

SOME SUGGESTED GUIDING PRINCIPLES FOR STATE TAX POLICY

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People think taxation is a terribly mundane subject. But what makes it fascinating is that taxation, in reality, is life. If you know the position a person takes on taxes, you can tell their whole philosophy. The tax code, once you get to know it, embodies all the essence of life: greed, politics, power, goodness, charity. Everything's in there. That's why it's so hard to get a simplified tax code. Life isn't simple.¹

INTRODUCTION

These words of former IRS Commissioner Sheldon Cohen suggest, at the very least, a certain modesty in developing suggestions to reform or improve a state's tax scheme. More modesty is probably needed in fleshing out concrete applications of guiding principles that may be found acceptable at an abstract, conceptual level. Nevertheless, if the principles are not sound and coherent, their potential applications could more easily shift the balance of power toward greed and away from goodness. Sound principles can help protect our relatively free market economy from becoming like the kind of capitalism Karl Marx criticized in the *New York Daily Tribune* of August 8, 1853 when he called for human progress that ceased to "resemble that Hindoo pagan idol, who would not drink the nectar but from the skulls of the slain."²

Before suggesting some principles for consideration by the Guiding Principles Subcommittee of the Citizens Finance Review Committee, I would like to note that a state or a country's tax system should be viewed not only in relation to its influence on the economic sector but in relation to the common good, which the state has the responsibility to promote formally and explicitly. Definitions of the common good vary but, in general, one could argue that it is concerned with promoting and protecting people's human, constitutional and civil rights within a lawful framework.

A more philosophical approach to the concept of the common good has been suggested by Bernard Lonergan, S.J. As he writes, "It is not the object of any single desire, for it stands to single desires as system to systematized, as universal condition to particulars that are conditioned, as scheme of recurrence that supervenes upon the materials of desires and the efforts to meet them and, at the price of limited restrictions, through the fertility of intelligent

¹Former IRS Commissioner Sheldon Cohen, quoted in Jeffrey H. Birnbaum and Alan S. Murray, *Showdown at Gucci Gulch, Lawmakers, Lobbyists and the Unlikely Triumph of Tax Reform*, New York: Vintage Books, 1988, p. 289.

²Quoted in R.G. Peffer, *Marxism, Morality, and Social Justice*, Princeton: Princeton University Press, 1990.

control, secures an otherwise unobtainable abundance of satisfactions.³ Ideally, a tax system should be an element in a state's array of tools, a scheme of recurrence, entailing limited restrictions on our income and capital, which when used intelligently by policy makers can help people realize an otherwise unobtainable abundance of satisfactions.

One comment on this approach to the common good. It has often been said and is still said in policy making/influencing circles in Arizona that people know how to spend their own money better than the state does. Fair enough, but the saying does not do justice to the fact that the concern of the state is primarily the common good, which is not the sum of individual goods, but an overall pattern that, as Lonergan says, stands to single desires as system to systematized, as universal condition to particulars that are conditioned

SOME PRINCIPLES

In the *Wealth of Nations* Adam Smith offered principles for tax systems that still make sense today:

The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state In the observation or neglect of this maxim consists, what is called the equality or inequality of taxation."

Smith also stressed ease of compliance, stating that a tax system should be 1) clear and certain as to the time, manner and amount of tax payments, 2) scheduled so as to facilitate payment by taxpayers and 3) administered efficiently so as "both to take out and to keep out of the pockets of people as little as possible, over and above what it brings into the public treasury of the state."⁴

The February 21, 2003 Statement for the Arizona Citizens Fiscal Review Committee, @ pages 6-7, by Scheppack and Duncan offers overall principles that are consistent with Smith's and takes them further. I believe they provide sound guiding principles for the CFRC. They call for: Adequacy, Stability, Equity (horizontal and vertical), Neutrality, efficient and effective Administration, and Economic Vitality. As they point out, These criteria, of course, often compete with one another in that pursuit of one goal may frustrate another. . . . They should, however, serve as useful guideposts in evaluating issues and potential changes within any individual tax and in evaluating the state and local system as a whole. Too, it should be noted that these criteria are similar to the criteria offered in *Governing's* February 2003 special issue *The Way We Tax: A 50-State Report* and pretty standard in public finance treatment of taxation.

