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The Hidden Costs of the Progressivity Debate

Nancy C. Staudt

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The Hidden Costs of the Progressivity Debate

Nancy C. Staudt*

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I. INTRODUCTION

Progressive taxation—taxing high income individuals at a proportionally higher level than low income individuals—has sparked

* Associate Professor of Law, State University of New York at Buffalo. I owe thanks to Guyora Binder, Susan Cahn, Markus Dubber, Barbara Fried, Barry Friedman, Estelle Lau, Ronald Mann, Jack Schlegel, Amartya Sen, Rob Steinfeld, Mariam Thalos, and the participants at the Columbia Law School Feminist Legal Theory Workshop and the SUNY-Buffalo Faculty Workshop for their insights on various drafts of this Article.

more than a century of controversy.¹ Those who support progressive taxation have heralded it as a policy that promotes the greatest good for the greatest number in society,² protects traditional democratic values,³ reflects the communitarian world-view of women who see themselves as responsible for the well-being of all individuals,⁴ and reveals the "aesthetic judgment" that income inequality is "distinctly evil or unlovely."⁵ At the same time, critics have condemned progressive income taxation as social policy that amounts to theft and involuntary servitude,⁶ reflects the democratic process gone awry,⁷ penal-

1. Progressive taxation can be implemented in a number of ways. For example, progressivity could be administered through ever-increasing marginal tax rates or a so-called degressive system in which low-income individuals are exempt and all others pay at flat or even declining rates. Importantly, few, if any, theorists oppose progressivity per se—rather, the debate centers on the proper rate structure for implementing the system. While the level of the rates is subject to debate, their coercive nature has not been the subject of extensive criticism in the legal literature. Coercive taxation has largely been accepted because of free-rider and assurance problems. But see Michael Meurer, *Private Provision of a Public Good in a Finitely Repeated Game* (unpublished manuscript) (exploring the provision of public goods through voluntary systems of payments). If voluntary payments by individual citizens were adequate to supply the desired level of public goods and services, there would be no need for coercive taxation. Because it is impossible (or uneconomical) to exclude individuals from consuming the benefits of public goods, individuals will seek to gain the benefits of public goods, or free-ride, on the contributions made by others. Although, some individuals may not free-ride, they might nevertheless fear that a large number of free-riders will prevent the production of the goods and services they desire. Thus, coercive taxation insures against the potential problems associated with free-riders. See David Schmidtz, *The Limits of Government: An Essay on the Public Goods Argument* 54-79 (Westview Press, 1991) (arguing that unanimous assurance contracts combined with an effective contractual enforcement mechanism would solve both the assurance and free-rider problems). See also Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* 14 n.21 (Harvard U., 1971) (distinguishing between a public good and collective good). The difficulty with granting the state the power to tax has revolved around the question of how best to allocate the cost of public goods throughout society.

2. See, for example, Joseph Bankman and Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 Cal. L. Rev. 1905, 1945-58 (1987) (arguing a utilitarian calculus calls for progressive taxation). See also Edwin Seligman, *Progressive Taxation in Theory and Practice* 285-90 (Princeton U., 1908) (providing historical background on early utilitarian arguments).

3. See Renald Frederick King, *From Redistributive to Hegemonic Logic: The Transformation of American Tax Politics, 1894-1963*, 12 Pol. & Soc. 1, 10-11 (1983) (quoting Populist rhetoric and discussing the nature of its impact on tax policy).

4. Marjorie Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 Mich. L. Rev. 465, 504-18 (1987) (arguing that cultural feminists would approve of progressive taxation). But see William Turnier, Pamela Johnsten Conover, and David Lowery, *Redistributive Justice and Cultural Feminism*, 45 Am. L. Rev. 1275, 1315-18 (1996) (arguing that empirical data indicates that gender and feminism have only a modest impact on one's support for redistribution through progressive taxation).

5. Henry Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* 18-19 (U. of Chicago, 1938).

6. Robert Nozick, *Anarchy, State, and Utopia* 169 (Basic Books, 1974).

7. Walter Blum and Harry Kalven, *The Uneasy Case for Progressive Taxation* 19-20 (U. of Chicago, 1953) (noting that progressivity is partly the result of an irresponsible majority imposing the costs of public goods on the wealthy minority).

izes hard-working individuals,⁸ and produces economic waste throughout society.⁹ Theorists in almost every discipline have entered the progressivity debate, proposing a variety of different tax rates in order to disburse the costs of public goods and services.

Despite their contending viewpoints, theorists on both sides of the debate have reached surprising consensus on the proper treatment of the truly poor. Both sides agree that legislators and policy-makers must avoid imposing tax costs on individuals living at or below subsistence levels of income.¹⁰ This agreement is notable in light

8. Dan Troop Smith, *High Progressive Tax Rates: Inequity and Immorality?*, 20 U. Fla. L. Rev. 451, 456 (1968) (asserting that by progressively reducing the net return from any given increment of gross income or gain, progressive taxation discourages additional efforts or activities).

9. William Vickrey, *The Problem of Progression*, 20 U. Fla. L. Rev. 437, 442 (1968) (stating that, given tax preferences, progressivity encourages individuals to invest in government bonds and wasteful private activities).

10. The list is literally endless. See, for example, Seligman, *Progressive Taxation* at 79-80, 129-30 (cited in note 2) (noting that benefit and faculty theorists argued that taxation should be imposed on property in excess of that necessary for minimum subsistence); Andrew Mellon, *Taxation: The People's Business* 55 (MacMillan, 1924) (proposing income tax that exempts the truly poor from taxation); Simons, *Personal Income Taxation* at 137, 141 (cited in note 5) (advocating exemption for the costs associated with raising dependents); Harold Groves, *Toward a Social Theory of Progressive Taxation*, 9 Nat'l Tax J. 27, 32-33 (1956) (noting that defenders and critics of progressivity are willing to allow a personal exemption for biological necessities and arguing that the exemption is warranted in light of the strong social interest in enabling an individual to meet her social responsibilities); Michael Graetz, *The 1982 Minimum Tax Amendments as a First Step in the Transition to a "Flat-Rate" Tax*, 56 S. Cal. L. Rev. 527, 533 (1983) (advocating a flat tax with an exemption for low income individuals); William Andrews, *A Supplemental Personal Expenditure Tax*, in Joseph Pechman, ed., *What Should Be Taxed: Income or Expenditure?* 127, 129 (Brookings Institute, 1980) (arguing that an expenditure tax should be phased in with an exemption of about \$20-25,000); Smith, 20 U. Fla. L. Rev. at 462-63 (cited in note 8) (noting that progressive rates that exempt the poor from taxation appeal to an "intuitive sense of fairness" but anything beyond that is deeply problematic); Richard Doernberg, *A Workable Flat Rate Consumption Tax*, 70 Iowa L. Rev. 425, 431 (1985) (advocating a tax that exempts the poorest families from taxation altogether and a small tax for low-income families); Charles O'Kelly, *Tax Policy for Post-Liberal Society: A Flat-Tax-Inspired Redefinition of the Purpose and the Ideal Structure of a Progressive Income Tax*, 58 S. Cal. L. Rev. 727, 744-751 (1985) (advocating a personal exemption equal to the minimum wage, which is perceived to be necessary to keep an individual out of poverty); Rebert Hall and Alvin Rabushka, *The Flat Tax* 91 (Hoover Institute Press, 2d. ed 1995) (proposing a flat tax with an exemption for income up to \$25,500 for a family of four); Jeffrey Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 Am. J. Tax Policy 221, 270 (1995) (proposing a head tax with a "degressive rate structure to account for those at a subsistence or lower level" of income); Alan Feld, *Fairness in Rate Cuts in the Individual Income Tax*, 68 Cornell L. Rev. 429, 433-41 (1983) (analyzing historical changes in the tax laws and noting the permanent, though ever-fluctuating, personal exemption and zero bracket levels implemented by Congress). See also John Rawls, *A Theory of Justice* 278 (Harvard U., 1971) (indicating that the taxation system should allow "the usual exemptions for dependents, and so on"); Nozick, *Anarchy, State, and Utopia* at 169-70, 265-68 (cited in note 6) (noting that most people envisage "something like a proportional tax on everything above the

of the widespread perception that advocates of progressivity worry about the poor while its detractors worry about the wealthy.¹¹

In fact, all tax theorists have divided society into two groups—relatively wealthy individuals who pay taxes and poor individuals who are excluded from the face of the laws entirely. Of course, if the goal of tax policy is to distribute the costs of public goods, then offering an exemption to the poor might seem desirable and perhaps even an obvious policy choice, given that the poor have little or no income. While the practical difficulty of collecting the tax explains why theorists have advocated an exemption, it does not explain why they have failed to explore any positive rights beyond an exemption or, indeed, any responsibility the poor might have to society despite their lack of income.

In this Article, I argue that by reaching the agreement that the poor should have no tax liability, the contest over progressivity has centered improperly on the rights and responsibilities of relatively wealthy citizens. The wealthy are widely perceived to have valuable property that, if shared with society, will enable the smooth operation of the democratic state.¹² At the same time, the wealthy are perceived to have liberty interests, which if violated, could lead to the ruin of the domestic economy.¹³

Although the debate over progressivity has lasted for more than a century, traditional tax theorists have limited their discussion to the negative rights of the poor and have never explored fully any positive rights the poor might have. Moreover, theorists have ignored completely any responsibilities the poor might have with regard to the state. Traditional tax theorists, for example, have never investigated in any detail the question of whether poor individuals have a right to basic needs and economic security simply because of their status as citizens.¹⁴ Theorists also have failed to explore the idea that the poor

amount necessary for basic needs" and arguing that it does not go far enough to eradicate the coercive aspects of the system).

11. Alternatively, some identify the debate as one of efficiency versus fairness. See, for example, Arthur Okin, *The Political Economy of Prosperity* 12 (Brookings Institution, 1970) ("Taxation is a key to linking equity and efficiency.").

12. Schmidt, *The Limits of Government* at 1-2 (cited in note 1) (stating that by paying for public goods and services, individuals advance the common good and contribute to a well-ordered society).

13. Barry P. Bosworth, *Tax Incentives and Economic Growth* 9-12 (Brookings Institute, 1984) (noting that market growth and productivity depend on individual incentives to work and invest, and stating that taxation often provides a disincentive to engage in these activities).

14. Three British economists have explored the possibility that the legislature should accord more than an exemption from taxation to the poor. See generally James A. Mirlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 *Rev. Econ. Stud.* 175 (1971) (arguing that maximizing the social welfare function under a utilitarian ethic calls for a tax structure

might have a social duty to contribute their talents and energies to the greater social good despite their lack of income. Indeed, the poor are viewed as having nothing of value to contribute to society. Many political, moral, and economic theorists have argued, however, that access to rights as well as fulfillment of duties are necessary components of one's full membership in a community. Accordingly, I argue that by drawing lines and divisions between taxpayers and nontaxpayers, traditional tax theorists have enabled relatively wealthy individuals to participate in society as full citizens. At the same time, the lines have virtually bound the poor to a subordinate position in society.

This Article begins by placing the progressivity debate within the broader context of tax fairness. Part II examines the underlying concepts of horizontal and vertical equity, the two standards that tax theorists have devised to test the fairness of the tax laws. In this

that awards a cash transfer to the poor); N.H. Stern, *On the Specification of Models of Optimum Income Taxation*, 6 J. Pub. Econ. 123 (1976) (arguing that maximizing the social welfare function under a Rawlsian ethic calls for the tax structure to award a cash transfer to the poor); A.B. Atkinson, *Public Economics in Action: The Basic Income/Flat Tax Proposal* (Clarendon Press, 1995) (exploring the possibility of insuring basic subsistence income for all individuals under a variety of theories). While these authors make an important contribution to the tax literature, they fail to explore in any detail the specific rights of the poor. Moreover, each of the authors entirely ignore the notion that the poor might have some level of responsibility to the state. As I argue in the text, most American tax theorists have failed to recognize the importance of the work of Mirlees, Stern, and Atkinson—and those who have are subject to the same criticisms. See notes 77-80 (discussing the work of Joseph Bankman and Thomas Griffith).

Section 32 of the Code, the provision that provides an Earned Income Tax Credit (EITC) to poor individuals who work in the waged labor market, begins to reflect legislative consideration of both the rights and responsibilities of the poor. While this provision is a welcome advancement to the one-sided debate on the rights and responsibilities of the wealthy, it cannot be argued that this single provision has dramatically shifted the century long focus on the wealthy to a new focus on the poor. See Lawrence Mead, *Beyond Entitlement: The Social Obligations of Citizenship* 2 (Free Press, 1986) (noting that welfare programs are planned and studied by economists who seldom address the issue of rights and responsibilities). In fact, very little has been written on the provision in the legal literature and most of the articles that have explored the EITC have addressed the mechanics of the provision and its shortcomings, rather than its ability to include the poor into the society as full and valuable members. See, for example, Stacy Dickert, Scott Houser, and J. Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, in James Poterba, ed., 9 *Tax Policy and the Economy* 1-50 (National Bureau of Economic Research, 1995) (exploring the determinants of transfer program participation); Ann Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 Harv. L. Rev. 533, 545-89 (1995) (exploring the work and marriage incentives found within the structure of the EITC as well as the problems associated with inaccuracy, unresponsiveness, and noncompliance); George K. Yin, *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 Am. J. Tax Pol. 225, 230 (1994) (noting that the goals of the program are both distributional and behavioral, but failing to explore them). See also Part III.B.3 for a more detailed discussion of the provision and its relationship to the rights and responsibilities of the poor.

Part, I argue that empirical and normative difficulties with horizontal equity (treating likes alike) have reduced the concept to a largely useless principle for tax policymaking. The controversy over fairness thus has centered on vertical equity, or the notion that the tax laws should distinguish between individuals in divergent economic circumstances. The concept of vertical equity, of course, raises the question of the relevant characteristics upon which to base differential treatment. Tax scholars have debated extensively the basis upon which distinctions, if any, should be made, using social contract theory, welfarist theories of distributive justice, and entitlement theories of property. These theories, in turn, have led tax theorists to propose a number of different marginal tax rate schedules ranging from the steeply progressive to the steeply regressive. Despite the number of tax reform proposals grounded on extremely diverse principles and ethical mandates, I note that tax theorists have spoken in almost perfect unison with regard to the proper treatment of the truly poor.¹⁵ All have taken the position that the tax laws should avoid imposing a burden upon those individuals living at or below subsistence levels of income.

In Part III, I seek to uncover the various underlying assumptions that have led tax theorists to advocate such a limited policy with regard to the rights of the poor. In this Part, I explore three possible justifications for tax theorists' narrow focus on the poor's negative right to noninterference by the state. I argue that theorists cannot justify their analytically incomplete approach to taxation. I also argue that the traditional approach imposes a number of hidden costs upon society in general and poor individuals in particular.

Finally, in Part IV, I examine the costs of traditional tax theorists' failure to explore the idea that all individuals, including the poor, have responsibilities to the state. I argue that both rights *and* responsibilities are linked to one's ability to participate in society as a full citizen. Although the poor have no economic resources to contribute, many political theorists outside the taxation debates have considered the importance of community involvement, education, and waged labor to an individual's membership in the community. Indeed, many have argued that the inability to fulfill these community obligations or to maintain some level of civic virtue is as much an obstacle to full membership in society as the lack of equal rights. By failing to investigate the possibility that poor individuals have responsibilities to the

15. See notes 77-80 for a discussion of the limited exception to this general rule.

state, I argue that traditional tax theorists have contributed to the exclusion of the poor from political and social institutions. Accordingly, I explore the possibility of expanding the existing tax structure in an effort to develop a tax-based system of obligations for the truly poor.

II. FAIRNESS IN TAXATION: THE DEVELOPMENT OF A CONCEPT

The traditional means for measuring the fairness of the federal tax laws involves examining the allocation of the tax burden under two distinct standards. Scholars and policymakers view the tax laws as fair if they impose similar economic burdens on similarly situated individuals (horizontal fairness) yet at the same time make appropriate distinctions between individuals in dissimilar economic circumstances (vertical fairness). When closely examined, however, the two notions of equity play very different roles in tax policymaking. The principle of horizontal fairness is riddled with practical and normative difficulties that make it a largely useless standard upon which to base tax policy. Indeed, while horizontal fairness has engendered very little debate,¹⁶ vertical fairness has excited substantial controversy in the tax literature, in legislative debates, and in the popular culture. In this Part, I first explore the limitations of horizontal equity and then explore the debate that has developed around vertical fairness, and in particular, the progressive marginal rate structure.

A. *Horizontal Equity*

Horizontal equity is simply the command that taxpayers in similar economic circumstances be treated similarly under the Tax Code. This notion of fairness is perceived not only to offer protection against arbitrary discrimination under the laws but it also reflects the basic principles of equal worth found in the Fifth and Fourteenth Amendments of the United States Constitution.¹⁷ As a number of

16. Although tax theorists have not completely ignored the concept, it has played more of a rhetorical than a substantive role. This seems to be especially true in the tax literature published since the time that Barbara Fried and Louis Kaplow published their trenchant criticisms of the concept. See notes 20-24 and accompanying text for a brief discussion of their work.

17. U.S. Const. Amend. V, Amend. XIV (all citizens are entitled to "equal protection under the law"). See also *Adarand Constructors, Inc. v. Peña*, 115 S. Ct. 2097, 132 L. Ed. 2d 158 (1995) (indicating that the Fifth Amendment's equal protection mandate is identical to that found in the Fourteenth Amendment); Richard Musgrave, *Horizontal Equity, Once More*, 43 Nat'l Tax J.

scholars both in and out of the tax context have noted, this principle of equality has been a fixture in Western thought for thousands of years.¹⁸

Horizontal equity does not inform policymakers of the full extent of an individual's rights and responsibilities with regard to the state. Rather, once these are identified, horizontal equity simply mandates that the state award the same benefits and impose the same burdens on all similarly situated individuals. Because no two people are alike in every respect, however, equal treatment could only be mandatory for those who are alike in relevant respects. For income tax purposes, like individuals are those who are in similar economic circumstances.¹⁹ Equal treatment of the poor, therefore, would satisfy the mandate of horizontal equity even if that treatment significantly disadvantaged them with respect to the wealthy (and vice versa). Moreover, the notion of horizontal equity has nothing to say with regard to the treatment of individuals in divergent economic circumstances: It neither mandates nor prohibits unequal treatment of differently situated taxpayers. This minimal rule of fairness, therefore, does not provide the necessary criteria for judging the legitimacy of the progressive marginal rates. Despite these limitations, many scholars continue to argue the concept is useful for ensuring tax fairness.

Although horizontal equity theoretically might be a valuable standard for determining the fairness of the tax laws, it is impossible to implement. Professor Barbara Fried's work highlights the difficulty of identifying similarly situated individuals. As Fried notes, individuals realize various levels of "economic rent" or surplus value depending upon where they lie on any given supply or demand curve.²⁰ Consider, for example, two hypothetical savers in similar economic circumstances earning the same market rate of interest on

113 (1990) (noting that horizontal equity is grounded on constitutional principles and arguing that the concept has unique importance for tax policy).

18. Plato and Aristotle first proclaimed the importance of equality of treatment and the concept has dominated Western thought ever since. See Peter Westen, *The Empty Idea of Equality*, 95 Harv. L. Rev. 537, 537-43 (1982) (tracing the development of the notion that likes must be treated alike); Ann C. Scales, *The Emergence of Feminist Jurisprudence: An Essay*, 95 Yale L. J. 1373, 1374 (1986) ("[I]n this country, the engine of the struggle for equality has been Aristotelian: Equality means to treat like persons alike, and unlike persons unlike."); Erwin Chemerinsky, *In Defense of Equality: A Reply to Professor Westen*, 81 Mich. L. Rev. 575 (1983) (arguing that the ideal of treating likes alike is morally, analytically, and rhetorically useful).

19. For a thorough discussion of the concept of income, see Simons, *Personal Income Taxation* at 41 (cited in note 5) (providing a historical analysis of the various definitions of income devised by a number of tax, economic, and political theorists).

20. Barbara Fried, *Fairness and the Consumption Tax*, 44 Stan. L. Rev. 961, 982 (1992) (noting that "marginal revolution" dispelled any assumption otherwise).

their endowment. At first cut, it might appear that horizontal equity mandates the imposition of an identical tax burden on each individual. But imagine that the first saver is on the margin of the supply curve—her cost for deferring consumption (or in economic terms, her reservation price) is identical to the market rate of interest. The second individual, however, has a reservation price below the market rate of interest and thus is a so-called “inframarginal” saver.²¹ In short, both earn the same absolute level of interest but the second taxpayer realizes greater surplus value (i.e. the level of economic gains over her reservation price). Tax theorists who ignore this differential in surplus value improperly ignore important distinctions for horizontal equity purposes.²²

The problem is that it is nearly impossible to identify inframarginal savers in practice—that is, those savers for whom the cost of deferring consumption is lower than the market rate of interest.²³ Nevertheless, because the inframarginal savers are in a

21. Id. at 983.

22. Id. at 982-84.

23. Id. See also Blum and Kalven, *The Uneasy Case* at 67 (cited in note 7) (noting that British economist J.A. Hobson advocates progressive taxation on the grounds that it would tax surplus value and arguing the difficulties associated with taxing only surplus value are “legion”).

