Listokin, supra note 157, at 10.
[160] Goldin & Listokin, supra note 157, at 13.

salient to rent-seekers, like the real estate industry and charities.[161] The symbolism of the mortgage interest deduction and the charitable contribution deduction are likely much more salient to taxpayers. The mortgage interest deduction tells taxpayers that the government wants them to live the American dream in their own home. The charitable contribution deduction tells taxpayers that the government wants them to support churches, schools, and food banks.

The attractive symbolism of tax expenditures may not survive the hunt for deficit reduction. Tax reform proposals by President Obama[162], presidential candidate Mitt Romney[163], and tax reform commissions[164] all suggest limiting tax expenditures. Eliminating tax expenditures has appeal for both political and economic reasons. Law professor Linda Sugin objects to cutting tax expenditures across the board, arguing that "Congress must pay as much attention to the purposes and effectiveness of individual tax expenditures, and evaluate them on a program-by-program basis, as they do in making decisions about whether to discontinue direct

---

[161] Zelinsky, supra note 145, at 1322. "Tax expenditure budgets, even if overlooked by many, are likely not overlooked by the groups petitioning for public assistance and by their respective lobbyists." Id (footnote omitted). See Roberta F. Mann, Housing & The Mortgage Interest Deduction, in Beyond Efficiency, supra note 15, at ___. See also, Gregory Korte, Mortgage deduction is popular, but few claim it, USA Today (Dec. 5, 2012) ("Industry groups are lobbying heavily to keep the [mortgage interest] deduction untouched . . . ."). And see, Naftali Bendavid, Charities Fight to Keep Tax Break on Donations, Wall St. J. (Nov. 29, 2012).

[162] The White House, Reforming the Tax Code, http://www.whitehouse.gov/economy/reform/tax-reform. ("Cut tax breaks that are inefficient, unfair, or both so that the American people and businesses spend less time and less money each year filing taxes and cannot avoid their responsibility by gaming the system.")

[163] Romney's Tax Deduction Cap, Wall St. J. (Oct. 19, 2012).

[164] NAT'L COMM'N ON FISCAL RESP. & REFORM. THE MOMENT OF TRUTH 29 (2010); BIPARTISAN POL'Y CTR., RESTORING AMERICA'S FUTURE 31 (2010).

spending programs."[165] Researchers at the Center for Budget and Policy Priorities (CBPP) agree, but note that, politically, legislators may be attracted to across-the-board limits to tax expenditures "precisely because it avoids making decisions on specific tax expenditures."[166] From an economic standpoint, reducing the number and size of tax expenditures broadens the tax base, which can be considered efficient.[167] A broad tax base efficiently reduces distortion because it does not discriminate between economic activities.[168] With more taxpayers subject to tax, the tax rate can be lower.[169] Broadening the base and lowering the rate is a classic recipe for tax reform, as illustrated by the Tax Reform Act of 1986. An across-the-board reduction in tax expenditures would raise revenue, but could significantly change the impact of the tax system on particular taxpayers. The Tax Policy Center estimated that eliminating all itemized deductions for all taxpayers would raise about $2.2 trillion over the 2013-2022 period, if the current top tax rates in 2012 remained in effect.[170] Sugin criticizes the tax expenditure budget for focusing solely on cost and failing to show the distribution of tax expenditures, particularly those affecting businesses.[171] We don't know who benefits from tax expenditures, she

[165] Linda Sugin, Tax Expenditures, Reform, and Distributive Justice, 3 Columb. J. Tax L. 1, 6 (2011).
[166] Chye-Ching Huang, Chuck Marr, and Joel Friedman, Restraining Tax Expenditures Should Complement, Not Replace, Letting High-Income Bush Tax Cuts Expire, Center on Budget and Policy Priorities 8 (Nov. 29, 2012).
[167] Weisbach & Nussim, supra note 151, at 967.
[168] Weisbach & Nussim, supra note 151, at 967.
[169] Weisbach & Nussim, supra note 151, at 967.
[170] Huang et al., supra note 166, at 3. Itemized deductions are one form of tax expenditure. Others include exclusions from gross income and preferential tax rates for long-term capital gains.
[171] Sugin, supra note 165, at 17.

complains.[172] Are economists failing to get lawyers and policymakers the information we need, or do we misunderstand what they are telling us?

