And Equal (Tax) Justice for All? (Part 4 of 8)

Part Four: How Much Progressivity

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The debate over progressivity is as old as history itself. At the center of that debate is how much progressivity is appropriate, if any. While there is no clear-cut answer, there are standards by which one can try to come to some rational judgment. One standard might try to assess the relative amounts of sacrifice individuals should bear; another might attempt to assess efficiency losses from different alternatives. Once again, it is balance that is required.

Throughout most of the relatively short history of economics as a formal discipline, the progressivity debate has centered mainly on taxation, rather than government expenditures. At one point an attempt was made to define the optimal amount of progressivity by the amount of sacrifice individuals should make. The basic theory was utilitarian and based on the common sense notion that at the margin those who have more bear less sacrifice—say, by avoiding a second yacht cruise—than do those with little—who might be threatened with, say, starvation.

Suppose that an additional dollar is not as valuable to someone who is rich as it is to someone who is poor. Then utility or well-being is assumed to be a declining marginal function of ability or income or wealth. Thus a person with $100,000 might value an additional $10 no more than $1 would be valued by someone with $10,000. These types of comparisons allow one to think about such notions as equal absolute sacrifice, equal relative sacrifice, and equal marginal sacrifice. Economics students are even taught to toy with various precise mathematical relationships between utility and the consumption made possible by income (for example, a student of economics might play with a function such as: utility or well-being equals the square root of consumption). In that case, formal measures can even be developed to compare the sacrifice of "utility" given up by different taxpayers.

Although these pedagogical devices are useful, the problem is that no one can really measure anyone else's utility nor know how much sacrifice anyone else has made, regardless of their starting level of ability, wealth, or income. At the same time, despite the inability to prove that some degree or another of progressivity is ideal, the utilitarian approach still has widespread appeal because it appeals to basic common sense.

Close to the middle of the 20th century, some famous articles or books—including one by the economist Herbert Simon and another by the lawyers Blum and Kalven—suggested that progressivity was probably a good thing, but the case was "uneasy." A progressive system in the end was prettier than one that was not, but it was as much a matter of aesthetic appeal, or qualitative and personal judgment, as anything else. Keep in mind that this was a period in which the world-wide debate between socialism and some sort of refined capitalism or mixed economy was raging far and wide.

By the 1970s to 1980s, however, many trained economists were taught essentially that equity was an issue no longer of relevance to economists. Economics, they were told (in my view, incorrectly) had little to contribute to the debate, thus waving aside substantial contributions for over two hundred years from Smith to Musgrave. The new view, however, was only a logical extension of the notion that if equity is simply a matter of qualitative judgment, then, like choosing among artwork, it is merely in the eye of the beholder. Economists, however, do understand something about efficiency. They understand that interference in various transactions among individuals results in distortions in behavior, so they were taught to focus their attention there, where they might have some relative advantage to non-economists.

By the 1980s, supply-side economists stretched the argument one step further. If equity didn't matter, and only efficiency did, then taxes should be set only as to minimize distortions. The more tax rates were low at low-income levels in an income tax, the more those effects were likely to be inframarginal and not affect behavior. Correspondingly, rates at the highest income levels were more likely to be marginal because they were more likely to apply to the last dollars of income. For example, take someone in a 40 percent bracket for any income earned above $50,000. That person would not be affected much in decision-making by whatever rate applied to the first $10,000 of income. She might, however, decide to work less or save less because of the 40 percent rate.

The supply-side attack on progressive taxes, therefore, scarcely mentions equity as an issue and argues mainly for lowering the higher marginal tax rates at the top of the income distribution.

The logical extension of supply-side theory, in fact, is the old argument that head taxes are the most efficient form of tax. If everybody is taxed the same merely for existing (assuming that such a tax can be assessed and collected and that incentives for having children are not affected), then taxes would not affect any dollar earned or consumed after the tax was paid because there would be a zero tax rate on all marginal decisions. The simple fact that almost no supply-sider, no matter how extreme, proposes a head tax as a substitute for all taxes indicates that in the back of their minds there are equity concerns after all. (Margaret Thatcher, by the way, finally lost her position as prime minister of Great Britain not long after proposing a type of head tax as a substitute merely for one small part of the British tax system.)

The new view of equity has been almost iconoclastic in its sweeping generalizations. For example, even if progressivity were in the eye of the beholder, horizontal equity, or the equal treatment of equals, or equal justice under the law, cannot be brushed aside so easily. Moreover, it is possible to think rigorously about progressive scales rather than imply that all choices along those lines are equally valid on equity grounds. To top matters off, one can use efficiency standards in determining whether equity or progressivity is being advanced. For example, if a program is designed to help the poor, then one can try to determine whether money is targeted efficiently to meet that end, or whether much is wasted on the non-poor. One can also compare the potential distortive effects of different levels of progressivity.

An uneasy truce now exists between the iconoclasts and most practitioners of public policy and finance. The latter recognize the power of equity principles in the development of policy, but no longer ignore efficiency issues as some—perhaps many—did in the past. The former, despite their claims of indifference to equity principles, often are the first to fall back on them. For instance, supply siders argued that across-the-board tax cut is fair (are they merely playing to the politics of equity or do they believe it?). Today, many opponents of progressive taxes suggest that expenditure programs should be targeted more at the poor (why would it matter if a dollar was worth the same to everyone? Wouldn't random distribution of benefits be just as fair and distort behavior less?).

Other Publications by the Authors

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