The difficulty of identifying similarly situated individuals can easily be seen in the context of the recent consumption tax proposals which are grounded upon concerns for horizontal equity between savers and spenders. Consumption tax advocates argue that savers and consumers are in like economic circumstances and thus are entitled to equal treatment under the Code. The notion that consumers and savers are similarly situated might initially seem surprising in light of the obvious fact that savers earn interest income on their endowment while consumers do not. Consumption tax advocates, however, argue that the two groups are alike due to the costs associated with deferring consumption (“the abstinence theory of interest”) or, alternatively, because the marginal utility of consumption decreases over time (the “declining utility of consumption theory”). Barbara Fried, 44 *Stan. L. Rev.* at 968 (cited in note 20) (uncovering hidden assumptions upon which consumption tax theorists have based their argument).

The abstinence theory of interest acknowledges that the interest earned by the saver generates utility beyond the initial endowment but argues that the saver’s additional utility is offset by the equal psychic costs incurred by deferring consumption for the future. The declining utility of consumption theory ignores the possible psychic costs associated with abstaining from consumption but argues that the subjective value of consumption declines over a taxpayer’s lifetime. Thus, even though the saver might actually consume more upon earning interest, in fact, the utility gained from the greater consumption is identical to the amount that she could have consumed in the earlier year in light of the declining utility of consumption.

Professor Barbara Fried has persuasively argued that while the abstinence theory of interest or the declining utility of consumption theories might prove that *some* savers and consumers are similarly situated, neither proves that *all* savers and consumers are in similar economic circumstances. The consumption tax argument however, only addresses a comparison between a consumer and a saver on the margin but not a comparison between a consumer and an inframarginal saver, thus ignoring significant disparities between the hypothetical

better position than those on the margin, unequal treatment under the income tax does not produce a violation of horizontal equity. Indeed, the mandate of horizontal equity should not even come into play.

Moreover, even if it were possible to identify all individuals who are in like circumstances, scholars and policymakers routinely argue that competing policy considerations must trump horizontal equity concerns. Consider, for example, the fringe benefits an employee obtains from her employer. Fringe benefits clearly provide an economic benefit and thus should be viewed as taxable income under the Federal Income Tax Code. Failure to tax the value of one individual's fringe benefits while taxing the small monetary gains of a second individual clearly violates horizontal equity. Yet this is precisely what the Tax Code does in this situation and countless others for administrative purposes.²⁴

taxpayers. Fried, 44 Stan. L. Rev. at 982 (cited in note 20) (the marginal saver is the implicit hero of consumption tax advocates).

The intuition underlying Fried's insight is based on widely understood economic concepts. Individuals value both current consumption and future consumption, so that an individual will defer consumption only if the value of the deferred consumption is at least as great as the value of the current consumption that is given up. If the market rate of interest goes down and thus reduces the additional consumption an individual will be able to enjoy by saving, then all else being equal, the individual will be less willing to defer current consumption for a later year.

Consider the abstinence theory of interest, which assumes that the market rate of interest is identical to the psychic costs of deferring consumption. Now imagine two hypothetical individuals, Saver and Consumer, each with an initial endowment of \$100 and a market interest rate of 5%. Saver defers consumption and earns 5% interest and thus has access to \$105 in year 2. Under the abstinence theory, however, Saver actually has a bundle of goods worth only \$100 because of the psychic costs of deferring consumption for a year. Thus both Saver and Consumer are in similar positions with similar levels of utility despite their different consumption patterns and despite the interest Saver earned on her \$100. Yet, because Saver under the income tax must pay tax on \$105 (\$100 plus interest) she is taxed more than Consumer despite their similar economic circumstances. According to consumption tax advocates, this account of each individual's utility level proves that the federal income tax violates the mandate that all similarly situated individuals be similarly treated under the tax laws. *Id.* at 968-69.

But now consider a third hypothetical individual who has a personal discount rate of 3% rather than the 5% market rate of interest. In other words, the psychic cost of deferring consumption to this third individual is not the market rate of interest but 2 percent below the market rate. She will continue to save even if the market rate of interest decreases while the saver on the margin will give up saving for current consumption. Accordingly, this inframarginal saver will earn 5% when her psychic costs associated with saving (or in economic terms, her reservation price) is only 3%. At the end of the year she will have a bundle of goods worth \$102 because of her inframarginal position, while both the marginal Saver and Consumer will have just \$100 worth of utility. *Id.* at 983. In short, as Fried notes, the consumption tax advocates have disregarded the inframarginal saver and have made the marginal saver the "implicit hero" of their analysis.

24. I.R.C. § 132 (1996) (excluding fringe benefits from the definition of taxable income). See also Nancy C. Staudt, *Taxing Housework*, 84 Geo. L. J. 1571, 1577-78 (1996) (noting that women's household labor is widely perceived to provide substantial economic income to their families but that the value of this income is left untaxed for administrative purposes). Perhaps

In addition to administrative concerns, efficiency concerns routinely prevail over horizontal equity. Indeed, economists have long argued that the canon of equal treatment of equals in taxation produces irrational tax policy. The economist Edmund Phelps for example, has argued that “[n]o efficient tax system . . . would overlook opportunities to discriminate among sources of income owing to their differing capacities to avoid the incidence of taxation.”²⁵ Efficient taxation, according to Phelps and others, would entail taxing certain individuals more than others based on the inelasticity of their behavior or the their degree of commitment to an activity.²⁶

even more problematic than the failure to tax fringe benefits is the fact that this slight deviation from equal treatment would count as a violation of horizontal equity while legislators could ignore further differential treatment (because the two individuals are now in dissimilar circumstances due the prior differential tax treatment) no matter how significant. Louis Kaplow, *Horizontal Equity: Measures In Search of a Principle*, 42 Nat'l Tax J. 139, 140-41 (1989) (noting that infinitesimal differences in treatment raise horizontal equity problems while further violations can be ignored under the standard).

25. Edmund S. Phelps, *Rational Taxation*, 44 Social Research 657, 658 (1977). See also F.P. Ramsey, *A Contribution to a Theory of Taxation*, 37 Econ. J. 47, 47-61 (1927) (arguing that the most efficient tax is one that taxes in inverse proportion to the elasticity of demand).

26. The argument for discriminatory tax treatment is related to economic theorists' concern for the operation of the free-market economy and the difficulty of reconciling taxation with the free-market ideal. That taxation can be at all consistent with free-market principles is surprising. The principle of taxation is, after all, a “purely communist one, since the right to levy taxes is derived in all countries from so-called national property. For either private property is sacrosanct, in which case there is no such thing as national property and the state has no right to levy taxes, or the state has the right, in which case private property is not sacrosanct.” Friedrich Engels, *Speeches in Elberfeld, February 8, 1945* in 4 *Karl Marx and Friedrich Engels, Collected Works* 254 (International Publishers, 1975). But see Karl Marx and Friedrich Engels, *Manifesto of the Communist Party*, in 10 *Karl Marx and Friedrich Engels, Selected Works* 330-31 (1978) (arguing tax reform will not threaten the foundations of capitalism or redistribute wealth and thus is the “hobby horse of every radical bourgeois”).

Nonetheless the argument with regard to market inefficiencies and taxation relates to the shift in taxpayers' behavior caused by the tax. Consider a tax on wages that reduces a taxpayer's spending power and thus her ability to consume. If the taxpayer seeks to maintain her pre-tax level of consumption, she must work additional hours after the imposition of the tax. In economic terms, the taxpayer incurs an *income effect*. Joseph Stiglitz, *Economics of the Public Sector* 460 (Norton, 1988). The tax on wages, however, does not always produce an income effect. Because the tax reduces the economic benefits associated with waged labor, the individual might decide she values leisure more than consumption in light of the increased number of hours she must work to maintain her pre-tax level of consumption. Thus, rather than working additional hours in the waged labor market, the individual might decide to substitute leisure for work, thereby producing a *substitution effect*. At high income levels, the individual is likely to incur a substitution effect while at low income levels the individual is likely to incur an income effect. See *id.* at 437-504.

The same choices exist when the government imposes a tax on commodities. For example, suppose a tax were placed on butter but not margarine. Consumers might then substitute margarine for butter even though in the absence of the tax, they would prefer butter. Thus the tax will cause a taxpayer to change her behavior, thereby producing market inefficiencies—an individual will choose margarine when she in fact prefers butter. According to economic

The practical application of an efficient tax can be seen in the context of "sin taxes" on alcohol and tobacco products. Studies indicate that goods such as cigarettes and alcohol are price inelastic. Thus, the demand curve for these goods is steep, ensuring that individuals will not turn to other commodities simply because the tax raises its price. According to efficiency-oriented theorists, therefore, the government should tax cigarettes and alcohol at high levels because the tax will not discourage their consumption.²⁷ In short, even if two individuals are in identical economic circumstances, with the only difference being that one is addicted to nicotine while the other is a non-smoker, many efficiency theorists would argue that discriminating between the two individuals is good tax policy in light of the market distortions that equal treatment would produce.²⁸

theorists, taxation will make an individual worse off no matter how she adjusts to the law, but certain taxes produce greater inefficiencies than others.

The extent of the inefficiency produced by the tax can be measured by the excess burden of the tax. The excess burden is tied to the substitution effect; the greater the substitution effect the greater the excess burden of the tax. The most efficient tax, by this standard, is a head tax. A head tax requires each individual to pay a predetermined amount regardless of her income, consumption patterns, or any other personal circumstances. Because the taxpayer could not avoid the head tax by changing her behavior, the tax cannot produce substitution effects. Geoffrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of the Constitution* 34-35 (Cambridge U., 1980); Gareth D. Myles, *Public Economics* 45-46 (Cambridge U., 1995) (noting that a lump sum tax does not avoid the cost associated with implementation and collection). Of course, an individual could avoid the tax by ceasing to exist for tax purposes, for example, by expatriation.

27. Of course, the legislators also might impose a high tax on items such as cigarettes and alcohol in an effort to drive smokers and drinkers out of the market. For an interesting article exploring the economic rationale for doing this and the potential unfairness associated with such a policy, see W. Kip Vicusi, *Cigarette Taxation and the Social Consequences of Smoking*, in James M. Poterba, ed., *Tax Policy and the Economy* 51-101 (MIT Press, 1995). See also Jendi B. Reiter, *Citizens or Sinners?—The Economic and Political Inequity of "Sin Taxes" on Tobacco and Alcohol Products*, 29 Colum. J. L. & Soc. Probs. 443, 449 (1996) (arguing that sin taxes are both regressive and inefficient).

28. This optimal theory of taxation, see note 26, is also relevant in the labor context. Consider, for example, an individual who will work for only \$6 per hour. Any salary below that amount will cause her to leave the waged labor market for nonmarket or leisure activities. The taxpayer has a perfectly *elastic* supply curve for labor. If Congress imposes a 10% income tax, the individual will earn just \$5.40 per hour. Because the taxpayer has decided to work only for \$6 or more an hour, she will quit the waged labor market. Consequently, the taxpayer will have no income, the employer will have no access to labor, and the government will gain no revenue. Taxing elastic behavior, therefore, produces only losses and thus makes no economic sense. Accordingly, optimal tax theorists argue that Congress should impose a tax only upon individuals with *inelastic* labor supply curves. In short, Congress should tax those individuals who prefer market labor over all other activities regardless of the ultimate after-tax salary. A 10% (or even higher) tax rate will not cause individuals with inelastic labor supply curves to give up their market labor and thus the tax will not have a substitution effect and, in turn, will produce fewer inefficiencies in the market. For a specific policy proposal based on these effects, see Edward McCaffery, *Taxing Women* (forthcoming 1997) (pointing to empirical studies indicating that women's waged labor curves are more elastic than men's and taking the position that

This narrow version of horizontal equity, which calls for Congress to impose equal tax burdens on equally situated individuals, therefore raises a number of barriers for policymakers. First, as Professor Fried's work shows, it is next to impossible to identify similarly situated individuals and any attempt to do so will most likely produce the very same inequities that theorists and legislators seek to remedy. Second, policymakers' concern for administrative complexity has produced a number of provisions that exempt certain items from taxation. Although the exemptions and limitations should register a violation of the narrow version of horizontal equity, most theorists would argue any attempt to tax small gains could only lead to further complexity and tax avoidance problems. Finally, economists have argued that even if it were possible to identify similarly situated individuals, it is irrational to pursue a policy of horizontal fairness. Efficiency-oriented tax theorists argue the Federal Tax Code should discriminate between individuals based on the elasticity of their preferences in order to reduce the market inefficiencies associated with taxation.

These theoretical and practical problems have reduced the importance of the traditional command that equals be treated equally under the Code. Consequently, many tax theorists have turned to a more expansive version of horizontal equity as a measure of fairness. The expansive or modified version of horizontal equity requires the preservation of the taxpayer's relative position in the pre-tax distribution of income.²⁹ In other words, horizontal equity might also encompass the appeal to maintain the relative rank ordering of taxpayer wealth prior to the imposition of the tax.³⁰ This version of horizontal

Congress should tax men at higher rates than women to avoid the problematic substitution effects).

29. See, for example, M.A. King, *An Index of Inequality: With Applications to Horizontal Equity and Social Mobility*, 51 *Econometrica* 99, 99-115 (1983) (advocating broad version of horizontal equity). See also Marcus C. Berliant and Robert P. Strauss, *The Horizontal and Vertical Equity Characteristics of the Federal Income Tax, 1966-1977*, in Martin David and Timothy Smeeding, eds., *Horizontal Equity, Uncertainty, and Economic Well-Being* 179-80 (U. of Chicago, 1985) (noting that the narrow version of horizontal equity is logically separate from the more expansive notion of horizontal equity). See also note 30. The expansive version of fairness dates back to the nineteenth century. See, for example, J.R. McCulloch, *A Treatise on the Principles and Practical Influence of Taxation and the Funding System* 17 (William Clones and Sons, 1863) ("[N]o tax on income can be a just tax unless it leaves individuals in the same relative condition in which it found them.").

30. The mandate that tax policy must maintain the rank ordering is significantly different from the mandate of treating likes alike. For example, consider four hypothetical taxpayers A, B, C, and D. In the pre-tax distribution of income, A and B both have \$10, and C and D each have \$100. According to the narrow definition of horizontal equity, merely requiring likes be

fairness, therefore, calls for policymakers not only to treat likes alike, but it also calls for policymakers to preserve the existing inequalities of wealth.

Unlike the narrow version of horizontal fairness, the expansive version seriously circumscribes the extent to which policymakers are permitted to treat taxpayers differently under the vertical fairness norm. By protecting an individual's relative rank in the distribution of wealth, the expansive version of horizontal fairness does not permit policymakers to equalize wealth or to give tax subsidies that push the income of one individual up to or beyond that of another with greater pre-tax income. Accordingly, if tax theorists and policymakers embrace the expansive version of horizontal fairness, they in effect take a position in the progressivity debate. They argue that while some level of progressivity might be justified, the progressive marginal rates cannot be so steep that they reverse the rank ordering of taxpayers in the distribution of wealth.³¹ Thus, if the narrow version of horizontal equity is of little use in taxation as I have argued, then the only relevant question for tax theorists relates to vertical equity—or on what basis and to what extent is differential treatment between individuals justified?³² Accordingly, this Article focuses on the theoretical arguments made in the progressivity debate with regard to the concept of vertical equity.

treated alike, A and B must both suffer the same tax burden, as should C and D. Thus, if A and B both owe \$1 while C and D each owe \$99, producing a post-tax distribution of income where A and B have \$9 while C and D each have \$1, there is no violation of the narrow version of fairness. If the more substantive version is used, however, the tax burdens would register a violation of horizontal fairness because the relative rank-ordering of the individuals has changed with the imposition of the tax. See Berlian and Strauss, *Horizontal and Vertical Equity*, in David and Smeeding, eds., *Horizontal Equity, Uncertainty, and Economic Well-Being* at 179-80 (cited in note 29), for a variety of other hypotheticals proving this point.

31. Tax theorists routinely characterize the mandate that an individual's relative position in the pre-tax distribution of income be maintained as an aspect of horizontal equity and not vertical equity. See Fried, 44 *Stan. L. Rev.* at 999-1016 (cited in note 20) (indicating that the ethical mandate to preserve an individual's position in the pre-tax distribution of income is a horizontal equity concept); Kaplow, 42 *Nat'l Tax J.* at 146-50 (cited in note 24) (same). But see Berlian and Strauss, *Horizontal and Vertical Equity*, in David and Smeeding, eds., *Horizontal Equity, Uncertainty, and Economic Well-Being* 180-82 (cited in note 29) (arguing the expansive version of horizontal equity is more accurately characterized as a vertical equity concept).

32. In short, horizontal equity, in the trenchant words of a Peter Westen, is an idea that should be "banished from moral and legal discourse as an explanatory norm." Westen, 95 *Harv. L. Rev.* at 542 (cited in note 18). It adds nothing to the debate and perhaps even obscures the important issues at hand. But see Kenneth L. Karst, *Why Equality Matters*, 17 *Ga. L. Rev.* 245, 246 (1983) (arguing that the notion of equality is not a simple abstraction but a substantive ideal).

B. Vertical Equity and the Progressivity Debate

While horizontal equity calls for the equal treatment of equals, vertical equity entails appropriately differentiating among individuals in dissimilar economic circumstances. The legitimacy of the vertical equity norm has been the source of political, moral, and legal debate throughout the history of federal income taxation. Prior to the time Congress adopted the first federal income tax in 1894 most argued the state must avoid distinguishing between citizens regardless of their differing economic circumstances. Countless theorists argued that the opportunity to distinguish between individual citizens could only lead legislators to adopt tax laws that reflected their own or their constituents' class biases.³³ This fear of undeserved preferential treatment prompted many early theorists to argue against any notion of vertical equity.

By the turn of the twentieth century, however, support for the idea that fairness requires differentiation between individuals began to swell. Indeed, many claimed that Congress not only must consider questions of vertical equity, but also must implement progressive marginal tax rates that require the wealthy to contribute a greater percentage of their income to the public good than the poor. Understanding this turn in tax theory and the controversy it has sparked requires a brief historical exploration of the development of the income tax laws.

Prior to 1894, Congress had used a system of tariffs and commodity taxes which resulted in a steeply regressive tax system. By imposing a tax on imported and domestic commodities, Congress ensured that all consumers contributed precisely the same amount to the federal government upon each purchase. In short, not only were individuals in like circumstances treated alike, but individuals in differing economic circumstances were also treated alike. Because the poor consumed a greater percentage of their wealth than did the rich,

33. Randolph Paul, *Taxation in the United States* 2-36 (Longmans, Green and Co., 1954) (discussing early taxation theory). See also Jennifer Nedelsky, *Private Property and the Limits of American Constitutionalism: The Madisonian Framework and Its Legacy* 1-67 (U. of Chicago, 1990) (providing a fascinating historical account of the Framers' worries about class bias and the possible approaches for remedying this potential problem in legislation).

however, this uniform tax treatment caused the poor to contribute a greater percentage of their wealth to the public good.³⁴

Populist social reformers argued that the regressive tax system played a key role in the unequal distribution of income that ultimately relegated the poor to an uneasy economic existence while the wealthy indulged in a more luxurious lifestyle. The social reformers argued that Congress must redeem "the overburdened and discouraged working people" by making legal distinctions between individuals and by replacing the regressive tax structure with a progressive one.³⁵ The Populists, in effect, suggested that Congress should transform its notion of equity from one of "equal treatment of all" to one that encompassed concerns for individuals in divergent economic circumstances.

Economic historians interested in the development of the federal income tax structure argue that it was the Populist argument that prompted the federal legislature to consider the concept of vertical equity. In its effort to achieve greater social justice in the law,³⁶ Congress adopted a two percent tax on annual income exceeding \$4,000 in 1894.³⁷ Since the average income was well below \$1,000, the vast majority of the population would not pay the federal income tax.³⁸ Although reformers applauded the tax, others viewed it as an

34. See Robert Stanley, *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913* at 13 (Oxford U., 1993) (noting the regressive nature of the tariff troubled even its authors).

35. Of course, vertical equity does not necessarily lead to a particular tax structure. Indeed, distinguishing between individuals could produce a tax system that is progressive, proportional, or regressive. The tax structure that policymakers choose pursuant to the constraints of vertical equity depends on the underlying theory of justice and key economic assumptions. Certain widespread assumptions and theories of justice, however, have led federal legislators to adopt and maintain a progressive marginal tax system since 1894.

36. See, for example, Roy Blakey and Gladys Blakey, *The Federal Income Tax* (Longmans, Green and Co., 1940) ("[T]he [federal] income tax . . . had only a loose causal connection with the Civil War income taxes; it was really the result of a great equalitarian movement generated by two prolonged post-war depressions of great severity."); Randolph Paul, *Taxation in the United States* 30-70 (Little, Brown, 1954) (federal income legislation was the symbol of populist reform); Sidney Ratner, *Taxation and Democracy in America* 145-192 (Wiley, 1967) (arguing that the Populist revolt encouraged legislators to incorporate the interests of the poor in tax legislation); John K. Buenker, *The Income Tax in the Progressive Era* 40 (Garland Publishers, 1985) (stating that the income tax was tied to the Populist notion that the burden should be shifted from consumers, laborers, and farmers to financiers and capitalists who had benefited under the tariff and through industrial expansion); John F. Witte, *The Limits of Symbolic Reform* 70-75 (Wisconsin U. Press, 1985) (noting that the Populist agenda was supported by the legislators who proposed the income tax); Ronald F. King, *Money, Time, & Politics* 94 (Yale U., 1995) (noting that the Democrat's left-wing proponents of the income tax saw themselves as defending fundamental democratic values against the selfish demands of the wealthy).

