

PRESIDENTIAL ADDRESS

WHY I LOVE MY JOB, AND THE NTA

Joel Slemrod, University of Michigan

I asked Fred Giertz, the NTA Executive Director, what was an appropriate topic for a presidential address. He said it could be anything from a substantive topic in public finance, to a policy issue, to a paean to the NTA. The most important thing, said Fred, was to keep it short. Given that advice, I have chosen as my topic “Why I Love My Job, and the NTA.” I’ve decided to omit, because of lack of time, why I love my family, why I love my house, and why I love my cat.

More or less, my job is to learn about, and teach others about, taxes. About 15 years ago my eldest child asked me “Daddy, how can you think about tax all the time?” As any diligent father, I thought a bit before replying. Annie, I said, tax is about everything. It’s about economic ideas you’ll learn about when you grow up -- like having a job, investment, saving, deciding whether or not you will buy a house or pay rent, drinking and smoking. Tax is also about items not entirely economic, like charity, fertility, getting married, death, how much money you will get when I pass on. I can think about tax all the time because nearly everything I might think of has a tax angle. The fact that many academic papers begin “The Effect of Taxes on” reflects the reality that modern tax systems affect the relative price of just about everything. Whether that is a good thing or not is another matter, but it is a fact.

My second job is that I am an economist. Economists think about policies that ultimately affect most things we care about, both in ways you can see and ways you can’t easily see, such as is the case with deficit, incidence, and border adjustability. Economics is a disciplined way of thinking about such problems. It is also a language that greatly facilitates communication and helps enormously to pinpoint differences in policy preferences, to see whether they arise because we have differing models of the economy, differing parameter values within a similar model of the economy, and/or different values about inequality.

Current controversies aside, economics has a narrow, albeit powerful pair of frameworks: maximization of explicit objectives by individuals and businesses, and maximization of known objective functions by governments. It also has a formidable

tool kit in empirical economics that help us to separate correlation and causality, the ubiquitous problem in empirical social science. Occasionally governments provide us with natural experiments that make this problem somewhat easier.

Taxes are also about human nature and behavior, about what makes us what we are. Are we selfish? Are we free riders? Do we cheat or comply with our tax obligations, and under what circumstances? Is it because we are afraid of being caught, are altruistic, or just plain dutiful? How sophisticated are we taxpayers about economic matters? Are we fooled by deficits, by multiple taxes, by statutory designations, by withholding? Are we less likely to free ride when there is a recognizable victim to our free riding, as psychological research suggests.

As helpful as it is, economics is not enough for us to understand policy, because tax is about much more than economics. For example, tax is about political process. To understand why we end up with the tax system we get, we need to study political economy. There are unlikely to be many Pareto-superior policies to be enacted, so that we need some framework to aggregate the results for winners and losers. How well the political process works is very controversial among political scientists. At this year’s NTA Spring Symposium, we had a panel featuring two political scientists, one arguing that voters know little about tax issues and are fooled into supporting policies that are not in their interest, and one arguing that voters use cues to make largely sensible choices.

Tax is about accounting. Public corporations make two reports about their income, one that is available to anyone and one to the Internal Revenue Service; corporations have an incentive to overstate how well they are doing in the former report, and to understate how well they are doing in the latter. Because of asymmetry of information, public corporations are often willing to forego cash to report higher book earnings, which changes the relative effective cost of capital of decisions with varying accounting treatments. This may explain why many corporations prefer a rate cut to accelerated depreciation, even when standard economic models say they should have the same effect. The

answer may be, as Tom Neubig has suggested, that they have different impacts on short-term book earnings. Some economists, but interestingly few accountants, favor a policy of conformity – making book income equal to taxable income for public corporations, as a way to restrain both the incentive to overstate earnings and to understate taxable income.

Economists also need to learn from lawyers and tax administrators. In a stylized economic model, it is easy to tax labor at a different rate than capital. In practice one has to distinguish between the two. Economic models feature a sharp distinction between debt and equity, but there are many ways of obtaining capital that are hybrids of the two, and the tax law attempts to characterize them by drawing on the essential characteristics of each. This kind of line drawing is ubiquitous, and how it relates to optimal tax analysis is a fascinating, unresolved, question. Moreover, no tax authority can just announce tax rules. The economics of tax is about what triggers tax, not who actually forks over the money (and when), but tax administration relies on withholding, information reports, audits, penalties, to collect resources efficiently and equitably. The remittance of tax liability is often as important as what actions, or states of the world, trigger the liability.

Of course, taxation is not all of public economics. In some cases, tax credits and deductions are really expenditure programs and, conceptually, there's no clear line between a tax and an expenditure. Expenditure programs tend to have a political constituency and taxes do not, while there's no National Government Expenditures Association, there are many National X Associations, where X may be restaurant, retail, manufacturers, etc.

Some supporters of small government have tried to use tax cuts as an instrument to get smaller expenditures, sometimes called the “starve the beast” strategy. Some conservatives favor tax administration changes, such as abolishing withholding, to ensure that taxpayers perceive the true cost of government. Others actually would like to

increase the *actual* cost of raising resources, so as to put sand in the wheels of a political process biased toward overspending. What is certainly true is that taxes do not measure the true cost of government, because deficits must eventually be paid off. Moreover, a low level of taxes does not necessarily imply a low level of government intervention. Dan Shaviro has even argued that tax *cuts* can be a symptom of *big*, redistributive, government, because they redistribute resources from future generations to current generations.

My third and final job is President of the NTA. It is important to realize that the NTA is a big umbrella for people studying taxation and, more generally, public economics -- for people making tax policy, and for people affected by tax policy. What can it accomplish? We can showcase our strength via the state-of-the-art research in the *National Tax Journal*, what is presented at an annual conference, and at special events such as the 5 Keys Conference. It is important to facilitate dialogue within and across disciplines, within and across countries, and between scholars and practitioners.

Some of you may wonder whether my answer to my daughter's question affected her life. My daughter graduated from the University of Michigan last spring, with honors I can proudly say. Alas, her lowest grade at Michigan came in the one economics class she took. But there's hope – my younger son is now a freshman at Michigan, writing for one of the student newspapers, and the other day he called me up to ask me about how taxes affect the Michigan economy for a story he was writing. I said Jonathan, my son, “taxes are about everything...”

Thank you. It's been an honor to serve as your President this past year. Enjoy the rest of the conference.

At the conclusion of the address, Slemrod turned the presidency of NTA over to Robert Tannenwald for 2006-2007.