The most recent tax expenditure budget published by the JCT, covering 2011 – 2015, estimates the distribution of the following tax expenditures: the medical expense deduction, property tax deduction, state and local sales tax deduction, charitable contribution deduction, child care credit, earned income credit, untaxed social security benefits, child tax credit, education credit, student loan interest deduction, and mortgage interest deduction.[173] Researchers Eric Toder and Daniel Baneman of the Tax Policy Center note that distributional estimates of tax expenditures should be viewed with caution for a number of reasons.[174] Importantly, the effect of repealing particular tax expenditures could more or less progressive, depending on how Congress decides to use the resulting revenue.[175] The OECD finds that reducing tax expenditures, which it assumes mostly benefit the well-off, can increase the tax system's equity while also increasing economic growth by allowing cuts in marginal tax rates.[176] Toder and Baneman found that taxpayers

---

[172] Id.
[173] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015* 48-53 (JCS-I-12), January 17, 2012.
[174] Eric Toder and Daniel Baneman, Distributional Effects of Individual Tax Expenditures 3, Tax Policy Center (Feb. 2, 2012).
[175] Toder & Baneman, supra note 174, at 4.
[176] OECD 2012, supra note 75, at 10.

> Moreover, scaling back tax expenditures would reduce the complexity of the tax system, and thus improve tax compliance and lower collection costs. Specific tax expenditures that should be reconsidered include tax relief on mortgage interest in countries that do not tax imputed rent, tax incentives to promote pension savings or reduced taxation of capital gains from the sale of a principal or secondary residence. Other tax reliefs may provide tax

in the top 1 percent of the income distribution would receive much larger proportionate benefits from special tax rates for capital gains and dividends, and would not be significantly affected by the elimination of other tax expenditures.[177] On the other end of the spectrum, refundable credits, such as earned income tax credit and the child tax credit, provide the largest benefits as a share of income to those in the bottom two quintiles of the income distribution.[178] How would particular changes to tax expenditures affect income inequality? Economists cannot tell us. "Without knowing how an increase in revenue would be spent (or a reduction financed), one cannot definitively estimate the distributional effects of any policy change."[179]

IV. The psychology of numbers

Lawyers (and other humans) want answers. Numbers seem to give us objective and trustworthy answers to complex questions. In the book "Proofiness," author Charles Seife says "if you want to get people to believe something really, really stupid, just stick a number on it. Even the silliest absurdities seem plausible the moment they are expressed in numerical terms."[180] Advertisers, those astute observers of human

avoidance instruments for top-income earners. In particular, there is little justification for tax breaks for stock options and carried interest. Id.

[177] Toder and Baneman, supra note , at 8.

[178] Toder and Baneman, supra note , at 10.

[179] Toder and Baneman, supra note , at 4.

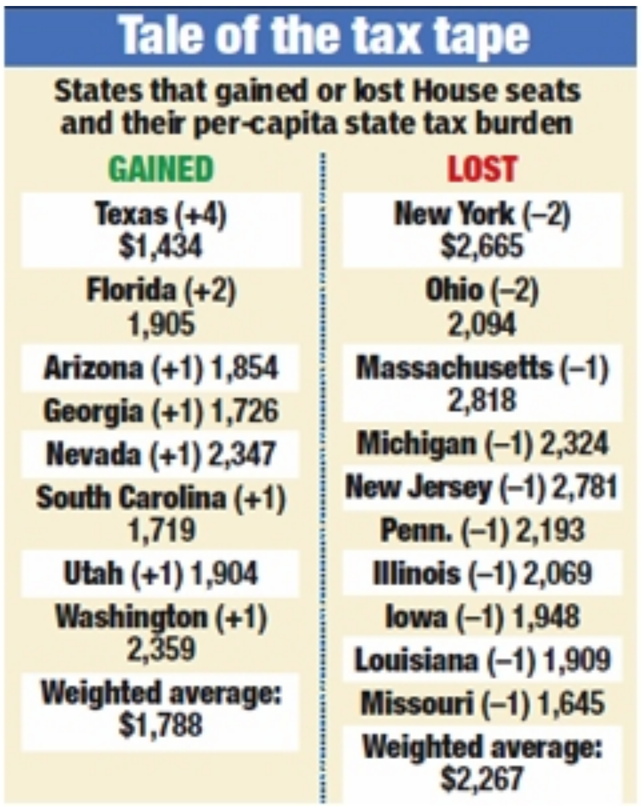
[180] Charles Seife, Proofiness: How You're Being Fooled by the Numbers 8 (Penguin 2010).