37. James W. Ely, Jr., *The Chief Justiceship of Melville W. Fuller, 1888-1910*, 117-25 (U. South Carolina, 1995) (discussing the details of the tax and the Supreme Court's response).

38. Buenker, *Income Tax in the Progressive Era* at 348 (cited in note 36).

illegitimate exercise of the federal government's power. The progressive rate system, it was argued, clearly violated the most basic tenet of fairness—that the government treat all citizens alike regardless of personal circumstances. Not only would the income tax produce varying effects on citizens based on their level of income, it would also produce a geographic bias because the northeast section of the country had far greater income than the other areas of the country. Many commentators saw the income tax as so out of line with American values at the time it was adopted that its advocates were labeled “communists” and “socialists” who were seeking an “undemocratic” measure that would penalize hard work and ruin the domestic economy.³⁹

39. *Id.* at 11. Immediately upon Congress's adoption of the tax, Charles Pollock filed suit in the Southern District of New York arguing that the tax directly violated the Constitution. The district court verdict was appealed to the Second Circuit Court of Appeals and then argued twice in the Supreme Court. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 430 (1895); *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 602 (1895) (rehearing). Finding that the Constitution gave Congress the power to tax, but not the power to impose an income tax with a geographical bias, the Court declared the tax unconstitutional. *Id.* at 634-37.

Despite the Court's holding in *Pollock*, popular interest in the income tax remained strong. Many theorists argued that the Court simply misinterpreted the Constitution and took the position that Congress should reenact the legislation despite the unfavorable *Pollock* decision. Ultimately, Congress proposed the Sixteenth Amendment to the Constitution which, when ratified, provided, “The Congress shall have the power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” In effect, the Sixteenth Amendment gave the federal government the power to adopt the income tax. Bunker, *Income Tax in the Progressive Era* at 386 (cited in note 36) (discussing the amendment process and the amendment itself).

Like the progressivity debate, the *Pollock* decision itself has been the subject of much debate. The *Pollock* decision sparked a strong public reaction that reflected the divisiveness of the issue at the time it was decided. Newspapers around the country reported that the *Pollock* decision was the final blow to communism while others complained the Supreme Court had frustrated the popular will of the people. Ely, *Chief Justiceship of Melville W. Fuller* at 117-25 (cited in note 37). The debate over *Pollock* continues even now among historians. Many historians argue the Court sought to protect the interests of wealthy citizens subject to the tax when invalidating the law. See, for example, Stanley, *Dimensions of Law in the Service of Order* at 136-175 (cited in note 34). Others argue that the Court did not seek to safeguard wealthy individuals as a class, but rather hoped to restrain the hand of the federal government in light of its potential to adopt measures that would work to the advantage or disadvantage of any identifiable group. See, for example, Ely, *Chief Justiceship of Melville W. Fuller* at 117-25 (cited in note 37). Ely's argument, of course, does not preclude the argument that the Court nevertheless hoped to protect the wealthy. In limiting the federal government's taxing power the Court indicated it would “prevent an attack upon accumulated property” by the majority, who were not property owners. *Pollock*, 157 U.S. at 583. In short, the Court seemed worried that, left to its own devices, the democratic political process would produce laws that systematically advanced the interests of the poor majority while imposing costs on the wealthy minority. See Nedelsky, *Private Property* at 16-66 (cited in note 33) (noting that the Framers of the U.S. Constitution had precisely this worry).

The progressive marginal rate structure clearly reflected a concern for the economic interests of the poor. By taxing the wealthy and excluding the poor from the scope of the laws, the legislature unambiguously advantaged the poor. At the same time, however, the rates set the stage for a century of debate over the rights and responsibilities of the wealthy and the simultaneous exclusion of the poor from taxation discourse.

In the next four subparts, I explore the various theories put forth either in support or as criticism of progressivity. The affirmative case for the progressive tax rates has rested largely on early social contract theory and a welfarist conception of distributive justice.⁴⁰ The case against progressivity has rested primarily on the entitlement theory of justice and efficiency concerns. While tax theorists are deeply divided on the legitimacy of progressivity, they are not divided on the question of how to treat the poor. Throughout this Part, I show that this consensus has led theorists to ignore completely the possibility that the poor have either a right to income beyond a minimal exemption from taxation, or a responsibility to the state despite their disadvantaged economic circumstances.

1. Early Social Contract Theory

Early theorists argued that individual tax burdens should be commensurate with the economic benefits an individual obtained from the state. The idea underlying this benefit theory of taxation grew out of Thomas Hobbes's general political theory, which conceived of the state as an agency with both protective and coercive powers.⁴¹ Using the principles underlying Hobbes's political theory, early tax theorists argued that the state legitimately could coerce its citizens to pay for the valuable goods and services it provided just as if an

40. For a discussion of these theories and various other theories supporting progressive taxation, see Elmer D. Fagan, *Recent and Contemporary Theories of Progressive Taxation*, in Richard Musgrave and Carl Shoup, eds., *Reading in the Economics of Taxation* 19-53 (Irwin, 1959) (discussing the sacrifice theories, the faculty theory, the surplus income theory, the social importance theory, and the socio-political theory).

41. Thomas Hobbes, *Leviathan* 238 (Cambridge U., 1991) (asserting that both the wealthy and the poor benefit from the government's protective measures and thus should pay for such benefits). See also Stephen Weston, *Principles of Justice in Taxation* 76-98 (AMS Press, 1968) (discussing the derivation of the benefit theory and the work of Thomas Hobbes, John Locke, and Jean Jacques Rousseau). For a discussion of modern contractarian theory, see Jody S. Kraus, *The Limits of Hobbesian Contractarianism* 27-36 (Cambridge U., 1993); for a discussion of the idea in contemporary politics, see generally D. Lee Bawden, ed., *The Social Contract Revisited: Aims and Outcomes of President Reagan's Social Welfare Policy* (Urban Institute Press, 1984).

individual had contracted for them in the private market.⁴² The case for progressivity under the benefit theory rested on the idea that the wealthy derived a greater level of governmental benefits than the poor and thus were contractually obligated to pay a greater portion of the costs of public goods.⁴³

While the benefit theory was attractive in theory and garnered much support, considerable disagreement existed with regard to the measure of the benefits received by individuals at different income levels. Although most agreed that the social contract called for the government to protect private property, which in turn encouraged market activities and ultimately created greater opportunities for all citizens, many argued that as an empirical matter it was next to impossible to identify the actual benefits one obtained from the state. Accordingly, the notion that the wealthy received more and thus should pay more was deeply disputed. Indeed, some argued that the benefits derived from government activities could inure to the poor to a greater extent than to the rich.⁴⁴ Moreover, the very notion of identifying the value of social goods made little sense to some theorists. In critiquing the benefit theorists, John Stuart Mill argued that "the practice of setting definite values on things essentially indefinite, and making them a ground of practical conclusions, is particularly fertile in false views of social questions."⁴⁵

42. See, for example, Adam Smith, *Wealth of Nations* 651 (London, Routledge & Sons, 1900) ("The expense of government to the individuals . . . is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their interests of the estate."); Nassau Senior, *Political Economy* 74-75 (London, Griffith, 1874) (stating that the collection of revenue should be determined by the same principles that determine all economic exchanges); Arthur Latham Perry, *An Introduction to Political Economy* 516 (Scribner & Sons, 1874) (asserting that taxation finds a "ready and solid justification in the common principles of exchange"); Erasmus Peshine Smith, *Political Economy* 264 (G.P. Putnam, 1853) ("As government renders services to each and every one of its constituents, everyone ought to contribute to the expense of its maintenance in the ratio that he receive advantage.").

43. Seligman, *Progressive Taxation* at 181-228 (cited in note 2) (exploring the work of twenty-seven English, French, and German political theorists who advocated progressive taxation under the benefit theory). Of course, the wealthy would have to derive a much greater absolute level of benefits to justify a proportional tax, let alone a progressive tax.

44. See John Stuart Mill, *Principles of Political Economy* 805 (Longmans, Green, 1920) (arguing that citizens with great wealth or high levels of consumption did not necessarily benefit from governmental goods and services and, in fact, might rely on the government less than "those who were weakest in mind or body"); Weston, *Principles of Justice* at 127-38 (cited in note 41) (noting that the German economist Karl von Hock and the French economist Simone de Sismondi both argued that the benefits of the government did not accrue simply because of property ownership but also involved immaterial qualities such as "honor, glory, education, and national well-being").

45. Mill, *Principles of Political Economy* at 805 (cited in note 44).

A notable aspect of the tax theorists' use of Hobbes's political theory in the sphere of taxation was the lack of significant disagreement over the treatment of the poor. Most benefit theorists argued that individuals living at or below the subsistence levels of income should be completely exempt from taxation.⁴⁶ While widespread agreement on this matter existed, the underlying rationale for exempting the poor under a theory that viewed taxation as part of a contractual relationship between individual citizens and the state was unclear. Although the exemption from taxation implicitly reflected the view that poor individuals were entitled to keep their minimal economic resources, the early social contract theorists did not thoroughly investigate this idea. Some theorists argued that the poor had no duty to contribute because they did not participate in the protection and enjoyment of the state.⁴⁷ The accuracy of this claim, however, was widely disputed while the exemption of the poor from taxation was not.⁴⁸ Other theorists argued that the underlying rationale for releasing the poor from the social contract was simply the practical impossibility of collecting anything of value from the poor. In commenting on the impossibility of actually collecting a tax from an individual simply because he was a citizen of the state, Jeremy Bentham noted, "because a man has a head, it does not follow he has anything else."⁴⁹

Theorists failed to explore the possibility that the benefit theory mandated that all individuals, wealthy and poor, contribute to the public good, be it through property or some other form of

46. See, for example, Jeremy Bentham, *Principles of the Civil Code*, in II *Collected Works* 319 (Russell and Russell, 1962) (arguing that the poor should be exempt from taxation); James Steuart, *An Inquiry into the Political Economy* 298, 314, 317 (U. of Chicago, 1966) (stating that whatever individuals consume beyond the necessary should be taxed). See also Seligman, *Progressive Taxation* at 150-53 (cited in note 2) (noting that even those committed to proportional taxation under the benefit theory in fact advocated a degressive tax that accounted for an exemption for minimum subsistence levels of income). But see Smith, 2 *Wealth of Nations* at 476-77 (cited in note 42) (arguing that taxation will not harm the poor because wages will naturally increase to enable subsistence living).

47. Seligman, *Progressive Taxation* at 187-92 (cited in note 2) (identifying German and French tax theorists who took the position that the wealthy gain more from the state than the poor).

48. The benefit theory was first criticized for its inability to provide guidance for determining how much an individual could or should pay in light of her individual circumstances. To this criticism, benefit theorists argued that "bakers and grocers do not sell commodities for prices that vary with the purchasers' income and thus tax policy should not be forced to accommodate individuals' varying levels of income." Seligman, *Progressive Taxation* at 105 (cited in note 2) (discussing the critique of the benefit theory).

49. Bentham, *Principles of the Civil Code*, in II *Collected Works* at 319 (cited in note 46).

contribution.⁵⁰ Of course, this failure to consider the potential obligation of the poor to contribute to the public good may have worked to advance the interests of the poor. By releasing them from any obligation to contribute to the greater social good, the benefit theorists avoided pushing poor individuals deeper into poverty. Even more importantly, social contract theorists avoided the conclusion that without access to valuable property, the poor must contribute labor—the only resource that many possessed.

At the same time, however, the tax theorists' failure to consider the possibility that all individuals should contribute may have been more detrimental than beneficial to low-income individuals. The assumption that the poor had nothing of value to contribute to society leads to the idea that the poor are not valuable citizens, but are a burden upon the state and society-at-large. It ignores the possibility that all individuals must benefit *and* contribute in order to fully participate in the political and social institutions found in a democratic state.⁵¹ Thus while the benefit theorists raised serious and difficult questions with regard to the obligations of individual citizens under the social contract, they analyzed this issue only with regard to the relatively wealthy. The failure to bring to the surface and to discuss explicitly discuss the responsibilities of citizens at all income levels foreshadowed a tradition in tax theory that has been followed by a surprising range of political, economic, and moral theorists in the taxation context.

The potential for the Tax Code to facilitate contributions by the poor to the greater social good, despite their lack of economic resources, is explored in Part IV below.

2. Utilitarianism

By the early twentieth century, tax theorists had rejected the early social contract theory of taxation and looked to a welfarist (or end-state) theory of justice as a means for justifying the allocation of

50. The inability to contribute income does not necessarily lead to the conclusion that one must contribute services. See Part IV for a discussion of how the poor might satisfy a duty to contribute without adopting laws that, in effect, coerce their labor.

51. Actively participating in social and political institutions is viewed by many theorists to be a key aspect of one's full citizenship status. See, for example, Will Kymlicka and Wayne Norman, *Return of the Citizen: A Survey of Recent Work on Citizenship Theory*, 104 *Ethics* 352, 352-53 (1994) (providing an excellent survey of recent theoretical work focusing on the rights and obligations of citizens).

the tax burden.⁵² Welfarist theories, in general, judge the goodness of a society by the welfare or utility of the individual citizens.⁵³ Utilitarianism, in particular, judges the welfare of society according to the unweighted sum of the utilities of its members. Although proponents of utilitarianism desire to maximize welfare, they do not focus on or advocate any particular distribution of income.⁵⁴ Instead, a utilitarian would argue that any distribution of wealth is good to the extent that it maximizes overall welfare. Utilitarians, therefore, analyze vertical fairness with the aim of maximizing society's overall utility rather than the level of benefits any particular individual derives from the public goods themselves. Thus utilitarianism imposes a moral obligation upon citizens to pay taxes pursuant to a tax structure that minimizes overall costs—or maximizes aggregate utility. This obligation exists even if a policy calls for certain individuals to pay more than others for the common good. In short, a utilitarian is not interested in the advantages and disadvantages to specific individuals but instead is focused on aggregate welfare.

John Stuart Mill was one of the earliest writers to expressly consider utilitarianism in the context of taxation.⁵⁵ Mill argued that by requiring each citizen to incur an equal sacrifice, policymakers would minimize overall sacrifice.⁵⁶ Equality of sacrifice, however, did

52. Theorists have not completely rejected the early social contract theory, but have sought to modify it in order to account for the fact that no individual would enter a contract that bound them to poverty. See, for example, Rawls, *A Theory of Justice* at 266 (cited in note 10).

53. The entitlement theory is more extensively discussed in Part II.B.4.

54. See generally Amartya Sen and Bernard Williams, eds., *Utilitarianism and Beyond* (Cambridge U., 1982) (collection of fourteen essays for and against the utilitarian ethic). See also Bankman and Griffith, 75 Cal. L. Rev. at 1949 (cited in note 2) (briefly describing utilitarianism and various other theories of distributive justice and their relationship to taxation).

55. Weston, *Principles of Justice in Taxation* at 187-88 (cited in note 41).

56. Mill, *Principles of Political Economy* at 804 (cited in note 44). Although Mill's position seems to call for identical tax burdens, many theorists have noted that Mill, in fact, argued that individuals pay an equal proportion of their income and not an equal amount. See, for example, Fagan, *Recent and Contemporary Theories of Progressive Taxation* at 20 n.2, in Musgrave and Shoup, eds., *Readings in the Economics of Taxation* (cited in note 40). See also Barbara Fried, *Robert Hale and Progressive Legal Economics* ch.4 (forthcoming Harvard U.) (discussing in detail Mill's position on "equal sacrifice").

While many contemporary tax theorists applaud the concept of equal sacrifice, its meaning is far from clear. Indeed there were and continue to be at least two variants of the equal sacrifice theory—each supported by a different philosophical argument. Entitlement theorists intent on protecting the income earned in a fair exchange argue for a tax structure that requires an equal absolute sacrifice. Pursuant to this approach, the tax system would require each individual to pay an identical amount in taxes regardless of individual economic circumstances. The head tax would produce an equal absolute sacrifice by all citizens and is advocated by some entitlement theorists. Schoenblum, 12 Am. J. Tax Pol. at 258-71 (cited in note 10). Another variation of the sacrifice theory often advocated by theorists uncomfortable with the head tax but committed to the notion of "equal treatment" is a tax system that requires an equal propor-

not necessarily lead to the conclusion that each individual should pay an equal amount to the greater social good. Indeed, prominent tax and economic theorists at the turn of the twentieth century persuasively argued that to ensure equality of sacrifice, Congress must adopt progressive marginal tax rates.

The claim for progressivity was grounded in the notion that money had decreasing marginal utility. Political and economic theorists argued that beyond the satisfaction of basic needs, the utility of additional wants and preferences diminishes.⁵⁷ Accordingly a dollar has less value to a millionaire than to a pauper. Based on the decreasing marginal utility of income theory, theorists argued that to take the same number of dollars from both the wealthy and the poor was not to require an equal sacrifice. Although taxing both under the same marginal rate would not affect the absolute level of revenue obtained by the government, it would affect overall utility. The utilitarian calculus, therefore, called for a progressive marginal rate system that imposed a greater tax on the wealthy than on the poor, but imposed the same costs in terms of utility.⁵⁸

As many utilitarians noted, the idea that income has declining marginal utility along with the ethical mandate to maximize overall

tional sacrifice from each citizen. A flat tax would require each citizen to contribute the same percentage of income to the government and thus would entail an equal proportional sacrifice to the public good. The flat tax recently advocated by Representative Dick Armey and 1996 presidential candidate M. Steven Forbes would have had this effect. Importantly, each approach allows for an exemption from taxation for the truly poor. For a discussion of these issues, see Donna M. Byrne, *Progressive Taxation Revisited*, 37 *Ariz. L. Rev.* 739, 766 (1995) (exploring the various meanings of equity in the tax context).

57. See, for example, Francis Ysidro Edgeworth, 2 *Papers Relating to Political Economy* 240 (MacMillan, 1925); Blum and Kalven, *The Uneasy Case* at 41 n.103 (cited in note 7) (agreeing with the notion that "income below the subsistence level has infinite utility"); M. Hare, *Ethical Theory and Utilitarianism*, in Amartya Sen and Bernard Williams, eds., *Utilitarianism and Beyond* 27 (Cambridge U., 1982) (noting the decreasing marginal utility of all commodities and of money justifies a fairly high degree of equality of individual's access to goods).

58. Specifically, Mill argued:

As government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all, which, it must be observed, is *the mode by which least sacrifice is occasioned on the whole*. If any one bears less than his fair share of burden, some other person must suffer more than his share, and the alleviation to the one is not, *ceteris paribus*, so great a good to him, as the increased pressure upon the other as an evil. Equality of taxation, therefore, as a maxim of politics means equality of sacrifice. It means apportioning the contribution of each person toward the expense of government so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.

Mill, *Principles* at 804 (cited in note 44).

utility could lead to a tax structure that taxes the rich for the benefit of the poor up to the point at which equality of income is achieved. Because poor individuals gain greater utility from each dollar than wealthy individuals, cash transfers from the rich to the poor are justified under the utilitarian ethic until equality of income is attained. Thus income above the mean would be taxed at a 100% rate, and all individuals with incomes below the mean would receive cash transfers to bring their income up to that level.⁵⁹ Although theorists acknowledged that a pure utilitarian ethic would lead to equality of income, few, if any, endorsed this outcome. Instead, utilitarian theorists argued that policymakers should impose a tax burden on the wealthy far below 100% and at the same time should not redistribute wealth to the poor on such a grand scale, but simply should exclude them from taxation. A marginal tax rate of 100%, it was argued, would curb wealthy individuals' incentive to work and at the same time redistribution would operate as a disincentive for the poor to enter the waged labor market.⁶⁰ Accordingly, the utilitarians, like the early social contract theorists, argued for less steep progressive rates along with an exemption for the poor from taxation.

While many theorists questioned the rationality of a tax structure that confiscated all income above the mean due to the market disincentives, some also questioned the accuracy of the decreasing marginal utility curve of money for individuals at all income levels. Accurately comparing the utility level of each additional dollar gained by persons at different income levels, it was argued, was impossible.⁶¹

59. See Bankman and Griffith, 75 Cal. L. Rev. at 1947 (cited in note 2). See also F.Y. Edgeworth, *The Pure Theory of Progressive Taxation in Economic Justice* 371, 373-74 (Penguin, 1973).

60. Thomas Carver, *The Minimum Sacrifice Theory of Taxation*, 19 Pol. Sci. Q. 66 (1904); Thomas Carver, *The Ethical Basis of Distribution*, 6 Annals of the Am. Acad. Pol. & Soc. Sci., 73, 73-79 (1895). See also Seligman, *Progressive Taxation* at 847-69 (cited in note 2) (citing a number of political economists who worried about the negative effects of a steeply progressive tax yet still advocated progressivity).

61. Seligman, *Progressive Taxation* at 847-69 (cited in note 2). Walter Blum and Harry Kalven have perhaps noted the problem in the most clear terms. Blum and Kalven argue:

Men have long speculated over whether the man in the palace is happier than the man in the cottage. On the one hand there is no doubt that money is good and that it is desirable. On the other hand, it seems that whenever we try to state more precisely its relationship to happiness the result approaches an absurdity. The error lies in trying to translate money, which can be measure in definite units, into corresponding units of satisfaction or well-being. In the end satisfaction in the sense of happiness defies quantification. Utility is a meaningful concept; units of utility are not. It is in the face of this difficulty, even waiving all other objections, the whole elaborate analysis of progression in terms of sacrifice and utility finally collapses

Blum and Kalven, *The Uneasy Case* at 63 (cited in note 7).