³Bernard Lonergan, *Insight*, New York: Philosophical Library, 1956 p. 596.

⁴Adam Smith, *The Wealth of Nations*, ed. Edwin Cannan, New York: The Modern Library, 1994, pp. 888-9.

SOME ARIZONA SPECIFIC STANDARDS AND CONSIDERATIONS

1. Adequacy. The documents provided the CFRC, especially APublic Finance in Arizona,@ indicate that, when compared with national averages and neighboring states, Arizona is both a low tax and low expenditure state.⁵ To the extent that the members of the CFRC believe that this is an unsatisfactory situation, the conclusion may be that increased taxes are needed to promote the common good of the state and improve the well-being of its residents.

One might note here that for the years 2000/2001 Census Bureau data indicate that the poverty rate in Arizona was 13.2%, while the national rate was 11.5%. During the same period 17.3% of Arizonans under 65 lacked health care coverage for at least 12 months. The national figure was 14.4%. (While poverty increased in Arizona from 1999/2000 to 2000/01, AZ was one of three states that saw its median income increase over the same period, going from \$40,095 to \$41,199.)

2. Stability. The data about Arizona=s revenue sources suggest that out tax system relies disproportionately on use taxes. The CFRC should develop recommendations for a more balanced mix of revenue sources.

3. Equity:

A. Horizontal equity would suggest: 1) exploring taxing more services, especially given the increasing role they play in the state=s economy, 2). exploring possibilities of taxing of out-of-state purchases, e.g., from catalogues or over the Internet and 3) revisiting tax exemptions and credits.

B. Vertical equity would call for improving the progressivity of taxation in Arizona. Both Marshall Vest=s presentation to the CFRC and the January 2003 report AWho Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition@ find Arizona=s tax scheme very regressive. This would suggest the importance of reducing its regressivity so that it treats lower income taxpayers fairly.

4. Neutrality is a criterion economists prize and that policy makers sacrifice for what they perceive as more important factors to promote the common good. (There is, obviously, a matter of judgment here. Some might attribute the passage of some A tax breaks@ as due to the skill of lobbyists and influence of campaign contributions. They may have a point.) In principle, neutrality is important, to avoid counterproductive distortions in Arizona=s economy and to respect the decisions of enterprises in that economy, but tax exemptions and credits need not be

⁵It might be noted that Arizona is a low tax state in a low tax country. Organization for Economic Cooperation and Development data for 1998 report that national, state and local taxes for the U.S. were 28.9% of our GDP, a smaller percentage than that of only a few other OECD members, e.g., Mexico and Turkey.

held sacred and inviolate. They should be evaluated in terms of whether or not they do contribute to the common good and sound, healthy economic development.

5. Administration. Adam Smith said it well in 1776. Obviously the simplicity of a tax code will contribute to the ease and economy of administration and to voluntary taxpayer compliance. On the other hand, should medical expenses be allowed as a tax deduction, as Arizona does? There can be tensions between fairness and simplicity.

6. Economic Vitality. In commenting on this criterion, Scheppach and Duncan make the point that ATaken as a whole, the tax system should produce a stable economic environment that fosters economic growth . . . and should also be consistent with the tax structures of other states so as to minimize any disincentives for investment in the state.@ This makes good sense. On the other hand, the statement should be taken with consideration of the observations in APublic Finance in Arizona@ that Athe empirical evidence is that neither tax increases nor tax decreases in Arizona have had a perceptible effect on the economy@ (p. 54) and that A tax payments are a small expense for most businesses.@ (p. 50)

WHAT SHOULD BE OFF THE TABLE

Since it is early in our work, I am reluctant to suggest that any element in Arizona=s recent tax, expenditure and economic saga should be off the table. As the CFRC moves further, the process will answer this question. Such an approach may, I hope, help us respect Cohen=s observation that since the tax code embodies life Ait's so hard to get a simplified tax code. Life isn't simple.@