behavior, understand the power of numbers.[181] Seife describes several categories of proofiness that may apply to the misuse of economic analysis, whether by design or misunderstanding. Disestimation is taking a number too literally, understating or ignoring the uncertainties that surround it.[182] Fruit-packing refers to the misleading presentation of numbers.[183] Fruit-packing techniques include cherry-picking selected data[184], comparing apples with oranges by using different units of measurement[185], and apple-polishing by manipulating data.[186] Using averages is a common form of apple-polishing almost invariably used by politicians announcing tax cuts.[187] An average is the total amount divided by the number of data points—it does not represent the typical or most common result, but people often interpret average as "typical."[188] Finally, human minds are designed to detect patterns, which makes us vulnerable to mistaking correlation for causation.[189] See also Black Swan.

---

[181] Seife, supra note 180, at 35 – 36.
[182] Seife, supra note 180, at 23.
[183] Seife, supra note 180, at 26.
[184] Seife, supra note 180, at 27.
[185] Seife, supra note 180, at 31.
[186] Seife, supra note 180, at 35.
[187] Seife, supra note 180, at 37. See FactCheck.Org, Here We Go Again: Bush Exaggerates Tax Cuts (Feb. 20, 2004), http://www.factcheck.org/here_we_go_again_bush_exaggerates_tax.html, ("President Bush stumbled Feb. 19, saying the average tax cut is $1,089. The White House corrected that figure to $1,586. But the fact is that most Americans won't see anywhere near either of those amounts."
[188] Seife, supra note 180, at 38.
[189] Seife, supra note 180, at 41.

There are countless examples of this mistake. One of my favorites is the New York Post article "States Taxing Themselves to Death."[190] The authors found "evidence" in the 2010 census—the states that had high state income tax rates lost population. The authors confidently stated "the trend is unmistakeable [sic]: the 'losing' states drove out their high-income citizens (and middle-income jobs) with heavier tax burdens."[191]



Tale of the tax tape

States that gained or lost House seats and their per-capita state tax burden

GAINED	LOST
Texas (+4) $1,434	New York (–2) $2,665
Florida (+2) 1,905	Ohio (–2) 2,094
Arizona (+1) 1,854	Massachusetts (–1) 2,818
Georgia (+1) 1,726	Michigan (–1) 2,324
Nevada (+1) 2,347	New Jersey (–1) 2,781
South Carolina (+1) 1,719	Penn. (–1) 2,193
Utah (+1) 1,904	Illinois (–1) 2,069
Washington (+1) 2,359	Iowa (–1) 1,948
Weighted average: $1,788	Louisiana (–1) 1,909
	Missouri (–1) 1,645
	Weighted average: $2,267

A skeptical reader found another possible explanation: perhaps the states are freezing themselves to death.[192]

---

[190] Dick Morris & Eileen McGann, States Taxing Themselves to Death, NY Post (Dec. 22, 2010).
[191] Id. Note the "weighted average" on the chart.
[192] Roberta Mann, *Some States Are Freezing Themselves to Death* (data derived from the Carbon Dioxide Information Analysis Center at the Oak Ridge National

Gained	Average Temperature	Lost	Average Temperature
Texas (4)	76 (Dallas)	New York (-1)	49 (NYC)
Florida (2)	75	Ohio (-2)	50
Arizona (1)	71	Massachusetts (-1)	50
Georgia (1)	65	Michigan (-1)	47
Nevada (1)	79	New Jersey (-1)	52
South Carolina (1)	64	Pennsylvania (-1)	52
Washington (1)	59	Illinois (-1)	53
		Iowa (-1)	48
		Louisiana (-1)	68
		Missouri (-1)	56

Both of these charts are equally persuasive, or silly, depending on your perspective. Neither proves causation.

Other scientific disciplines are reaching out to solve economic problems. Economists turned to psychology to explore the behavioral aspects of economic decisions, such as optimism bias and loss aversion.[193] Economists originally borrowed the idea of modeling from physics, which has had mixed success.[194]

Laboratory, available at http://cdiac.ornl.gov/r3d/ushcn/statemean.html), posted on TaxProf Blog (Dec. 28, 2010) http://taxprof.typepad.com/taxprof_blog/2010/12/index.html.