Indeed, even theorists sympathetic to progressivity have acknowledged that while individuals living in poverty derive infinite value from each dollar, a stronger claim with regard to

At the same time, however, even theorists critical of the decreasing marginal utility curve theory were willing to acknowledge that income has *infinite utility* to individuals living below the subsistence level.⁶² Accordingly, utilitarian theorists could have advocated a tax system that would not promote equality of income but would redistribute wealth in a more modest fashion, ensuring that all individuals had basic subsistence income. This approach would have produced a higher level of utility without reaching the "acme of socialism."⁶³ Thus, although the utilitarians hesitated to implement a scheme that equalized incomes, simply exempting the poor from taxation was not the only policy choice available. Nevertheless, like tax theorists who used Hobbes's political theory to justify taxation, the early utilitarians simply advocated an exemption from taxation but failed to consider the full potential of their underlying principles.

Although early utilitarians focused primarily on the decreasing marginal utility of income theory to argue for progressivity, modern utilitarians have been less convinced of the validity of this theory given the difficulty of interpersonal comparisons. Moreover, modern utilitarians writing in the taxation context are primarily concerned with the market incentives and disincentives found within the Code. The graduated tax rate system, it is argued, reduces the market labor supply, encourages individuals to invest capital in unproductive activities, and forces society to incur costs associated with the administration of the complex rate structure. While tax theorists widely dispute the extent to which progressivity exacerbates these problems,⁶⁴ there is no disagreement that the graduated rate system is

the marginal utility of income to all other individuals is impossible to prove. Consequently, many scholars and theorists committed to progressive taxation have turned elsewhere for support of the graduated rate system. Many advocates have simply argued that while the marginal utility of income cannot be pinned down, it remains clear that the rich have a greater ability to pay than do the poor. While the ability to pay theory clearly exempts individuals at subsistence levels of income from taxation, it does not necessarily lead to progressivity. A proportionate tax, for example, that requires high income individuals to pay a greater absolute amount of income to the government but the same percentage of income as low income individuals is consistent with the notion that one's ability to pay should be the underlying principle of the tax laws. Ultimately, some sacrifice theorists have defended progressivity not on objective findings or logic but on "ethics or aesthetic judgment." See, Simons, *Personal Income Taxation* at 18 (cited in note 5).

62. Groves, 9 Nat'l Tax J. at 33 (cited in note 10) (poor individuals get "infinite utilities" from each dollar). See also authorities cited in note 61.

63. Seligman, *Progressive Taxation* at 845 (cited in note 2).

64. See Alstott, 108 Harv. L. Rev. at 545 (cited in note 14) (recognizing that taxation often works as a disincentive to work but arguing that "it is essential to distinguish disincentives from the effects of those disincentives on behavior"); Bankman and Griffith, 75 Cal. L. Rev. at

inefficient, at least to some degree. These inefficiencies, in turn, reduce market growth and overall wealth. Because modern utilitarians often view market growth as the key to maximizing overall utility, they have generally opposed progressivity.

The negative effects of the graduated rate structure are related to the substitution effects produced by taxation.⁶⁵ While an individual's responsiveness to changes in the tax rates are conditioned on many forces, including personal preferences and social mores, a number of empirical studies have demonstrated that high marginal tax rates decrease the time that many individuals are willing to spend in the waged labor market.⁶⁶ Thus, as the level of taxation increases, the number of market participants willing to remain in the market decreases. As individuals move out of the wage labor market and into non-market activities, overall market productivity and aggregate wealth also decrease. Accordingly, modern utilitarian theorists have argued that a better approach to taxation would entail proportionate or even regressive marginal tax rates that avoid the inefficiencies associated with the graduated rate system.⁶⁷

1922-23 & nn.67, 68, 69, 72 (cited in note 2) (describing various approaches for estimating the elasticity of waged labor and citing to over thirty different empirical studies).

65. In the context of market labor, the extent of the substitution effect is related to an individual's relative preference for consumption over leisure. Because individuals value both consumption and leisure, an individual will work only if the value of the additional consumption is at least as great as the value of the leisure she gives up. Imposing an income tax reduces the amount of additional consumption an individual will be able to enjoy by working an extra hour. An individual who is willing to give up an hour of her leisure time for six dollars' worth of consumption, for example, will only work if her after-tax salary is six dollars. If Congress imposes an income tax that reduces the individual's after-tax salary to below six dollars, the individual will refuse to sacrifice an hour of leisure. Thus if the market wage is seven dollars per hour and Congress imposes a 10% tax, the taxpayer will have \$6.30 of post-tax income and the individual will continue to work. If Congress imposes a 20% tax, however, the taxpayer will have just \$5.60 of after-tax income and will refuse to work in the wage labor market. See note 26 for a further discussion of substitution effects.

66. See M. Killingsworth and J. Heckman, *Female Labor Supply* in Orley Ashenfelter and Richard Leyer, eds., *Handbook of Labor Economics* (Elsevier Science, 1986) (noting the high elasticity of women's labor supply and women's responsiveness to wage decreases). See also Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. Rev. 983 (1993) (arguing that women are less committed to the waged labor force due to cultural mores and family responsibilities and thus have a more elastic labor supply than men, who tend to be far more committed to market activities); Lawrence Zelenak, *Marriage and the Income Tax*, 67 S. Cal. L. Rev. 339 (1994) (arguing that the joint return system does not fit current American attitude and living patterns); J. Penceval, *Labor Supply of Men* in Orley Ashenfelter and Richard Leyer, eds., *Handbook of Labor Economics* (Elsevier Science, 1986) (summarizing major empirical studies indicating that the labor supply elasticity of men is very small and thus unresponsive to taxation).

67. Stiglitz, *Economics of the Public Sector* at 462 (cited in note 26) (noting that a lump-sum tax produces an income effect rather than the substitution effect produced by a progressive tax).

The second market-oriented argument raised by modern utilitarians relates to individual investment activity. Critics of progressivity argue that such rates distort investment behavior by encouraging the movement of capital into tax-favored investments.⁶⁸ Theorists also argue that progressivity encourages individuals to misappropriate their human capital. High income individuals, it is argued, will spend significant energy and time seeking unproductive tax shelters for their professional income rather than engaging their talents in more productive activities in the open market.⁶⁹ In other words, taxpayers will employ their capital for the purpose of avoiding taxation rather than for more productive activities, ultimately decreasing the level of society's overall economic growth and prosperity.

Finally, progressivity is associated with the perceived complexity of the federal tax system.⁷⁰ The complex rate structure, in turn, imposes administrative costs associated with taxpayer time spent on tax planning and return preparation, the expense of purchasing professional assistance, as well as the governmental costs of preventing tax evasion. Arguably, society also incurs these costs because individuals and government agencies spend time and resources on difficult legal questions rather than investing in more productive activities that would enhance society's overall wealth.

The costs associated with the labor supply, the investment of human capital, and the administration of a complex system have prompted many utilitarians to call for the repeal of the progressive marginal rate structure. A more efficient tax system, it is argued,

68. William Vickrey, for example, has argued that high marginal rates will encourage individuals to invest in tax-exempt municipal bonds. This type of investment, he argues, is far less productive than investment in the private market, where resources are likely to be used far more efficiently. Vickrey, 20 U. Fla. L. Rev. at 442 (cited in note 9) ("Capital best adapted to riskbearing and equity investment is diverted to government bonds."). See also Mellon, *Taxation* at 170-72 (cited in note 10) (making the same argument in an earlier decade).

69. Charles O. Galvin and Boris I. Bittker, *The Income Tax: How Progressive Should It Be?* 18 (American Enterprise Institute, 1969) ("The present system tends to prostitute the talents of our most capable citizens.").

70. Because a graduated rate system taxes individuals at various rates depending on their level of income, identifying the proper taxpayer in any transaction is key to the smooth operation of the tax system. Identifying the taxpayer responsible for paying the tax, however, can be quite difficult if family members and business partners attempt to shift income to the low-bracket individuals, thereby avoiding the high marginal tax rates. Blum and Kalven, *The Uneasy Case* at 21-28 (cited in note 7) (discussing the detrimental effects of progression on economic productivity). Moreover, the progressive rate schedule gives greater significance to the annual accounting period. If a taxpayer falls into a high tax bracket due to significant earned and unearned income in one year but drops to a lower tax bracket in the next year due to decreased income, then the year in which income is recognized becomes extremely consequential.

will promote greater economic growth and thus work to the advantage of all citizens—including the poor.⁷¹ Although the concern for the poor is often difficult to identify because the efficiency-oriented theorists simply assume the benefits of growth,⁷² the underlying idea is that as the gross domestic product increases, material wealth and market opportunities also increase for both the rich and the poor.⁷³

71. As Amartya Sen has aptly noted, economics is not solely concerned with income and wealth but also with using these resources as means to significant ends, including the promotion and enjoyment of long and worthwhile lives. Amartya Sen, *The Economics of Life and Death*, 268 *Sci. Am.* 40 (1993).

72. Economic theorists interested in the effect of legal rules on the domestic economy routinely fail to explain why the government should pursue growth strategies beyond the tautologous observation that this approach to policymaking maximizes revenue. See, for example, Richard Posner, *The Economics of Justice* 67 (Harvard U., 1981) (arguing that free-market policy is best because it is likely to produce the greatest level of aggregate wealth). Economists exploring the development of poor countries, however, frequently identify the underlying aims of markets and growth with regard to material resources. See, for example, *Employment, Growth, and Basic Needs: A One-World Problem* (ILO International Labour Office, 1976). See also Sen, 268 *Sci. Am.* at 40-50 (cited in note 71) (arguing that policymakers must keep in mind that the underlying purposes of growth are related to the provision of both basic needs and overall prosperity).

73. Because all the data bear a close relationship to income, and because income is perceived to be a proxy for all other goods, the GDP and other measures are viewed as worthwhile indicators of well-being and indicative of the success of social policy. None of the measures, however, clearly identify what it is we are seeking to produce or to buy. Economists might argue that there is no purpose in discussing the character of the goods ultimately purchased. Income is valuable because it enables the individual to buy goods and services according to her revealed preferences. The nature of the preference is exogenous and, for the most part, unimportant to the policy of growth. In short, more is always better because it widens the area of individual choice—regardless of the nature of one's choice. Milton Friedman, *Capitalism and Freedom* 7-21 (U. of Chicago, 1962) (arguing that economic arrangements should expand individual choice and freedom). Wealth, however, must be a proxy for some identifiable good. One who values money and wealth for more than its instrumental uses simply has a fetish for "little green paper." Ronald Dworkin, *A Matter of Principle* 242 (Harvard U., 1985) (using hypothetical market exchange to prove that an increase in social wealth alone does not improve society unless the wealth is instrumental for obtaining other goods). See also John Kenneth Galbraith, *The Affluent Society* 87-88 (Riverside, 1964) (noting three benefits from amassing wealth).

Nevertheless, economic theorists routinely claim that market-oriented policymaking is legitimate precisely because of its trickle-down effects. See, for example, Kenneth Hoover and Raymond Plant, *Conservative Capitalism in Britain and the United States* 263 (Routledge, 1989) (noting that free-market theorists argue that individuals living in poverty will gain far more under a productive and efficient market than through egalitarian or redistributive policies). Throughout the history of taxation, theorists have argued that efficient tax rules will increase aggregate market growth, thereby ensuring the poor's access to basic economic resources. Tax theorists in the 1920s claimed that lower taxes on the wealthy would "solve the housing problem . . . make possible lower freight and passenger rates . . . increase the number of jobs and at the same time advance general prosperity." Mellon, *Taxation* at 137 (cited in note 10). Similarly, economic theorists in the 1960s argued that decreasing the marginal tax rates on wealthy investors would produce economic growth and would "enable millions to enjoy better lives . . . [by] providing more fully both such basic needs as food, clothing and shelter and the amenities of civilized life—education, medical care, travel, and recreation." *The Annual Report of the Council of Economic Advisors*, in James Tobin and Murray Weidenbaum, eds., *Two Revolutions in Economic Policy: The First Economic Reports of Presidents Kennedy and Reagan*

Despite the trenchant efficiency-oriented criticisms and the view that redistributive programs, of any kind, are more harmful than helpful, no theorist has ever seriously advocated the head tax, which is perceived to be the most efficient tax.⁷⁴ The head tax would mandate that each individual pay an identical sum to the fisc, in effect forcing poor individuals to pay a greater percentage of their income than a wealthy individual. An exclusive concern for efficiency, therefore, would lead to a steeply regressive tax. Because a head tax would prevent poor individuals from purchasing everyday necessities, efficiency-oriented theorists have not proposed a head tax but instead have proposed proportionate taxation with an exemption for the poor. Importantly, these theorists have also failed to identify a normative theory that supports the conclusion that a degressive or proportionate tax with an exemption for subsistence levels of income is the best and most ethical tax.⁷⁵

195-96 (MIT, 1988). And, of course, the supply-side economic theorists argued throughout the 1980s that the benefits of lower tax rates and higher growth would trickle down to all American citizens. Statement of the Council of Economic Advisors, *1982 Annual Report*, in James Tobin and Murray Weidenbaum, eds., *Two Revolutions in Economic Policy: The First Economic Reports of Presidents Kennedy and Reagan* 435-45 (MIT, 1989). See also Bruce E. Moon and William J. Dixon, *Politics, the State, and Basic Human Needs: A Cross National Study*, 29 *Am. J. Pol. Sci.* 681 (1985) (quoting Ronald Reagan's Budget Director, David Stockman, as saying, "My Grand Doctrine . . . is aimed to reverse both the national impoverishment and the rampant injustice [of being poor]"). In short, economic theorists have viewed growth policies as doing much more to lift the incomes of the poor and disadvantaged than more direct redistributive programs. King, *Money, Time, & Politics* at 192 (cited in note 36) (quoting James Tobin, one of the architects of Kennedy's economic strategy). King argues that capital and labor, employer and employee, saver and consumer have all perceived market growth strategies as advantageous to their own economic position. He notes that even politically left and liberal legislators have argued that "[i]t is the false friend who leads the poor man to believe that capital can be unreasonably taxed or soaked without injury to him. . . . Soak capital and you soak labor." *Id.* at 111.

74. Theorists have criticized the head-tax for centuries. Jeremy Bentham has perhaps defined the problems with the tax most clearly, "The individual being unable to pay the tax on account of his indigence, finds himself subject to grave evils. Instead of inconvenience of the tax, the suffering of privation are experienced; for this reason a capitation tax is bad; because a man has a head, it does not follow that he has anything else." Bentham, *Principles of the Civil Code*, in II *Collected Works* at 319 (cited in note 46). See also Jack Straw, *Poll Tax Dies but Haunts Democracy*, *Independent* 22 (Mar. 31, 1993) (providing brief historical account of the head tax experiment in England).

75. While economic scholars frequently argue that society should not provide direct economic assistance to the poor, some have argued that if society believes the poor have a right to income, the government should offer a subsidy rather than relying on voluntary contributions. Milton Friedman, for example, has noted the federal government must avoid intervening in the free market while at the same time he has argued the government is in the best position to alleviate poverty in light of free-rider problems. Friedman, *Capitalism and Freedom* at 190-91 (cited in note 73).

There is, however, one important exception to modern utilitarians' consensus with regard to the tax treatment of the truly poor. The British economist, James Mirlees, argued in 1971 that the utilitarian ethic might call for a more affirmative policy than the exemption that traditional tax theorists had previously considered. In his article, *An Exploration in the Theory of Optimum Income Taxation*,⁷⁶ Mirlees argued that a utilitarian calculus should lead to a tax structure that makes the poor economically better off post-taxation. Mirlees, in effect, seeks to revive the early utilitarian argument that focused on the decreasing marginal utility of income. Put differently, Mirlees argues that taxation should accommodate both market concerns and the utility the poor gain from an increase in income. American economic and tax theorists, however, have virtually ignored the redistributive potential of Mirlees's work, focusing instead on various other aspects of his model. Indeed, while Mirlees's work has won international acclaim, only two American legal theorists have used Mirlees's work to explore the possibility of tax-based transfers to the poor.⁷⁷

Joseph Bankman and Thomas Griffith look to Mirlees's work to challenge the traditional assumption that the Code can offer nothing more than an exemption from taxation to the truly poor. Bankman and Griffith argue the equity and efficiency of the tax system should not be considered in isolation, but in conjunction with the transfer system. Although they raise the possibility that the tax laws could provide a cash transfer or (or a demogrant) to the poor,⁷⁸ Bankman and Griffith fail to explore this proposition. Indeed, their primary focus is on the claim that progressive taxation is inefficient and costly to society.⁷⁹ The importance of their article ultimately lies not with their exploration of any positive rights the poor might have, but rather with their argument that progressivity can be attained without significant market inefficiencies.

76. Mirlees, 38 Rev. Econ. Stud. at 175 (cited in note 14).

77. James Mirlees won the 1996 Nobel Memorial Prize in Economic Science for his advancements in the theory of asymmetric information—or the problems that arise when two parties have different interests and different information. It is this aspect of his work that has sparked a cottage industry of literature investigating informational problems. See *Secrets and the Prize*, 341 Economist 86 (Oct. 12, 1996) (noting that Mirlees's argument for redistributing wealth has never been seriously explored while his insights on asymmetric information have gained widespread notice and have been applied in many other fields). See, for example, Bengt Holmstrom, *Moral Hazard and Observability*, 10 Bell J. Econ. 74 (1979) (using Mirlees's work on asymmetric information to explore the role of imperfect information in principal-agent relationships).

78. Bankman and Griffith, 75 Cal. L. Rev. at 1949-60 (cited in note 2).

79. These claims are explored in notes 64-71 and accompanying text.

Bankman and Griffith identify the work disincentives inherent in the graduated rate structure and explore alternative policy options that avoid this negative impact while preserving progressivity. Using Mirlees's work, they argue that Congress should tax the poor at high levels and that any regressivity occurring under such a system should be offset by a demogrant or cash transfer to the poor. The authors, however, do not investigate whether the demogrant should do more than offset the high tax burden, thereby putting the poor into a better economic position post-taxation. Instead, Bankman and Griffith simply note that the amount of the demogrant awarded to the poor depends on one's theory of distributional fairness; a utilitarian seeking a distribution of income that maximizes overall wealth might transfer less than an egalitarian seeking to enhance the well-being of the poorest individuals in society.⁸⁰ The authors, therefore, raise the possibility that the poor might have a positive right to income and thus push tax theorists to address unexplored questions. Yet they fail entirely to investigate this difficult question themselves.

Utilitarian tax theory, therefore, has taken a number of different analytical turns over the course of the last century. Early utilitarians focused on the decreasing marginal utility of income in arguing for progressivity. Although early scholars noted this theory of utility should lead policymakers to equalize income, none advocated this position. Instead, the early utilitarians argued that policymakers should tax the relatively wealthy at a rate far below 100% and should simply exempt the poor from taxation rather than affecting a large scale redistribution of income. Modern utilitarians have turned away from the marginal utility of income theory and have focused on the efficiency costs of taxation. Like the early utilitarian theorists, the modern theorists have also refused to consider the full potential of their underlying principles. Although the most efficient tax is the head tax, modern utilitarians have not advocated this in light of its perceived unfairness to the poor.

80. Bankman and Griffith, 75 Cal. L. Rev. at 1959-60 (cited in note 2) (noting that distributive theories of justice could lead to different tax rates and different levels of demogrants and arguing that the Rawlsian theory is unlikely to have a large impact on policymaking because of its extreme egalitarianism).

3. Modern Social Contract Theory

Although utilitarianism has been the primary ethical foundation of the tax laws throughout the twentieth century, recent tax theorists have sought to devise an ethical approach to policymaking that considers not only aggregate welfare, but also the welfare of individual citizens. Accordingly, tax theorists have turned to John Rawls's work, *A Theory of Justice*.⁸¹

Rawls argues that social structures are just only if they are based on impartial and impersonal criteria. Or in Rawlsian terms, social structures are just if they are based on principles chosen behind a "veil of ignorance."⁸² According to Rawls, rational individuals acting without knowledge of their place in society, their class position, or their social status (that is, behind the veil of ignorance) would not accept utilitarianism or the idea that policymaking should maximize the algebraic sum of utilities. "It hardly seems likely," Rawls argues, "that persons who view themselves as equals, entitled to press their claims upon one another, would agree to a principle which may require lesser life prospects for some simply for the sake of a greater sum of advantages enjoyed by others."⁸³ In short, no rational individual would sacrifice her own life or her ability to survive even if that choice maximized overall utility under the utilitarian calculus.

Instead, Rawls argues that rational individuals would bargain for a social contract that first requires equality of liberty for all individuals and second allows social and economic inequalities only if they ultimately work to the advantage of the least well-off member of society. Put differently, the social contract first mandates that the state protect the basic liberties of all individuals at all times. Second, when choosing between a policy that promotes inequality and one that promotes perfect equality, the state must choose the one that advantages the worst-off individual.⁸⁴ Unlike the utilitarians, who are focused on individuals' moral *obligation* to maximize overall utility even at the expense of their own interests, Rawls focuses on the

81. Rawls, *A Theory of Justice* (cited in note 10).

82. *Id.* at 264.

83. *Id.* at 266.

84. Specifically, Rawls puts forward two principles of justice:

First: each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others.

Second: Social and Economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all.

Id.

rights of individuals under the social contract. The right to basic liberties and the right to equality of opportunity is key for Rawls.

The implication of Rawls's theory of *rights* for taxation, an area of the law fundamentally concerned with a citizen's *obligation* to the state, initially might appear awkward. By identifying and understanding the extent of an individual's rights, however, tax theorists are in a far better position to shape obligations under the Code in a manner that avoids violating those rights. Rights and obligations, therefore, are integrally related for purposes of taxation.

According to Rawls's theory, any policy that impinges upon an individual's right to equal liberty is problematic. Because the progressive marginal tax rates mandate that the wealthy pay more than the poor, progressivity arguably impinges upon the rights of the wealthy to a greater extent than on the rights of the poor and thus represents questionable social policy. At the same time, Rawls argues that if liberty and equality are to have any meaning, each individual must have access to basic economic resources or "primary goods." Redistributive measures and progressive taxation, therefore, are legitimate if they work "to correct the distribution of wealth and to prevent concentrations of power detrimental to political liberty and equality of opportunity."⁸⁵ Unlike utilitarianism, which supports any distribution of wealth that works to maximize overall welfare, Rawls's theory of justice is concerned with the least well-off individuals in society and their right to equal liberty and opportunity.⁸⁶

Using Rawls's theory of rights, Charles O'Kelly has attempted to address the rights and responsibilities of both high- and low-income individuals.⁸⁷ O'Kelly argues that Congress should pursue a system of taxation that impinges only minimally on the liberty interests of successful market participants but at the same time advantages the least well-off individuals in society.⁸⁸ A flat tax arguably would recognize the obligation of each member of society to contribute her income and effort to the public good but would not disproportionately sacrifice the

85. Id. at 277-78.

86. Rawls's theory has been extensively criticized both inside and outside of the legal literature. See, for example, Amartya K. Sen, *Resources, Values and Development* 279-80 (Harvard U., 1985) (providing a brief critique of Rawls's work for failing to accommodate the special needs of the disabled, poor, and the ill). See also Mari Matsuda, *Liberal Jurisprudence and Abstracted Visions of Human Nature: A Feminist Critique of Rawls' Theory of Justice*, 16 N. Mex. L. Rev. 613 (1986) (arguing that Rawls's theory of justice is flawed for its failure to "explore real-life potential of humankind in a concrete context").

87. O'Kelly, 58 S. Cal. L. Rev. at 727-55 (cited in note 10).

88. Id. at 739-55.

liberty interests of one citizen for the benefit of others. The validity of the flat tax, according to O'Kelly, rests on the fact that each taxpayer would pay precisely the same portion of her income to the state and thus the costs of taxation could not be disproportionate. At the same time, O'Kelly proposes a personal exemption equal to the income needed for basic subsistence.⁸⁹ The personal exemption arguably recognizes society's commitment to ensuring access to the basic income necessary to participate in the democratic process. More importantly, O'Kelly argues the tax exemption expresses the view that society values the contribution made by low-income individuals to the social product and recognizes this contribution entitles them to receive at least a minimum wage by virtue of that work.⁹⁰ Through his flat tax/basic income exemption proposal, therefore, O'Kelly seeks to protect the liberty interests of both the wealthy and the poor pursuant to Rawls's rights oriented theory of distributive justice.⁹¹

Like the early social contract theorists and the utilitarians, O'Kelly would limit the Tax Code's potential to advantage the poor by advocating only an exemption from taxation, not by providing any affirmative benefits. O'Kelly's failure to advocate affirmative benefits for the poor is particularly unfounded because Rawls's theory of justice expressly calls for the state, and the tax laws in particular, to provide assistance to the poor by highlighting the relationship between meaningful participation in a democracy and access to basic subsistence income and "primary goods."⁹² Yet O'Kelly fails to consider what the tax laws could or should do beyond offering an exemption to the poor.⁹³ This cramped interpretation of a theory that potentially could lead to much greater intervention reflects the deeply ingrained notion that the most taxation can do for the poor is to exclude them from the scope of the laws. At the same time, it reflects the idea that taxation raises serious questions with regard to the rights and responsibilities of the relatively wealthy, but not with regard to the poor.

89. Id. at 751-55.

90. Id. at 747.

91. Id. at 751.

92. See Joseph H. Carens, *Rights and Duties in an Egalitarian Society*, 14 *Pol. Theory* 31, 39 (1986) (noting that it is puzzling that Rawls himself does not advocate a steeply progressive tax system with redistribution in all circumstances).

93. See Stern, 6 *J. of Pub Econ.* at 123 (cited in note 14) (noting that with a Rawlsian social welfare function—where the only concern is with the poorest individual, taxpayers should be taxed at a rate of 80% with a guaranteed minimum income equal to about 38% of the median income). See also Atkinson, *Public Economics in Action* at 29-33 (cited in note 14) (arguing that Rawls's work would support a right to basic income).

4. Entitlement Theory of Property

Entitlement theories of distributive justice also focus on the rights of individuals. Like social contract theory, there are many variants of the entitlement theory, each with unique policy implications. Entitlement theorists, however, generally argue that a person is deserving because of some action she has taken or some trait she possesses.⁹⁴ A modern version of the entitlement theory is Robert Nozick's conception of property rights, under which a person has the right to property acquired in uncoerced exchanges with others. Nozick argues that government laws taking (or taxing) property obtained in a fair market exchange amounts to theft or, even worse, involuntary servitude under the 13th Amendment. "Taking the earnings of n number of hours," he argues, "is like forcing a person to work n hours for another person" and thus is forced labor.⁹⁵

While Nozick's argument naturally leads to the conclusion that any taxation is constitutionally infirm, his expansive view of entitlement has never gained widespread support.⁹⁶ Instead, theorists who advocate a version of Nozick's entitlement theory have argued that to the extent that taxation is a necessary evil, policymakers must avoid disproportionately infringing upon any person's economic gain. In short, because all individuals are entitled to the property they acquire through fair market exchange, there is no basis for unequal treatment under the Tax Code.⁹⁷ Accordingly, tax theorists adhering to the entitlement theory of property argue Congress must impose identical tax burdens on all individuals to avoid violating the rights of one individual to a greater extent than another. This view has led some to argue for a proportionate or flat tax rate. Others, however, have argued Congress must take an identical sum from each citizen, not simply an identical percentage of their income. A noteworthy aspect of theorists' use of Nozick's work is their unwillingness to take the position that Congress must impose identical *utility* costs on all

94. Bankman and Griffith, 75 Cal. L. Rev. at 1915 (cited in note 2) (providing short but helpful descriptions of the various contemporary theories of justice).

95. Nozick, *Anarchy, State, and Utopia* at 169-70 (cited in note 6).

96. Even Nozick believes in the minimal state and thus would agree the state must have access to revenue. *Id.*

97. See Schoenblum, 12 Am. J. Tax Pol. at 258-271 (cited in note 10) (advocating a head tax). See also O'Kelly, 58 S. Cal. L. Rev. at 735-744 (cited in note 10) (arguing that taxpayers have an entitlement to a flat tax).

citizens. This argument could, of course, lead to a progressive tax rate structure as the early utilitarians noted.⁹⁸

Like all other tax theorists, however, no entitlement theorist has advocated that Congress subject the truly poor to the same tax burden as the wealthy. Theorists exploring the possibility of a Nozickean tax structure argue the legislature should adopt a head tax with an exemption to account for those at a subsistence level⁹⁹ or a proportionate tax with an exemption for the truly disadvantaged.¹⁰⁰ Thus even individuals strongly opposed to any form of redistribution contend that the poor should pay less or nothing at all to the common good, confirming the notion that the government is morally and politically justified in adopting some variant of a graduated rate structure.

That poor individuals might be entitled to *more* than just a tax exemption under Nozick's theory of entitlement, however, is suggested by the fact that Nozick leaves open the question of whether "catastrophic moral horrors" provide the moral grounds for ensuring access to basic material goods.¹⁰¹ Since the only resource that many individuals legitimately possess under Nozick's theory is their labor power, which may turn out to be unsaleable in the market, Nozick's theory most likely gives way to situations that result in starvation.¹⁰² At the same time, "once it is admitted that consequences can be important in judging what rights we do or do not morally have, surely the door is quite open for taking a less narrow view of rights."¹⁰³ Tax theorists advocating some form of Nozick's entitlement theory, however, have never explored these arguments. Instead, they have focused their attention on individuals above the subsistence level of income and have emphatically argued that policymakers must avoid violating the rights of one individual to a greater extent than the rights of another through disparate levels of taxation.¹⁰⁴

98. See Nancy Staudt and Mariam Thalos, *Nozick's Theory of Justice and the Progressive Marginal Rate Structure* (unpublished manuscript) (on file with the Author).

99. Schoenblum, 12 Am. J. Tax Pol. at 270 (cited in note 10)

100. James A. Dorn, *Introduction: The Principles and Politics of Tax Reform*, 5 Cato J. 361, 380 (1985) (noting that policymakers advancing entitlement theories of justice advocate modified fiat tax programs that call for "some progressivity" to account for the truly poor).

101. Nozick, *Anarchy, State, and Utopia* at 79-80 (cited in note 6).

102. Sen, *Resourees, Values and Development* at 312 (cited in note 86).

103. *Id.* See also John Deigh, *On Rights and Responsibilities*, 7 L. and Phil. 147, 168-69 (1988) (arguing that the Lockean right to property is not necessarily violated by federal law ensuring basic subsistence income if the law is written to account for circumstances that are unexpected and unaccounted for in the Lockean regime).

104. See Schoenblum, 12 Am. J. Tax Pol. at 258-71 (cited in note 10); Dorn, 5 Cato. J. at 380 (cited in note 100).

Countless theorists have criticized Nozick's entitlement theory of justice. Critics argue that the idea that individuals are entitled to the full extent of their market gains ignores what most citizens recognize—that the level of their material well-being is inextricably linked with the goods and services produced by others and depends upon the success of the national economy.¹⁰⁵ Society and not just the individual, therefore, should be entitled to market gains.

Barbara Fried, for example, demonstrates the manner in which Nozick's theory of entitlement obscures difficult issues related to market price and surplus value. To make her case, Fried assumes a hypothetical taxpayer that has significant market gains. The hypothetical taxpayer purchased a vacant parcel of land located in a sparsely populated county near New York City. Because of economic, demographic and other social changes, the value of the real estate increased 500-fold and produced significant gain upon a sale. Fried argues that while the entitlement theory would legitimate a return of the original cost of the land plus a fair return on the cost (for risk, perhaps), it is far from clear that any appreciation beyond that amount rightfully belongs to the seller. Indeed, Fried argues society-at-large might be just as entitled as the seller to the benefits resulting from scarcity of the supply of land located near New York City, changing tastes, and available material wealth. Because society has acted as a silent partner in conferring benefits, Fried argues that society also might be justified in sharing the gains of the transaction.¹⁰⁶ In short, while Nozick contends that progressivity amounts to society stealing from the wealthy, a theorist could argue that progressive taxation assures the wealthy cannot cheat society.

Fried makes the case that wealthy individuals are *advantaged* by social structures and thus are not necessarily entitled to the full extent of their material gains simply because they obtain gains through a fair market transfer. Fried, however, fails to consider the flip side of her argument. Perhaps economic, demographic, and social

105. O'Kelly, 58 S. Cal. L. Rev. at 737 (cited in note 10). See also Carens, 14 Pol. Theory at 40 (cited in note 92) (arguing that if income differences were purely compensatory for hard work, there would be no disadvantaged position in society and no envy problems because people with more income would not really be better off in light of the sacrifice they made to obtain the income).

106. Barbara Fried, *Wilt Chamberlain Revisited: Nozick's Justice on Transfer and the Problem of Market-Based Distribution*, 24 Phil. & Pub. Affairs 226, 235-45 (1995). See also Carens, 14 Pol. Theory at 41 (cited in note 92) (noting that high incomes are due more to societal demand than to hard work and arguing on this basis that progressive taxation would not deprive individuals of their hard-earned and deserved income).

change have *disadvantaged* the poor—creating a possible entitlement to payment from society. For example, assume a hypothetical individual who was born into unfortunate social and economic circumstances. Because of these early, undeserved misfortunes, the individual has failed to adopt society's standards for hygiene, has always been a bit disheveled, has no education, and has had no ability to support his basic need for food, clothing, health care, and shelter. In short, the individual is not only homeless and in poverty, but his very survival is at risk. Fried's argument ought to suggest that society's peculiar taste for clean, neat, and extensively educated individuals may have prevented this hypothetical individual from attaining minimal living standards. Just as society contributed to the wealth of the land-holder in Fried's example, perhaps society has contributed to the unfortunate position of this hypothetical individual and thus should provide a cash transfer or a demogrant.

Fried intended only to address the question of how to tax relatively wealthy individuals and not the question of the proper tax treatment of individuals living at subsistence levels.¹⁰⁷ Various other theorists, however, have also identified market imperfections as playing a significant role in the production of wealth and have argued that an individual's entitlement to the full extent of her market gains is questionable in light of these imperfections. Unlike Fried, these theorists have advocated a specific tax program that taxes individuals with income at progressive levels and that exempts the poor from taxation, but have advocated nothing more affirmative.¹⁰⁸ The critics of the entitlement theory, like all other tax theorists, therefore, have failed to investigate the possibility that poor individuals might have a

107. Fried, however, appears to be aware of this question. She notes, for example, that rent theorists have also ignored the question of how to treat losses. "If investors are entitled to no more than compensation for their sacrifice," she asks, "are they also entitled to no less? If so, then the government should protect losers to the extent that assets fall in value from their historic cost either by artificially keeping price levels high enough to generate a fair return on costs or by reimbursing their losses." Although this question arises in a different context, it is arguably similar to my example in the text. Fried, *Robert Hale and Progressive Legal Economics* 77 (cited in note 56).

108. See Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 *Yale L. J.* 259, 274-75 (1983) (arguing that market distributions are due not only to hard work but also to fickle markets, joint efforts, societal conditions, and pure luck and thus the assumption that each person is entitled to keep what she earns on the market is therefore in serious doubt under any theory). See also Graetz, 56 *S. Cal. L. Rev.* at 532-33 (cited in note 10) (arguing that any tax reform should maintain the existing progressivity of the Code which incorporates an exemption for the extremely low levels of income). But see Michael Graetz, *The Troubled Marriage of Retirement Security and Tax Policies*, 135 *U. Pa. L. Rev.* 851, 906 (1987) (arguing that the social security system is biased against the poor and briefly commenting in his conclusion that perhaps the poor should be exempt from employment taxes while still getting the benefit).

right to a cash transfer or a demogrant under the same theory that justifies progressive taxation for the wealthy.

C. Summary

Tax theorists have developed notions of horizontal and vertical equity as the standards for measuring the fairness of the tax laws. Horizontal fairness, however, can play only a small, almost insignificant, role in tax policy, while the concept of vertical equity is key for tax policymaking and has been at the center of controversy for over a century. The debate over vertical equity has, in turn, centered on the legitimacy of progressive marginal tax rates.

Theorists in a wide range of disciplines have entered the progressivity debate, each contending their underlying political, moral, or economic theory resolves the difficult questions at hand. Early social contract theorists and utilitarians focused on the obligations of an individual to contribute to the common good, while modern social contract theorists and entitlement theorists have focused on individual rights in order to identify the proper tax structure. Each group of theorists has set forth competing marginal rate systems that are intended to govern the tax obligations of individuals with income above the subsistence level. Despite their contending arguments and policy proposals, however, theorists have reached a remarkable agreement with regard to the tax treatment of poor individuals. Theorists have almost universally agreed that policymakers must avoid imposing tax costs on society's disadvantaged individuals by offering an exemption from the tax laws. Although theorists have unanimously concluded that the poor deserve an exemption from taxation, they have not followed their own logic to the conclusion that the poor might deserve positive benefits as well. Thus the exemption from taxation is valuable, but it falls far short of what many of the theorists could have concluded given their underlying principles. This surprising agreement among theorists who are deeply divided on the underlying aims and goals of policymaking raises the question of what shared underlying assumptions have led them to this limited policy proposal?

The next two Parts seek to bring to the surface the embedded assumptions found in traditional tax theory with regard to the rights and responsibilities of the poor. In Part III, I explore three possible reasons for tax theorists' neglect of the positive rights of the poor. I argue that not only are tax scholars unable to justify their failure to consider positive rights, but also that the current progressivity debate

imposes hidden costs upon both society and the poor. In Part IV, I turn to the assumptions found in traditional tax theory with regard to the responsibilities of the poor. I first argue that theorists have assumed that poor individuals have no responsibility to contribute to the state. I then explore the hidden costs associated with this assumption, and explain how policymakers might use the Tax Code to impose responsibilities upon the poor without further marginalizing them.

III. THE MISSING DEBATE OVER POSITIVE RIGHTS

Traditional tax theorists implicitly agree that individuals at subsistence levels of income should have, at the minimum, the privilege or the negative right to be free from coercive interference by the government, at least with regard to taxation.¹⁰⁹ It is surprising that theorists have not explored more thoroughly any positive rights the poor might have in light of their underlying principles and ethical mandates. Many of the theories, taken to their own logical conclusion, could justify a positive right to income. If traditional tax theorists have purposefully failed to consider the positive rights of the poor, the obvious question is—why? One reason might be related to the notion that tax policy involves the imposition of *liabilities*, not the award of *rights*. The question of positive rights, therefore, should be left to the welfare debate which largely takes place outside of the federal taxation context. A second reason for tax theorists' neglect of positive rights could be related to the existence of the deductions, credits, and exemptions that arguably protect any positive rights the poor might have. In short, because the political process has addressed satisfactorily the question of the poor's positive rights, traditional tax theorists have focused only on the relatively wealthy. Finally, tax theorists might argue that they have not ignored positive rights, but they have pursued an alternative strategy altogether for assuring economic security. Rather than specific subsidies that ensure a

109. Individual property rights are generally grounded in the "negative claim" to be let alone and to hold, keep and enjoy as opposed to "positive claims" to active assistance in obtaining or enjoying the use of wealth. Frank Michelman, *Tutelary Jurisprudence and Constitutional Property*, in Ellen Frankel Paul and Howard Dickman, eds., *Liberty, Property, and the Future of Constitutional Development* 128 (State U. of New York, 1990). See also Stephen Holmes, *Passions and Constraint: On the Theory of Liberal Democracy* 311-12, n.8 (U. of Chicago, 1995) (describing negative liberty "as the absence of coercive interference, in voluntary social interactions, by the government or other wielders of power" and positive liberty as "collective self-government").

minimum income for the poor, theorists have focused on the possibility of using the Tax Code as a means for promoting market growth and productivity. The benefits of market growth are assumed to trickle down to the poor and are often assumed to provide benefits far greater than any direct subsidy ever could.

A. Assuming Others Will Solve the Problem

Tax theorists' failure to explore fully the positive rights of the poor might be due to the notion that taxation involves the imposition of liabilities and not the award of positive rights. Thus while resolving the question of whether the poor have an affirmative claim to additional income is an important question, it is arguably not for tax theorists to determine. In short, traditional tax theorists might acknowledge their analytical oversight, but would argue their approach should not be objectionable because theorists can and do explore positive economic rights within the context of the social welfare laws.

While this explanation for tax theorists' narrow focus on the rights of relatively wealthy individuals might seem persuasive—this approach to taxation theory imposes serious, hidden costs upon society, and poor individuals in particular. First, social welfare subsidies are funded largely through the revenue obtained under the tax laws. Accordingly, if tax scholars have limited relatively wealthy individuals' duty to pay taxes—they have also circumscribed the possibility of funding social welfare subsidies. Second, even if policymakers set the marginal tax rates high enough to fund fully basic income for all individuals, separating the discussion of wealthy individuals' rights (in the taxation context) from poor individuals' rights (in the welfare context) works to further marginalize the poor.

The way in which traditional tax theory works to limit the positive rights of the poor can easily be demonstrated. As Wesley Hohfeld argued decades ago, any time the state confers an advantage or imposes a disadvantage on a certain citizen, it necessarily and simultaneously creates a vulnerability or a benefit on the part of another.¹¹⁰ In the Hohfeldian lexicon, both private individuals and the

110. Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 Yale L. J. 16 (1913). See also Joseph William Singer, *Property Law: Rules, Policies, and Practices* 163 (Little, Brown, 1993) ("Any time the state confers an advantage on some citizen, it necessarily simultaneously creates a vulnerability on the part of

government have a duty to respect an individual's rights and entitlements.¹¹¹ Thus, the "logical relationship between rights and duties makes clear that while an owner's set of rights may increase his security, and thus his own personal sense of liberty, the duties so created necessarily restrict the freedom of others. Every question about private property is therefore also a question about public restraint."¹¹²

Under a Hohfeldian analysis, poor individuals' freedom from taxation naturally leads to the conclusion that individuals above subsistence levels of income are liable for the costs associated with the provision of public goods and services. A poor individual's right to subsistence levels of income obtained through her own private transactions, therefore, creates an obligation upon wealthier individuals to pay the full cost of public goods. Stated in yet another way, poor citizens' *right* to retain all of their income leads to the conclusion that the government and the wealthy have a *duty* to respect that right. Thus, given the legitimacy of the current system of taxation, individuals living above subsistence levels of income will be obligated to contribute a portion of their property to the greater social good. The policy choice of exempting the poor from taxation, therefore, simultaneously limits the rights and entitlements of relatively wealthy individuals.