193 See, generally, George A. Akerlof & Robert Shiller, Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters For Global Capitalism (Princeton Press 2009); Thaler & Sunstein, supra note 57, at 31 - 34.

194 James Owen Weatherall, The Physics of Wall Street: A Brief History of Predicting the Unpredictable (Houghton Mifflin 2012) (Jan Tinbergen, the first Nobel prize winner in economics, was a physicist who introduced the word "model" to economics in the 1930s).

Physics based economics has been blamed for the blow-up of the financial markets.[195]

Understanding what numbers, and economists, can and cannot do is key to respecting the role of economists. Economists cannot give lawyers all the answers. Nevertheless, policymakers will continue to try to find certainty.

> It is astonishing how confident people both outside and inside the Congress can be in predicting the consequences of tax law changes, when those consequences are impossible to know, given the current state of knowledge. Such estimates should be taken for what they are: expressions of religious belief, not a consensus of predictions of the economics profession. In the political process, economic predictions routinely serve to justify, and sometimes mask, ideological battles. Clear and noncontroversial answers to crucial questions simply do not exist.[196]

At the same time, it is important to recognize our human tendencies—we like a good story. Graetz, a long-time Washington observer, notes that "Congress has long been excessively vulnerable to memorable anecdotes," whether true or not.[197] The one-year repeal of the estate tax was facilitated by the largely apocryphal story of the lost family farm.[198]

V. Conclusion

---

[195] Nassim Nicholas Taleb, Antifragile: Things That Gain from Disorder 150 (Random House 2012).
[196] Graetz, supra note 98, at 177-78.
[197] Graetz, supra note 98, at 189.
[198] Michael J. Graetz & Ian Shapiro, Death by a Thousand Cuts: The Fight Over Taxing Inherited Wealth 126 (Princeton Press 2005).

Like any human, I've tried to distill this article into a narrative. Undoubtedly, it contains my own biases and assumptions. Optimistically, I assume that economic analysis attempts to be objective. Economists oversimplify, and lawyers read what they want to into the results. To paraphrase author John Gray (Men are from Mars, Women are from Venus) again, lawyers could complain that economists don't listen.[199] An economist listens to the lawyer ask a question, like "what will the effect of raising taxes on high-income individuals," assesses what is bothering the lawyer, and then offers a solution. Lawyers want equity, but economists keep offering efficiency. [200]

Economists could complain that lawyers keep asking them questions they can't answer, like "what is the carbon impact of the Internal Revenue Code?"[201] The lawyers are disappointed at the answer. Economists value efficiency.[202] Lawyers are intuitive. [203] Rather than lawyers blaming economists and economists blaming lawyers, understanding and acceptance are key to creating a good relationship between the two types of professionals.

---

[199] Gray, supra note 2.
[200] Gray, supra note 2, at 15.
[201] See forthcoming study, mandated by the Energy Improvement and Extension Act of 2008, P.L. 110- 343, section 117, 122 Stat. 3807, 3831, proposed by Congressman Earl Blumenauer, a lawyer. See Blumenauer Press release, May 21, 2008, *available at* http:// blumenauer.house.gov/index.php?option=com_content&task= view&id=1322.
[202] Gray, supra note 2, at 16.
[203] Gray, supra note 2, at 17.

Understanding can be difficult. Economists and lawyers seldom mean the same things even when they use the same words, like equity or fairness.[204] Economists want to quantify, and tend to think that money is the solution to all problems.[205] Lawyers should appreciate economists' efforts and skill,[206] while at the same time recognizing their limitations. The tax system is complex, and interactions between taxes, spending, trade policy, and innovation can be impossible to untangle. Even without advanced math training, lawyers can read economic analysis critically, looking for proofiness. What are the stated assumptions? Is correlation presented as causation? Does the analysis mix units of measurement? Are averages presented as typical results? Lawyers, politicians, and policymakers need to take responsibility for including equity in deliberations, and not blame economists if equity is not front and center.

---

[204] Gray, supra note 2, at 60.
[205] Gray, supra note 2, at 129.
[206] Gray, supra note 2, at 136.