At the same time, traditional tax theorists' analysis of wealthy individuals' rights and obligations imposes hidden constraints and limitations on the poor, and in effect, decides what the poor have no right to claim. Indeed, virtually every group of tax theorists discussed in Part II above, imposed unstated constraints upon the poor. Consider the utilitarian ethic, which mandates that social policies promote the greatest good for the greatest number. The early utilitarian principles could have led theorists to conclude that Congress should take, through taxation, all income above the mean for redistribution to those below the mean.¹¹³ Under a pure utilitarian

others."); Carl Wellman, *Welfare Rights* 8-11 (Rowman and Littlefield, 1982) (arguing that Hohfeld's analysis both reveals and obscures the complexities of property rights).

111. See Wendy Gordon, *An Inquiry into the Merits of Copyright: The Challenges of Consistency, Consent, and Encouragement Theory*, 41 *Stan. L. Rev.* 1343, 1357 (1989) (arguing that the right to exclude and the right against interference find support in the Fifth Amendment's Takings Clause).

112. *Id.* at 1343. As Walter Wheeler Cook (the editor of Hohfeld's book) has noted, the value of Hohfeld's work is that it enables (forces?) one to examine a situation "first from the point of view of one person and then from that of the other." Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* 10 (Greenwood, 1966). See also Stephen R. Munzer, *A Theory of Property* 15-36 (Cambridge U., 1990) (providing a useful explanation of the value and shortcomings of Hohfeld's vocabulary).

113. See notes 59-63 and accompanying text.

ethic, this scheme would promote the greatest utility for the greatest number. Despite the policy implication of the utilitarian calculus, no theorist has supported this type of tax-based redistribution. Instead, tax theorists have worried about market incentives and thus have proposed marginal tax rates far below 100% and have not advocated a wide-scale redistribution to the poor (except to the extent that the poor benefit from public goods and services without having paid for them). The conclusion that the wealthy have no obligation to pay tax at a rate of 100%, in Hohfeldian terminology, means that the poor and society have *no right* to equality of income.

Moreover, while both Rawls and Nozick have argued that the state must avoid impinging upon individual rights and liberties, both authors plausibly could be interpreted as tolerating an affirmative claim to economic security even if that claim infringes upon the liberty interests of those who would be called upon to satisfy it. Most tax theorists using modern social contract and entitlement theories, however, have expressed far greater sympathy for a wealthy individual's liberty interests and have advocated low and uniform tax rates and no cash transfers to the poor. By seeking to protect the rights of the wealthy and by refusing to impose the obligation upon the wealthy to support wealth transfer programs, theorists have denied the poor a right to subsistence income that cannot be obtained in the private market. If the wealthy have the *right* to keep their income, neither the poor nor the state have the right to claim it for redistribution.

Of course, theorists might argue that the tax rates on the relatively wealthy could still be set high enough to finance the welfare payments to individuals outside the context of taxation without necessarily violating the principles and ethical mandates to which they adhere. Theorists have not taken a position on the absolute level of revenue obtained by the laws, but rather have only addressed the problem of treating differently situated individuals differently under the marginal rate structure. Put differently, many theorists might not object to higher marginal tax rates, so long as each taxpayer is treated identically under the Code. Indeed, that tax theorists have not hindered any potential positive claim to income is reflected by the social welfare programs that provide for those in need.¹¹⁴

114. While poor individuals gain only a tax exemption under the federal tax rules, they are potentially entitled to additional benefits under various other laws. None of these programs, however, guarantee subsistence income for *all* individuals. Access to many of the poverty relief

In effect, tax theorists have not awarded a right but they may have reserved for the poor the *privilege* to go elsewhere to obtain basic needs. But in Hohfeldian terminology, if the wealthy have a right to keep their income and they have no obligation to subsidize the cost of their basic needs, then the poor do not have the privilege to seek economic security even in other forums.¹¹⁵ In short, the poor only have the privilege to go to the state for economic assistance if the wealthy do not have a right to all of their income after incurring the cost of public goods (except redistribution).¹¹⁶

programs, for example, is tied to one's attachment to the labor force. Failure to participate in the market (or to be married to a waged laborer), therefore, prevents one from benefiting from old age pensions and Medicare. Kathleen A. Kost and Frank W. Munger, *Fooling All the People Some of the Time: 1990's Welfare Reform and the Exploitation of American Values*, 4 Va. J. Soc. Pol. & L. 3, 13 (1996). Although additional programs, such as the Aid to Families with Dependent Children, the Food Stamp program, and Medicaid provide financial support based on need, none guarantee subsistence levels of income. Indeed, even considering these transfer programs, 15.1% of American citizens were living in poverty in 1993. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1996 at 472*, table 730 (U.S. G.P.O., 1996).

Richard Epstein argues the current approach to redistribution is remarkably unfair because it imposes costs upon a limited number of individuals rather than society at large. Epstein notes two examples of this perceived problem. First, rent control systems often deny the landlord the power to increase rent because of the weak financial condition of the poor. Second, federal legislation has mandated that employers purchase health and life insurance for the victims of AIDS. Although Epstein doesn't entirely dismiss the notion that society may want to provide these basic needs to the poor and disadvantaged, he argues if the public at large wishes to create a welfare system, it should fund these programs through federal taxation rather than by forcing the costs upon certain private individuals. Richard Epstein, *Takings: Of Maginot Lines and Constitutional Compromises*, in Ellen Frankel Paul and Howard Dickman, eds., *Liberty, Property, and the Future of Constitutional Development* 173, 193 (State U. of New York, 1990).

115. Hohfeld, *Fundamental Legal Conceptions* at 43-44 (cited in note 112) ("To the extent that the defendants have privileges the plaintiffs have no rights; and, conversely, to the extent that the plaintiffs have rights the defendants have no privileges ('no-privilege' equals duty of opposite tenor)."). As another commentator has stated,

Suppose A., owner and possessor of a chattel, tells B. that he may take the chattel if he can do so, but that A. will do all he can to stop B. The permission thus given by A. to B. has as its consequence the destruction of B.'s *duty* to refrain from taking the chattel and confers upon him the *privilege* of taking it. It does not, however, give B. a *right* (in the strict sense) to take it, *i.e.*, it does not place A. under a *duty* to let B. take it.

Walter Wheeler Cook, *Privileges of Labor Unions in the Struggle for Life*, 27 Yale L. J. 779, 787 (1918).

116. As Barbara Fried points out, however, failure to tax the wealthy does not necessarily give rise to a "right," but simply may reflect a concern for incentives. Nevertheless, refusing to tax the wealthy, for any reason, implicitly denies the poor a claim to basic income. Of course, one possible way that the interests of both the wealthy and the poor could be satisfied is through lower rates which spark market activities, ultimately leading to the government coffers being filled with revenue. This is precisely what the economist Arthur B. Laffer argued in the 1980s. Arthur Laffer, *Government Exactions and Revenue Deficiencies*, 1 Cato J. 1, 1-21 (1981) (asserting that decreased levels of taxation will increase government revenue up to a certain point beyond which increased taxation decreases government revenue because of the disincentives imposed on work and investment activities). Laffer argued that the tax rate had far exceeded the point at which the government could attain maximum revenue and thus a tax cut would actually increase revenue. The argument, however, proved to be wrong: the 1980

Moreover, if tax theorists are willing to accommodate a positive right to income, it is surprising that none have explored the idea in any detail. Indeed, tax theorists uniformly have refused to propose tax reform that ensures basic income for all citizens even though each of their underlying theories could easily be interpreted as mandating such a policy. Accordingly, it is far more likely that traditional tax theorists do not believe the poor are entitled to anything beyond a negative right to be free from coercive taxation. That the social welfare laws offer some income security to the poor simply suggests that traditional tax theorists have failed to convince policymakers that the wealthy have a right to retain their income and no duty to subsidize redistribution. The disturbing aspect of tax theorists' limited view on the rights of the poor is that they have steadfastly refused to state it expressly—thus avoiding a serious debate on this difficult question in the context of taxation.

Regardless of whether tax theorists have intended to limit positive rights or not, there are good reasons for investigating the rights and duties of both the wealthy and the poor in a single forum rather than in two separate contexts (that is, the tax laws and the social welfare laws). While explicitly merging the debate over the rights and duties of the poor with that of the wealthy might not substantively change the underlying policy proposals, it might alleviate the social costs of focusing only upon wealthy individuals' rights in the tax context and poor individuals' rights in the context of the welfare laws.

Leaving these questions to be debated in separate contexts contributes to the false perception that policymaking accords an unfair advantage to the poor. Consider, for example, the widespread notion that the welfare laws give the poor free handouts while at the same time failing to consider thoroughly the rights of the wealthy. Put differently, the welfare debate has led to the false conclusion that society is unfairly prioritizing the interests of the poor in social policymaking. As the traditional scholarly debate in taxation conclusively demonstrates, however, political, economic, and moral theorists have all given extensive and serious consideration to the rights and entitlements of the relatively wealthy. Indeed, the debate has thus far

Reagan cuts ultimately expanded the federal deficit as never before. Anthony S. Campagna, *U.S. National Economic Policy, 1917-1985* at 501, 528-29 (Praeger, 1987). Moreover, Laffer's argument would not appeal to rights-based theorists who would not support using the increased revenue for redistributive purposes.

virtually ignored the rights and entitlements of the poor except with regard to their negative right not to be further impoverished by the tax system. Merging the discussion of the rights and obligations of the poor with the discussion of the rights and obligations of the wealthy would enable society to see that the interests of both are and should be considered in social policymaking.¹¹⁷

As Thomas Ross has noted, merging the institutions that award benefits and impose obligations would subject both the wealthy and the poor to the same level of administrative oversight. In light of the current view that poor individuals are likely to cheat and defraud the federal government, policymakers assume the welfare system must be implemented and monitored on the substantial possibility of fraud.¹¹⁸ Tax laws, of course, also give wealthy individuals substantial opportunities to cheat the government. Taxpayers can and do easily avoid reporting income and exaggerate deductions to avoid paying their taxes. Yet tax fraud is not viewed as so systemic and substantial that it necessitates special monitoring beyond the threat of an audit.¹¹⁹ In short, structuring one institution to award rights to the poor and another to accord rights to the wealthy allows society to view the poor as undeserving individuals intent on hustling the system while the relatively wealthy are viewed as productive and honest members of society—assumptions that are entirely unwarranted.¹²⁰

117. See David T. Ellwood, *Poor Support: Poverty in the American Family* 115 (Basic Books, 1988) (asserting that integrating the social welfare programs into the Tax Code will reduce the stigma and isolation associated with welfare); Theda Skocpol, *Targeting Within Universalism: Politically Viable Policies to Combat Poverty in the United States*, in Christopher Jenks and Paul E. Peterson, eds., *The Urban Underclass* 411, 431 (Brookings Institute, 1991) (asserting that public assistance is a more sustainable program if incorporated into the "income tax system in which all workers participate"). For an argument opposing a unified tax-transfer system, see Alstett, 108 Harv. L. Rev. at 564-590 (cited in note 14) (arguing that the tax transfer program raises problems of inaccuracy, unresponsiveness, and noncompliance).

118. Thomas Ross, *The Rhetoric of Poverty: Their Immorality, Our Helplessness*, 79 Geo. L. J. 1499, 1538 (1991) (noting that Congress has structured the welfare system on the assumption of substantial fraud).

119. Of course, even tax-based programs raise issues of fraud. See George K. Yin, *The Uncertain Fate of the Earned Income Tax*, in Mary Louise Fellows and Karen B. Brown, eds., *Taxing America* 307-08 (New York U., 1996) (noting that countless theorists and policymakers have worried that taxpayers fraudulently claim they are entitled to the EITC). Yin's work, however, might simply indicate that programs intended for the poor are likely to be criticized regardless of whether they are found in the Tax Code or elsewhere in federal laws.

120. This assumption is reflected in the work of Geoffrey Brennan and James Buchanan, who argue that the tax laws should be written in a manner that actually enables wealthy individuals to avoid transferring hard-earned money to the government. Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* 199 (Cambridge U., 1980) (arguing that tax reform should create loopholes for taxpayers to avoid rate increases and other "undue fiscal exploitation").

Traditional tax theorists' assumption that for tax purposes the poor have only a negative right to noninterference by the state is problematic, therefore, in two ways. First, theorists appear not to be taking a position on any positive rights the poor may hold when, in fact, their analysis seriously circumscribes these rights. Second, by explicitly addressing only the rights and obligations of the wealthy, tax theorists have contributed to the inaccurate perception that the poor are particularly prone to cheat society by demanding more than the amount to which they are entitled. A more explicit discussion of poor individuals' rights would avoid these unintended consequences and at the same time subject controversial aims and goals to greater public debate.

B. Assuming the Problem Already Is Solved

In this subpart, I explore the possibility that tax theorists have viewed the series of exemptions, deductions, and credits as adequate for protecting the positive rights of the poor. Many of these provisions subsidize basic everyday needs including childcare, healthcare, and housing. I argue that while these provisions clearly subsidize basic needs, they fall short of ensuring income security.

1. A Brief Description of the Provisions Subsidizing Basic Needs

In seeking to promote social and economic well-being and to assure access to basic human necessities, Congress has adopted a number of provisions that allow the taxpayer to deduct costs related to items such as healthcare, childcare, and home ownership. Additionally, the legislature has implemented provisions unrelated to these targeted expenses but to subsidize general living expenses. The provisions have various limitations and qualifications.

The most significant provision that subsidizes basic human needs is the earned income tax credit under section 32 of the Code (the EITC). Pursuant to section 32, Congress permits low-income individuals working in the waged labor force to take a refundable tax credit. A family earning between \$8,425 and \$11,000 with two or more children, for example, is entitled to offset its tax burden by a credit up to \$3,370.¹²¹ If its value exceeds the actual tax imposed on the individual's earnings, the credit works as a cash transfer program

121. I.R.C. § 32 (a), (b). $\$8,425 \times .40 = \$3,370$.

entitling the taxpayer to the amount of the credit in excess of the tax. Congress intended the EITC to provide these economic benefits only to individuals who work in the waged labor force and who live at extremely low levels of income. If the taxpayer withdraws from the market economy, the EITC will provide no benefits; and if the individual's income exceeds \$11,000, the EITC program will drastically reduce the level of benefits available until they are fully phased out.¹²²

Congress has adopted various other general provisions relating to basic human needs. The standard deduction under section 63 permits a single taxpayer without children to deduct \$4,000 if she does not itemize her expenses.¹²³ Under section 151 of the Code, a taxpayer is entitled to a \$2,000 exemption for each parent and dependent in the household.¹²⁴ In an effort to ensure economic stability in old age, Congress also allows the taxpayer to defer taxation of income by depositing it into a qualified retirement account. The pension system is largely an employment-based savings program that entitles the employee to defer taxation on her salary if it is held until retirement.¹²⁵ Congress, however, permits individuals seeking security in old age but left uncovered by employer pensions plans, to defer taxation on up to \$2,000 if contributed to a qualified individual retirement account.¹²⁶

122. *Id.* Congress decreases the credit by 21 cents per dollar until it is fully phased out at \$27,000 because $(\$8,425 \times .40) - [2106 \times (\$27,000 - \$11,000)] = 0$. For a family with just one qualifying child, the credit is phased out at rate of 16 cents per dollar until it is fully phased out at \$23,760 because $(.34 \times \$6,000) - [1598 \times (\$23,760 - \$11,000)] = 0$. *Id.*

123. The amount of the standard deduction, however, changes according to an individual's family characteristics. See I.R.C. § 63 (c) (2) (West 1996 ed.) (outlining amounts deductible for married couples filing jointly, married individuals filing separate returns, and heads-of-household and surviving spouses).

124. This amount increases, however, to reflect increases in the consumer price index. I.R.C. § 151(a).

125. Congress has imposed contribution limitations on the various forms of pensions funds. A "defined contribution plan," for example, limits the taxpayer to contributing \$30,000 of her salary to the tax-exempt fund; and the employee is not permitted to receive more than \$90,000 per year under a "defined benefit plan." I.R.C. §§ 415(c)(1) (annual contributions and additions to a defined contribution plan may not exceed the lesser of \$30,000 or 25% of the participant's compensation); I.R.C. § 415(b)(1) (annual benefits under a defined benefits plan may not exceed the lesser of \$90,000 or 100% of the participant's average compensation of his three highest-paying years). For a more extensive highest-paying discussion of the congressionally imposed limitations on these plans and others, see John H. Langbein and Bruce A. Wolk, *Pension and Employee Benefit Law* 262-73 (Foundation, 1995).

126. See Langbein and Wolk, *Pension and Employee Benefit Law* at 55 (cited in note 125), for an elaboration on the characteristics of the IRA. For a brief discussion on these programs as well as recent proposals for further tax incentives to savings, see also Regina T. Jefferson, *The American Dream Savings Account: Is It a Dream or a Nightmare?*, in Mary Louise Fellows and Karen B. Brown, eds., *Taxing America* 253-76 (New York U., 1996).

While the economic benefits awarded under the EITC, the standard deduction, the personal exemption, and the retirement provisions may be used for any expense incurred by the taxpayer, Congress has also targeted specific expenses for preferential tax treatment. The targeted provisions award exclusions, deductions, and credits for items associated with gains on home ownership,¹²⁷ healthcare,¹²⁸ education,¹²⁹ and childcare.¹³⁰ If the taxpayer forgoes the \$4,000 standard deduction, she also may deduct additional health care expenses that exceed 7.5% of her adjusted gross income,¹³¹ and the interest component of a home mortgage.¹³²

This brief description is intended simply to highlight the provisions in the Code that arguably reflect Congress's concern for an individual's access to basic human necessities. In the next two sections, I argue these provisions not only fail to satisfy the poor's positive claim to economic security, but in most cases they work to the far greater benefit of the wealthy.

2. General and Targeted Tax Provisions

The provisions Congress adopted to secure basic subsistence for poor individuals are all very similar in purpose and effect, with the exception of the EITC. For purposes of discussion, therefore, I will first address the provisions that are analytically similar. I then turn to the EITC and explore its relationship to economic security in the next Part.

As outlined above, each of these provisions, in effect, operate to decrease an individual's federal tax burden, thereby leaving a greater level of resources for individual consumption. While each of the provisions reduce the tax costs associated with income, they do

127. With regard to home ownership, individuals who have attained age fifty-five may exclude the gain from the sale of a primary residence. I.R.C. § 121.

128. In the realm of health care, Congress permits the taxpayer to deduct compensation received for injury or sickness as well as contributions to health plans. I.R.C. §§ 104, 105, 106.

129. As to the cost of education, the legislature has exempted or deducted scholarships used for tuition and related educational expenses, the costs of certain educational assistance programs, and the income from savings bonds used to pay for higher education. I.R.C. §§ 117, 127, 135.

130. Congress permits the taxpayer to take a nonrefundable tax credit calculated as a percentage of expenses up to \$4,800 a year or a tax deduction of \$5,000 per year. I.R.C. § 21(c) (saving the taxpayer, at the most, \$1,440 per year in taxes); § 129 (a)(2) (saving the taxpayer, at the most, \$1,980 in taxes).

131. I.R.C. § 213(a).

132. I.R.C. § 163(h).

nothing for those who have no access to income. In short, without gross income to offset or a tax burden to credit, the various deductions, exemptions, and credits offer no economic assistance. Of course, poor individuals have little gross income, making the general-needs provisions largely superfluous from their perspective.

The marginal effect of these provisions can easily be demonstrated by examining the financial circumstances of those who live at poverty levels. The poverty line designated by the U.S. Census Bureau varies according to family size and composition. In 1995, the federal government considered a married couple with one child and income equal to or over \$12,590 to be outside the boundaries of poverty.¹³³ Accordingly, this Article explores the benefits that Congress provides to a family earning \$12,590.

The federal income tax rate applicable to a three person family earning this amount is subject to a marginal tax rate of 15%. Thus, the family would owe \$1,888.50 in federal income taxes without the taking into consideration the preferential treatment for basic needs (that is, the provisions outlined above). The standard deduction and the personal exemptions permitted under sections 63 and 151, however, allow this hypothetical household to protect up to \$11,000 in gross income from federal taxation.¹³⁴ Without even considering the childcare, health care, or other basic needs provisions, therefore, the standard deduction and personal exemptions operate to alleviate \$1,650 in taxes, leaving a tax burden of \$238.50. If the family incurs childcare expenses, it is likely the family's entire tax burden will then be offset completely by the credit available under section 21 of the Code.¹³⁵ It is important to understand, however, that the most this family can possibly save under the basic needs provisions is their income tax burden of \$1,888.50. These provisions award nothing more than the negative right to be free from taxation.

While the basic needs provisions potentially exempt the poor from paying *income taxes*, they offer no protection from federal *employment taxes*. Under sections 3101 and 3111, employees must pay social security, medicare, and unemployment taxes (collectively known as "FICA taxes") at a rate of 7.65%. Thus while the income tax

133. U.S. Department of Health and Human Services, Office of the Secretary, *Annual Update of the HHS Poverty Guidelines*, 60 Fed. Reg. 7,772 (Feb. 9, 1995).

134. I.R.C. § 63(c) (\$5,000 standard deduction for a couple filing a joint return); I.R.C. §151 (\$2,000 exemption for taxpayer, spouse, and child). The allowable deductions are increased, however, to reflect increases in the consumer price index.

135. I.R.C. § 21 permits the taxpayer to take a credit equal to 29% of up to \$2,400 in childcare expenses. Because $.29 \times \$2,400 = \696 , the tax burden will be reduced to \$0.

is imposed only on income exceeding the standard deduction, personal exemptions, and the numerous other more targeted provisions, the employment tax applies to each dollar earned irrespective of these provisions. Thus a family of three with a single market participant earning \$12,590 will owe \$963 in employment taxes,¹³⁶ but will be exempt from paying the \$1,888.50 in income taxes due to the personal deduction and exemptions. Accordingly, the family's after-tax income will equal \$11,627. Admittedly, every dollar is extremely valuable to individuals living at this low level of income.¹³⁷ At the same time, it can hardly be argued that this minimal amount ensures meaningful economic security for a family of three with everyday expenses that include items such as food, rent, clothing, transportation, health care, and potential emergencies.

Indeed, tax theorists have argued the basic needs provisions not only fail to assist the poor in any meaningful manner,¹³⁸ but in some circumstances operate to exacerbate economic difficulties. Joseph Bankman, for example, has argued that many low-income individuals are less interested in long-term economic security due to their impending need for everyday necessities. The pension provisions (like the other provisions), therefore, are entirely useless to poor individuals.¹³⁹ Bankman points out that Congress not only adopted retirement subsidies that benefit savers (mostly high-income individuals), but it further compounded the biases in the pension area by adopting the anti-discrimination rules that work to ensure employers include low-income wage earners in the corporate pension plan.¹⁴⁰ The anti-discrimination rules, in effect, force the employer to

136. $\$12,590 \times .0765 = \963.13 .

137. See, for example, Blum and Kalven, *The Uneasy Case* at 56-57 (cited in note 7) (arguing that the poor get greater utility from each dollar than do the wealthy).

138. Staudt, 84 *Geo. L. J.* at 1599-1605 (cited in note 24) (explaining why the childcare credit offers very little assistance to low-income families); McCaffery, 40 *UCLA L. Rev.* at 1017-18 (cited in note 66) (same).

139. See, for example, Joseph Bankman, *The Effect of Anti-Discrimination Provisions on Rank-and-File Compensation*, 72 *Wash. U. L. Q.* 597, 603-05 (1994) (arguing that pension plan provisions operate to deny low-income individuals' access to everyday necessities because employers reduce immediate wages in order to deposit the sums into long-term savings plans); Alstett, 108 *Harv. L. Rev.* 546-64 (cited in note 14) (outlining the manner in which the EITC program discourages work and marriage among the recipients). For further criticisms of the basic needs provisions, see Staudt, 84 *Geo. L. J.* at 1599-605 (cited in note 24) (arguing that the childcare and elder care deductions and credits are virtually worthless to the poor); McCaffery, 40 *UCLA L. Rev.* at 1017-18 (cited in note 66) (demonstrating the limited economic impact of the provisions on women at all income levels).

140. I.R.C. § 401(a)(5) (West 1996 ed.) (requiring the ratio of retirement benefits to total compensation be as great for rank-and-file employees as for highly compensated employees).

divert low-income employees' salaries into the pension funds, potentially denying the poor money that is needed to purchase everyday necessities. Although analysts might respond that the anti-discrimination rules are justified on paternalistic grounds for precisely this reason, Bankman argues the rules pose further problems for rank-and-file employees. He notes that because low-income wage earners value an immediate cash payment more than they value money deposited into an inaccessible pension fund, the cost of including the low-income wage earners into the corporate pension plan might correspondingly increase the cost of employing these individuals. The additional costs (that is, the difference between immediate wages and long-term retirement benefits), in turn, are likely to reduce the demand for rank-and-file employees and ultimately reduce the perceived compensation of the employees left in the industry.¹⁴¹ Congress's strategy of promoting individual economic security in the long-run, therefore, might produce economic insecurity in the short term for low-income wage earners.

Although the tax exemptions, deductions, and credits offer little or nothing to poor individuals, they provide extremely lucrative benefits to wealthy individuals. As the taxpayer's income increases, therefore, the general and targeted provisions become more valuable.¹⁴² This characteristic can easily be illustrated. Imagine, for example, a single hypothetical taxpayer, Ellen. Ellen earns \$24,000 a year, she is subject to a fifteen percent marginal tax rate, and thus pays \$2,617.50 in taxes.¹⁴³ Ellen's financial circumstances change when she takes out a \$50,000 mortgage at ten percent interest to purchase a home. She pays approximately \$5,000 of interest each

For further elaboration of the anti-discrimination provisions, see Bankman, 72 Wash. U. L. Q. at 599-600 (cited in note 139); Joseph Bankman, *Tax Policy and Retirement Income: Are Pension Plan Anti-Discrimination Provisions Desirable?*, 55 U. Chi. L. Rev. 790 (1988).

141. Bankman, 72 Wash. U. L. Q. at 605-10 (cited in note 139). Bankman, however, also points out that in *one* set of circumstances the anti-discrimination provisions will lead to an increased demand and thus increased compensation for rank-and-file employees in an industry. In all other contexts, provisions will reduce the perceived compensation and welfare of the low-income wage earners. See *id.* at 609, 612-13.

142. As Bankman highlights, in the pension context, highly compensated employees often value long-term pension benefits more than immediate cash transfers. Because the employer is able to deposit moneys into the corporate pension plan for the benefit of these individuals, often at a rate lower than the individual's salary, the costs of employing highly compensated individuals decrease. These decreased costs might, in turn, increase demand and ultimately the perceived wages of this group. Bankman, 72 Wash. U. L. Q. at 606 (cited in note 139).

143. Ellen's income is reduced by \$6,550—the amount of the personal exemption and standard deduction. Thus 15% tax on \$17,450.00 equals \$2,617.50. Ellen can take no targeted deductions, and she is not entitled to the EITC under section 32 of the Internal Revenue Code because she is single with no children. See I.R.C. § 32.

year to her lender, and as discussed above, Ellen is entitled to deduct her interest payments under section 163(h) of the Code. Accordingly, Ellen's tax burden decreases from \$2,617.50 to \$2,467.50—a tax savings of \$150.00.¹⁴⁴

Now consider a second hypothetical taxpayer, Deborah, who is also single and has also borrowed \$50,000 from a bank at ten percent interest to purchase a home. The single economic difference between Ellen and Deborah is Deborah's salary, which is \$55,000 per year and the corresponding marginal tax rate which is thirty-one percent. Taking into consideration the interest deduction under section 163(h), Deborah will owe \$10,869.50 in taxes; without the mortgage interest deduction she would owe \$11,179.50. Due to Deborah's higher marginal rate, she saves \$310 as compared to Ellen's tax saving of \$150.¹⁴⁵

Although these hypothetical taxpayers demonstrate the upside-down nature of the deduction to taxpayers with divergent income tax rates, the discrepancies are often far more extreme than these simple examples indicate. Deborah, earning more than twice as much as Ellen, will most likely purchase a larger, more expensive home with a correspondingly bigger mortgage and greater interest payments. Accordingly, the tax preference found in section 163(h) will become even more valuable to a taxpayer in Deborah's position. That the mortgage interest deduction is limited to loans up to one million dollars demonstrates the potential for the provision to benefit the wealthy to a far greater extent than the poor.¹⁴⁶

144. Section 163(h)(3) allows Ellen to take the mortgage interest deduction only if she foregoes the standard deduction. Because the standard deduction for a taxpayer in Ellen's position is equal to \$4,000 and the interest payments are \$5,000, Ellen will, of course, choose to deduct the latter. I.R.C. § 163(h)(3).

145. The analysis would be the same in the context of an exemption from taxation but not with the provisions allowing a tax credit—although the value of the credit still generally increases as the taxpayer's marginal tax rates increase as the following example indicates. In the typical tax credit context (that is, when the tax credit is nonrefundable), Congress permits the taxpayer to offset her actual tax burden with a specified amount. With regard to childcare, for example, Congress permits a taxpayer with two children to offset her tax burden with a credit of up to 30% of \$4,500.00 or \$1,350, I.R.C. § 21. If the taxpayer's tax does not equal the amount of the credit, the remaining portion is simply lost to the taxpayer. For a further discussion of these and related issues, see Staudt, 84 *Geo. L. J.* at 1643-47 (cited in note 24).

146. I.R.C. § 163(h)(3)(c). Section 68, however, reduces the percentage a taxpayer can claim for certain itemized deductions after adjusted gross income exceeds \$108,000. Thus, it is those taxpayers in the highest tax bracket, but below the phaseout who gain the greatest benefit—not those who are the wealthiest of all taxpayers. Moreover, if one views the deductions and exemptions as appropriate for reaching a definition of taxable income, the current system is not an upside-down subsidy for the rich.

Additionally, the example discusses two hypothetical taxpayers who are both able to afford the cost of a home. Countless low-income individuals do not have the credit history necessary to borrow funds from a commercial bank.¹⁴⁷ Rather than buying a home, these individuals will rent living space and thus garner no special privileges under section 163(h) of the Code. The mortgage interest deduction, therefore, affords the greatest benefits to the wealthiest taxpayers and literally no economic advantage to the poorest individuals. Although this analysis considers the mortgage interest deduction under section 163(h), a close examination of every preferential provision outlined above, with the exception of the EITC, will yield identical results.¹⁴⁸ Paradoxically, then, the basic needs provisions offer little or no assistance to the extremely poor and become far more lucrative as one's income increases.

3. The Earned Income Tax Credit

The EITC must be calculated in order to understand the full tax consequences to the hypothetical family earning \$12,590 of pre-tax income. While the provisions outlined in the last subpart offer

147. For a discussion of the explicitly racist red-lining procedures followed by several federal loan programs working to deny low-income individuals loans, see John A. Powell, *How Government Tax and Housing Policies Have Racially Segregated America*, in Mary Louise Fellows and Karen B. Brown, eds., *Taxing America* 80-115 (New York U., 1996).

148. Many individuals, for example, cannot afford health care or childcare and cannot afford to deposit moneys into tax-deductible retirement funds. These citizens, therefore, do not receive the economic benefits of the provisions outlined above. See, for example, Stephanie Golden, *The Women Outside* (U. of Chicago, 1992) (detailing the lives of homeless women and the financial difficulties associated with "real life outside"). For further discussion of the upside-down nature of the tax preferences, see Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures* 71-82 (Harvard U., 1985).

Even considering the impact of the EITC, the tax burden historically has increased for the poor, while Congress has lowered the effective marginal tax rates for the wealthy through the preferential treatment given to these expenses and countless others. The following chart reflects the Congressional Budget Office estimates of the changes in income tax burdens that have occurred for individuals at different levels of income:

Estimate of Percent Change in Tax Liabilities from 1977-1990.

<u>Income Quintile</u>	<u>Percent change</u>
lowest	0.6
second	7.1
third	8.4
fourth	8.0
highest	-23.8
top 10%	-30.8
top 5 %	-36.2
top 1%	-39.0

little or nothing to the poor, the EITC is far more successful at satisfying a positive right to income. The EITC, found in section 32 of the Code, entitles a low-income wage earner to a refundable tax credit based on income level and number of children in the household. For example, the program entitles a family with income equal to \$6,000 and one child, to a subsidy of thirty-four cents on every dollar earned.¹⁴⁹ Once the taxpayer's income exceeds \$11,000, however, the credit begins to decrease until it is completely phased out when the taxpayer's salary reaches \$23,760. Thus, a married couple with one child earning \$12,590 is entitled to an earned income credit of \$1,786.¹⁵⁰ Importantly, Congress did not adopt the credit to lift all individuals out of poverty, but rather to provide minimal financial assistance to the extremely needy *who work* in the waged labor force.

Based on the calculations above (including those in the last section), the hypothetical family will not owe any income tax, will be subject to \$963 in employment taxes, and will receive a \$1,786 cash transfer under the EITC. Thus, after taking into consideration all potential burdens and benefits found within the Code, this family will receive \$823 from the federal government on top of the \$12,590 salary earned in the private market—totaling \$13,413. Although countless theorists have debated the level of income necessary to ensure basic human needs and the concept of poverty in general,¹⁵¹ the claim that a payment from the government of \$823 ensures basic economic security for a family of three living on the edge of poverty would be disingenuous.

Moreover, Congress has not tied the EITC cash transfer only to the level of an individual's poverty, but conditions the transfer on the taxpayer's market participation. If the taxpayer fails to participate in the market economy, the credit is unavailable irrespective of economic need. In this respect, the EITC fails to account for the difficulties

149. I.R.C. § 32(b).

150. $(.34 \times \$6,000) - [1598 \times (\$12,590 - \$11,000)] = \$1,786$. See I.R.C. § 32(b). For a detailed description of the EITC, see Alstott, 108 Harv. L. Rev. at 541 & n.38, 542-43 (cited in note 14) (providing useful graphs and discussing the operation of the provision for a low-income family with two children). See also Timothy J. Eifler, Comment, *The Earned Income Tax Credit As a Tax Expenditure: An Alternative To Traditional Welfare Reform*, 28 U. Rich. L. Rev. 701, 713-15, 750-55 (1994) (discussing tax credit for families of various sizes and income levels); Yin, *The Uncertain Fate*, in Fellow and Brown, eds., *Taxing America* at 297 (cited in note 119) (discussing the limitation of the EITC program and proposing an alternative solution for ensuring low-income individuals have access to basic needs and resources).

151. Amartya Sen, *Poverty and Famines: An Essay on Entitlement and Deprivation* 9-38 (Clarendon, 1981) (discussing various conceptions of poverty).

that an individual might have in entering and maintaining a position in the formal market economy. Many individuals, for example, are unable to enter the private market due to childcare or elder care responsibilities.

Academic studies have repeatedly demonstrated the manner in which the tax structure itself discourages the market participation of individuals with these household responsibilities. Consider the financial circumstances of women with children. The Tax Code does not impose a tax on the value of women's household services but does impose employment and income taxes on the benefits of waged labor in the market.¹⁵² Additionally, women working in the market, like workers generally, will be forced to incur costs for items such as business attire and transportation—all nondeductible personal expenses. Although Congress allows working women to deduct a portion of the cost of childcare under section 21 of the Code, the savings obtained under section 21 is far below the actual cost of childcare.¹⁵³ Indeed, due to the tax and other costs associated with market labor, women often lose money by working in the market and thus rationally choose to stay home and care for their own children.¹⁵⁴ That decision, however, will bar them from obtaining the benefits under the EITC even if they live deep in poverty.

Additionally, the federal government has frequently adopted policies that maintain a certain level of unemployment. In order to avoid the cost of accelerating inflation, economists have persuaded policymakers that unemployment is not only necessary but key to growth and productivity of the economy.¹⁵⁵ Accordingly, policymakers

152. See, for example, Staudt, 84 Geo. L. J. 1587 (cited in note 24) (discussing impact of the Tax Code on women's work labor and considering the possibility of taxing housework); McCaffery, 40 UCLA L. Rev. at 1059 (cited in note 66) (also discussing impact of Tax Code on women's labor but using the optimal tax theory as an analytical framework for arguing Congress should reduce the tax on married women). See also note 26 (discussing the optimal tax theory).

153. A woman earning a \$15,000 salary, for example, will have tax savings of just \$15. See McCaffery, 40 UCLA L. Rev. at 1014-29 (cited in note 66) (calculating the potential tax savings of the childcare and other provisions for women at various levels of income). See also Mary Heen, *Welfare Reform, The Child Care Dilemma, and the Tax Code*, in Mary Louise Fellows and Karen B. Brown, eds., *Taxing America* 322-23 (New York U., 1996) (calculating the benefits under the childcare provisions and noting their limited impact).

154. See Staudt, 84 Geo. L. J. at 1571 (cited in note 24).

155. Countless economic theorists have noted the costs of inflation, including its distortionary effects on the distribution of income and wealth and its tendency to discourage investment activities. See, for example, Rebecca M. Blank and Alan S. Blinder, *Macroeconomic, Income Distribution, and Poverty* (U. of Wisconsin-Madison, IRP Conference Paper, Feb. 1985) (discussing the impact of inflation on the poor and claiming it is "the cruelest tax"); Paul A. Samuelson and William D. Nordhaus, *Economics* 314 (McGraw Hill, 1989) (noting the major problems occur when inflation is volatile—unanticipated inflation redistributes wealth from

have sought to maintain the "natural rate" of unemployment in an effort to ward off problematic inflation.¹⁵⁶ At the same time, however, some economists have argued that the perceived natural rate of unemployment is far above the voluntary level of unemployment. Put differently, the state potentially keeps individuals who want jobs out of the market in order to avoid the social and economic costs of inflation.

Under current circumstances, therefore, unemployment is inevitable and perhaps made even worse by legislative policies intended to promote growth and stability. Yet, the architects of the EITC have mandated that poor individuals maintain employment in the waged labor market if they hope to receive financial assistance from the state. By tying basic human needs to wage labor and at the same time pursuing policies that make it impossible for the poor to

creditors to debtors while unforeseen disinflation has the opposite effect); Robert Barro, *Inflation and Economic Growth*, in National Bureau of Economic Research, *Working Paper 5326* (1995) (arguing that inflation inhibits growth); Irving S. Friedman, *Inflation: A World-Wide Disaster* 205-53 (Houghton Mifflin, 1980) (discussing the problem of inflation in the world economy). In seeking to deter inflationary pressure on the market, many economic theorists have noted that there exists a tradeoff, at least in the short term, between inflation and unemployment. Alice M. Rivlin, *Reviewing the American Dream: The Economy, the States, and the Federal Government* 57 (Brookings Institute, 1992). Thus, stimulative fiscal policies reduce unemployment but are likely to aggravate inflation, and restrictive measures will take the pressure off inflation but will probably raise unemployment. In short, "control of inflation in a modern industrial economy poses one of the cruelest dilemmas that must be faced by economy policymakers." See Samuelson and Nordhaus, *Economics* at 329-36 (cited in this note) (arguing that the natural rate of inflation might lie somewhere above the level necessary for frictional migration and young and untested workers looking for jobs). See also Marc Bendick, Jr., *Government's Role in the Job Transitions of U.S. Dislocated Workers*, in F. Stevens Redburn, Terry F. Buss, and Larry C. Ledebur, eds., *Revitalizing the U.S. Economy* 158, 159 (Praeger, 1986) (stating that "cyclical macroeconomic factors" (such as a recession), not structural factors (such as technological change), push millions of workers out of the waged labor force). See also Mark Kelman, *Could Lawyers Stop Recessions? Speculations on Law and Macroeconomics*, 45 *Stan. L. Rev.* 1215, 1227-46 (1993) (discussing and critiquing various theories of unemployment).

156. The level of unemployment that economists and policymakers deem necessary for an efficient operation of the economy is the "natural rate of unemployment" or the "nonaccelerating-inflation rate of unemployment." See Robert J. Gordon, *Understanding Inflation in the 1980s*, *Brookings Papers on Economic Activity* 263-302 (1985) (discussing the rising level of the "natural level of unemployment"). See also Samuelson and Nordhaus, *Economics* at 296-97 (cited in note 155) ("Responsible and farsighted policymakers, therefore, generally do not intentionally aim the economy at . . . unemployment rates below the natural rates. To do so would lead to inflation."). While the natural rate of inflation might fluctuate, it seems to be rising. See Herbert Stein, *Presidential Economics: The Making of Economic Policy from Roosevelt to Clinton* 150-51 (American Enterprise Institute, 1994) (noting that in the 1960s and 1970s most economists calculated the rate around 4% and by the 1980s it was calculated at 6-7%). See also James K. Galbraeth, *Time To Ditch the NAIRU*, 11 *J. Econ. Persp.* 93-108 (1997) (arguing that the concept of the natural rate of unemployment is controversial and largely useless and thus should be abandoned).

obtain a position in the market, the state has established procedures and policies that operate to deny the poor the very rights it has bestowed upon them.¹⁵⁷ The ineffectiveness of the EITC, along with the superfluous deductions and exemptions, therefore, indicate that tax policy makers either are not pursuing a program that ensures the poor have access to basic subsistence income or are completely ineffective in their pursuit.

C. Assuming the Problem Will Solve Itself

Tax and economic theorists have taken the position that growth policies are the surest way to provide wealth and opportunity for all individuals, both wealthy and poor.¹⁵⁸ National growth and economic stability, it is argued, will not only assist families and individuals to purchase nutrition, medical care and other basic necessities, but it can also enable the state to provide education, health care, and shelter for low-income and poverty-stricken individuals.¹⁵⁹ Thus while tax theorists have not explored the possibility of awarding specific subsidies to the poor beyond an exemption, they have pursued a strategy of growth that many believe is a more effective route to economic security. In short, tax theorists might argue that they have not ignored positive rights but have pursued them indirectly through growth strategies.

Theorists consider the Tax Code an important instrument for promoting market growth and productivity. One obvious example of this use is the lower marginal tax rate Congress has imposed upon gains earned through capital investments.¹⁶⁰ Decreased taxation arguably provides an incentive for investment and savings, thereby increasing overall growth. This provision is just one of countless provisions intended to spur the growth of the market.¹⁶¹

157. See Jonathan Barry Forman, *Simplification for Low-Income Taxpayers*, in Mary Louise Fellows and Karen B. Brown, eds., *Taxing America* 279 (New York U., 1997) (noting that all the benefits of the EITC go to families with adjusted gross income of \$30,000 or less).

158. See discussion of the market growth and the trickle-down effect in note 73 and accompanying text.

159. Sen, 268 Sci. Am. at 45 (cited in note 71). See Richard A. Easterlin, *Does Economic Growth Improve the Human Lot? Some Empirical Evidence*, in Nations and Households, in Paul A. David and Melvin W. Reder, eds., *Economic Growth: Essays in Honor of Moses Abramovitz* 89 (Academic, 1974).

160. Compare I.R.C. § 1(a) (West 1996 ed.) (imposing tax rate of 39.6% on ordinary income) with I.R.C. § 1(h) (imposing tax rate of 28% on capital gains).

161. See, for example, Cathie Martin, *Shifting the Burden: The Struggle Over Growth and Corporate Taxation* (U. of Chicago, 1991) (exploring Congress's historical focus on growth and the mechanisms used to promote it).

Unfortunately, economic growth is a policy that most nations pursue, but that has never provided economic security or access to basic material needs. Amartya Sen, for example, points to a number of economies that have maintained a high level of GDP but have inferior records on education, health, and general welfare as compared to those with a lower GDP. Although the relationship between a growing economy and the provision of basic human needs has been extensively discussed and analyzed in the context of developing nations,¹⁶² it is also relevant to wealthy industrial nations. Indeed, as Sen argues, "American public policy-makers may have failed to understand important dimensions of social welfare because of an overconcentration on aggregate wealth and overall economic growth."¹⁶³

The disjointed relationship between aggregate economic growth and poor individuals' access to basic human needs is clear in a number of contexts. Consider the availability of health care. Many policymakers and theorists have noted the relationship of health care to basic human survival and have argued that the state has a role in providing this basic need. Stephen Holmes argues, for example, that virtually every major liberal and democratic theorist would argue that it is incumbent upon our society to provide the resources necessary for such care.¹⁶⁴ The Tax Code itself reflects the importance of adequate health care through sections 102, 104, 106, and 213, all of which give preferential treatment to costs associated with maintaining personal health.

Despite this prevailing view on the importance of health care *and* the extremely high level of gross domestic product in the United States, countless American men and women have no access to health care. This lack of care has had an observable and troubling impact on the lives of many poor Americans living in poor urban communities. Indeed, Amartya Sen has collected data indicating that black men

162. See, for example, H. W. Arndt, *Economic Development: The History of an Idea* 89-113 (U. of Chicago, 1987) (discussing the origins and issues of economic growth policies in developing countries and their success in providing basic needs); Jagdish N. Bhagwati, *Wealth and Poverty: Essays in Development Economics* (MIT, 1985) (outlining economic growth strategies and the social and political issues they raise).

163. Sen, *Sci. Am.* at 45-46 (cited in note 71).

164. "How can constitutional principles originally designed to outlaw judicial torture and religious persecution plausibly be invoked to forbid the provision of prenatal care to the impoverished?" Holmes, *Passions and Constraint* at 37 (cited in note 109) (arguing modest redistributive measures are not even remotely similar to the tyrannical behavior that worried the framers).

living in east Harlem have a shorter expected life span than individuals living in Bangladesh, China, and India.¹⁶⁵

The nature of the health care problem in the United States, however, cannot be understood simply by measuring the GDP or even the relative income levels between American individuals and those living in developing countries. The U.S. GDP far exceeds the level of the GDP in the Bangladesh, China, and India. Additionally, data indicates that while the Americans with these high mortality rates live in poverty according to American standards, they are much richer and have much higher levels of purchasing power than the Bangladeshi, Chinese, and Indian citizens.¹⁶⁶ A rising level of national economic growth and high individual income levels, therefore, do not ensure access to the basic material needs necessary for social and economic well-being.

Perhaps the data that most explicitly show that high levels of aggregate economic growth do not necessarily ensure access to the basic human needs are the government statistics relating to current poverty levels. Although the number of individuals with income under the poverty line tends to rise during recessions and fall during periods of economic growth, there is a definite upward trend in overall poverty levels.¹⁶⁷ In 1993, fifteen percent of the U.S. population was living in poverty.¹⁶⁸ If the data is broken down according to personal characteristics and family circumstances, the percentages drastically increase. Thirty-three percent of African-American citizens live in poverty; fifty-three percent of all families with a female head-of-household live below the poverty level; and twenty-two percent of all children live with poor families.¹⁶⁹ Thus, while this country has experienced economic growth over the last several decades, there has been no correlative decrease in the level of poverty as the market growth theorists have anticipated.¹⁷⁰

The market growth approach to tax policymaking, therefore, is as flawed as the approach that awards subsidies to taxpayers through

165. Sen, 268 *Sci. Am.* at 45-46 (cited in note 71).

166. *Id.*

167. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1995*, 480 tbl. 744 (1995) (providing data on persons living below the poverty level between the years 1960 and 1993).

168. *Id.* at 480 table 744. See also Nancy Folbre, *The New Field Guide to the U.S. Economy* 1.1-4.18 (Pantheon, 1995) (providing various statistics and information that is useful for understanding the distribution of income and wealth based on class, gender, and race).

169. U.S. Bureau of the Census, *Statistical Abstract* at 480 tables 744 & 745, 483 table 750 (cited in note 167).

170. Blank and Blinder, *Macroeconomic, Income Distribution, and Poverty* at 4 (cited in note 155).

the provisions outlined in the preceding subpart. Neither approach ensures that the poor will have access to basic income needs. Indeed, the two approaches have advanced the interests of the wealthy to a far greater extent than the interests of the poor. Accordingly, traditional tax theorists cannot claim that the provisions and policies accord the poor a positive right to income.

Of course, tax theorists are not responsible for the failings of the tax system, but they can be held responsible for comprehending the easily observable limitations of the tax policies grounded in the very theories they advocate. By arguing the poor have a positive right to wealth and market opportunity while pursuing policies that are entirely ineffective, theorists and policymakers appear to have given the poor something of value when in fact what is given amounts to nothing.¹⁷¹ This approach not only imposes material costs upon the poor, but it also imposes serious social and cultural costs. The illusion that tax theorists and policymakers are genuinely protecting the interests of the poor allows society to avoid resolving the difficult question of whether poor citizens in fact do have positive rights and entitlements.

Moreover, by creating the illusion that tax policy fully addresses the concerns of the poor, theorists and policymakers, in effect, make any further claims on society unjustified. Indeed, it allows society to view the poor as not only unproductive and lazy, but also as hustlers trying to cheat the system when they make claims for income and security beyond what is already provided. In short, society might falsely perceive the poor as undeserving when in fact they might deserve more than they have received.¹⁷²

IV. THE MISSING DEBATE OVER RESPONSIBILITIES

In this Part, I turn from rights to responsibilities. Although traditional tax theorists appear to assume that the poor have at least some minimal rights with regard to the state, no theorist has ever

171. See note 176.

172. This problem is similar but not identical to the problems associated with tax theorists' complete failure to address the rights of the poor. In the preceding Part, I argued one unified discussion of the rights and obligations of both the wealthy and the poor might avoid the false perception that the rights of the poor consistently trump the rights of the wealthy. In this Part, I argue that theorists and policymakers appear to have already considered and protected the positive rights of the poor, when in fact they have not done so.

considered the possibility that the poor might also have responsibilities. While tax theorists' failure to investigate rights imposes obvious and hidden costs upon the poor, the problems associated with their failure to explore a poor individual's positive obligation to the state is much more subtle. At first cut, it might appear that in more thoroughly addressing individual rights we can only advantage the poor while addressing responsibilities can only produce further marginalization. When the effects of tax theorists' failure to consider a poor individual's responsibility to the state are analyzed closely, however, it becomes clear that this oversight has seriously disadvantaged the poor. Accordingly, I argue that tax theorists must recognize the possibility that all citizens, wealthy and poor, are capable of contributing to the greater social good.

Early social contract theorists and utilitarian theorists explicitly addressed a relatively wealthy citizen's obligation and responsibility to the greater social good.¹⁷³ The contemporary debate on distributive justice, however, has focused on individual rights which, in turn, has led traditional tax theorists to center their discussion on taxpayer rights and entitlements before considering the individual's obligation to the state.¹⁷⁴ Focusing primarily on rights in the taxation context is particularly surprising in light of the fact that the laws raise obvious and fundamental questions with regard to a citizen's responsibility to the public good.

Countless theorists have lamented society's preoccupation with rights, arguing that "it is the responsibilities of a citizen that . . . pro-

173. Theorists using Hobbes's political theory attempted to impose tax burdens commensurate with social benefits, assuming that one's responsibility to the social good was equal to the benefits obtained. Under the utilitarian ethic, individuals have a moral responsibility to support policies that promote overall welfare, even if they are not in one's own economic interest. Thus, a utilitarian tax regime calls for the wealthy to pay a higher percentage of their wealth to the common good because poor individuals get infinite utility from each dollar whereas lower levels of utility inure to the the wealthy. See Part II.B.2.

174. See, for example, Carens, 14 *Pol. Theory* 31 (cited in note 92) (arguing that contemporary liberal political theories focus on rights and not responsibilities). But see Kent Greenawalt, *Promise, Benefit, and Need: Ties that Bind Us to the Law*, 18 *Ga. L. Rev.* 727, 733 (1984) (arguing that traditional debates imply that individual citizens have duties under the social contract). See notes 110-16 and accompanying text (discussing Hohfeld's terminology and the link between rights and duties). With regard to economic theorists' failure to perceive responsibility as relevant to policymaking, see Friedman, *Capitalism and Freedom* at 133 (cited in note 73) ("[F]ew trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."); Suzanna Sherry, *Responsible Republicanism*, 62 *U. Chi. L. Rev.* 130, 151 (1995) ("[B]ecause the stockholders have a right to their earnings and the community at large has no right to be free of whatever unethical practices are being challenged, these economists conclude that the answer is clear cut: the presence or absence of rights pretermits any discussion of responsibility.").

vide[] a bridge between selfish, rights-bearing individuals and their . . . community.”¹⁷⁵ Rights talk, it is argued, “promotes unrealistic expectations, heightens social conflict, and inhibits dialogue that might lead toward consensus, accommodation, or at least the discovery of common ground.”¹⁷⁶ Moreover, many political and moral theorists have forcefully argued that the very notion of citizenship is intimately linked with both individual entitlement and obligation to a community.¹⁷⁷ The political theorist T.H. Marshall, for example, contended that by guaranteeing civil, political, and social rights to all, the state ensures that every member is able to participate in and enjoy the common life of society.¹⁷⁸ Withholding these rights ultimately marginalizes individuals in the community. At the same time, theorists have argued that the inability to fulfill community obligations or to maintain some level of civic virtue is as much of an obstacle to full membership in society as is the lack of

175. Sherry, 62 U. Chi. L. Rev. at 132 (cited in note 174).

176. Mary Ann Glendon, *Rights Talk: The Impoverishment of Political Discourse* 14 (Free Press, 1991) (“[I]n its silence concerning responsibilities, it seems to condone acceptance of the benefits of living in a democratic social welfare state, without accepting the corresponding personal and civic obligations.”). The power of Glendon’s point is particularly relevant in the tax context. Consider the tax revolt in California during the 1970s, which resulted in the adoption of Proposition 13—a law that operated to dramatically reduce state property taxes. As a result of the tax reduction, Californians suffered major cutbacks in education funding, social welfare programs, and many other programs. Indeed, the tax reduction ultimately worked to the greater benefit of commercial taxpayers and to the burden of the poorest individuals. See Susan B. Hansen, *The Politics of Taxation: Revenue Without Representation* 212-46 (Praeger, 1983) (describing Proposition 13 and its consequences). At the time Proposition 13 was enacted, citizens argued the California tax laws violated their right to income but they never considered what level of obligation they had or should have to the state. See *id.*

Suzanna Sherry highlights the problems associated with “rights talk” by pointing to two hypothetical discussions with two hypothetical individuals. In the first discussion, one individual argues she has the right to a childcare subsidy and the other contends that she has the right not to be burdened with the higher taxes necessary to support the the childcare. Now imagine the same question examined in the context of whether it would be good for society as a whole to ensure that all citizens have access to economic security. One leads to compromise while the other is a zero-sum game. Sherry, 62 U. Chi. L. Rev. at 147 (cited in note 174) (citing the work of Ronald Beiner).

Professor Sherry argues that in letting rights overwhelm responsibilities, society seems to give something of value when often what is given amounts to nothing. Consider, for example, the idea that women have a right to work. This right is meaningless if family obligations and the workaholic tendencies of their male colleagues prevent women from being assimilated into the workforce. Suzanna Sherry, *Without Virtue There Can Be No Liberty*, 78 Minn. L. Rev 61, 73 (1993) (also noting that a “poor pregnant woman has a ‘right’ to an abortion, but no resources with which to turn her life around whether or not she chooses to have the child” and school children have a right to integrated education, but not an adequate one).

177. Kymlicka and Norman, 104 *Ethics* at 353 (cited in note 51) (describing the work of several theorists who have made the link between social obligation and meaningful citizenship).

178. T.H. Marshall, *Class, Citizenship and Social Development Essays* (Doubleday, 1965).

equal rights.¹⁷⁹ Accordingly, I seek to refocus tax theorists on the importance of individual fulfillment of social obligation and at the same time expand the discussion to include both the wealthy and the poor.

It is obvious that by contributing money to the fisc, taxpayers fulfill an obligation to the community. Paying taxes, however, does not only impose a burden. Taxpayers share in the benefits of an organized society as well as the provision of public goods and services that could not be obtained in the private market.¹⁸⁰

Moreover, by paying taxes, the relatively wealthy seem to attain a privileged status in contemporary political and legal debates. The idea that an individual's social standing improves upon the payment of taxes is likely to be met with suspicion, perhaps even laughter, by contemporary tax theorists.¹⁸¹ Understanding the social value of paying taxes, however, is key to understanding fully why traditional tax theory has contributed to the marginalization of the poor.

First, consider the fact that tax policy debates have generally privileged the interests of the relatively wealthy. In the 1996 presidential election, both candidates focused on tax issues that could only be of importance to middle and upper class individuals. Bill Clinton and Bob Dole, for example, both proposed tax reform that would enable individuals to set aside a greater percentage of income in tax-free retirement funds.¹⁸² Dole also advocated a decrease in the

179. Sherry, 62 U. Chi. L. Rev. at 148 (cited in note 174) (asserting that citizenship is "so intertwined with responsibility"); Carens, 14 Pol. Theory at 31-49 (cited in note 92) (arguing that all individuals have the moral duty to contribute their talents and energies to society to the greatest extent possible); Mead, *Beyond Entitlement* at 12-13 (cited in note 14) (stating that programs that afford rights but fail to impose responsibilities infringe upon equality because responsibilities are "just as necessary for belonging"); Morris R. Cohen, *Property and Sovereignty*, 13 Cornell L. Q. 8, 26 (1928) (arguing that property rights carry with them the positive duty to use the property in the public interest and for the benefit of one's community).

180. Weston, *Principles of Justice* at 128 (cited in note 41) (noting that the benefits from the state include "glory, honor, education, religion, national well-being, etc.").

181. The idea that one has an obligation to society and that fulfilling that responsibility improves one's social standing is not, however, foreign to theorists in all disciplines. See, for example, Carens, 14 Pol. Theory at 33-34 (cited in note 92) (arguing that all individuals have the responsibility to give their talents and energies to society and that a person who satisfies this obligation contributes to an egalitarian society and deserves moral praise); Mead, *Beyond Entitlement* (cited in note 14) (satisfying the social obligation to work enables one to participate in society in a more meaningful way); Seligman, *Progressive Taxation* at 184-85 (cited in note 2) (quoting, admittedly, Robespierre as arguing that the "result of any exemption for such an honorable obligation to be taxed would necessarily result in the restriction of democracy").

182. See *The President's Economic Plan: Targeting Tax Relief to Middle-Income Americans* (proposing to expand the limitations on retirement fund contributions imposed on couples with incomes up to \$80,000); *Restoring the American Dream: Bob Dole's Pro-Growth Plan for America's Families* (proposing similar expansion on limitations imposed on IRA contributions).

marginal tax rates in general and the capital gains rates in particular.¹⁸³

Perhaps more disturbing than devising tax legislation tailored to the interests of the relatively wealthy is the fact that society itself accords more respect to taxpayers than nontaxpayers in the public debates. The discourse related to the distribution of welfare benefits easily demonstrates this point. This dialogue views taxpayers as hard-working and disciplined individuals who unfortunately must provide economic assistance to the deviant and lazy welfare recipients. Not only does the welfare rhetoric paint relatively wealthy taxpayers as humanitarians who must save the poor from themselves, but welfare legislation also often more explicitly addresses the interests of taxpayers than the needs of the poor.¹⁸⁴

In advocating an exclusion from the tax laws and from all other social obligations, traditional tax theory, therefore, has worked to marginalize the poor in both the social policymaking process and in society-at-large. This exclusion and marginalization, in turn, works to curb the poor's interest and commitment to broader social and political issues.¹⁸⁵ Rather than participating in the political process by expressing their own ideas and viewpoints, the poor often remain

See Adam Clymer, *Poor Losers: Class Warfare? The Rich Win By Default*, N.Y. Times, § 4 at 1 (Aug. 11, 1996) (arguing that both candidates have created a platform tailored to the interests of middle and upper income individuals). Of course, the idea that the political process panders to the interests of powerful players is widely understood. See, for example, Brennan and Buchanan, *The Power to Tax* at 13 (cited in note 120) (describing the economic approach to the political process and arguing it is nothing more than an "institutional setting within which persons and groups interact to pursue their own end"); Jamin Raskin and John Bonitaz, *Equal Protection and the Wealth Primary*, 11 Yale Law & Pol'y Rev. 273 (1993) (arguing that private money controls both policies and government);

183. See Bob Dole's Tax Proposal, *Restoring the American Dream*.

184. See Note, *Dethroning the Welfare Queen: The Rhetoric of Reform*, 107 Harv. L. Rev. 2113 (1995) (the welfare debate has been "reduced to a clash of moral symbols"); Richard Pildes, *The Unintended Cultural Consequences of Public Policy*, 89 Mich. L. Rev. 936, 952 (1991) (arguing that the laws are set up to permit individuals simply to pay for welfare assistance but not to change underlying problems associated with poverty and isolation).

185. Feminist scholars have argued that the laws excluding women also work to marginalize women in a number of ways. The federal government's decision to exclude women from certain military positions, for example, prevents women from sharing in valuable patriotic and political responsibilities. This, in turn, promotes indifference to matters of security, defense, war, and peace. See Rebin Regers, *A Proposal for Combating Sexual Discrimination in the Military: Amendment of Title VII*, 78 Cal. L. Rev. 165, 168 (1990); Judith Hicks Stiehm, *The Effects of Mythe about Military Women on the Waging of War*, in Eva Isaksson, ed., *Women and the Military System* 104 (St. Martin's, 1988). Compare Lucinda Finley, *Breaking Women's Silence in Law: The Dilemma of the Gendered Nature of Legal Reasoning*, 64 Notre Dame L. Rev. 886 (1989) (noting that women's historical exclusion from the law has produced gendered legal language that works to subordinate and marginalize women).

outside public debate even in circumstances under which they could easily make their views more widely known. The demographic characteristics of those who vote reflect the political apathy of poor individuals. Only eight percent of voters come from families with income under \$15,000,¹⁸⁶ though these same families represent twenty-three percent of the population.¹⁸⁷ Conversely, families with income above \$15,000 make up seventy-eight percent of the population but represent ninety-two percent of the voters. Commentators have argued that this political indifference is directly linked to the manner in which social policy, and tax policy in particular, tends to address the interests of the relatively wealthy rather than the concerns of the those living in poverty.¹⁸⁸

Of course traditional tax theorists may not have entirely neglected the poor, but may have intended to impose *negative* rather than *positive* responsibilities (that is, self-restraint versus positive activities). Indeed, just as many other public policy areas rely on self-restraint,¹⁸⁹ successful tax policy also relies upon the poor to meet their negative responsibility to society. If poor individuals avoid demanding excessive benefits under the Code, for example, they will avoid imposing inefficient costs upon society and infringing upon the property rights of the relatively wealthy. That traditional tax theorists have raised these concerns for over a century implies that they have sought to impose just this type of negative responsibility upon the poor. While all citizens have certain negative obligations to society, the notion that the poor must privilege the rights and interests of the relatively wealthy is precisely the notion that has led to the deep bias against the poor in taxation debates as well as their cultural marginalization and political apathy. It leaves the poor in the disadvantaged position of patiently and quietly waiting for the wealthy to decide their social and economic fate. To ensure the poor

186. Clymer, N.Y. Times § 4 at 1 (cited in note 182) (noting that politicians have no fear of poor voters in light of their history of not voting and arguing that this pattern has produced class-biased legislation).

187. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1996* (1996).

188. See, for example, Clymer, N.Y. Times § 4 at 1 (cited in note 182).

189. Will Kymlicka and Wayne Norman note that public policy relies on negative obligations in a number of areas. In order to keep Medicaid and Medicare costs down, for example, policymakers rely on citizens to act responsibly with regard to their health. And to protect the environment, policymakers rely on households to avoid making unnecessary waste and to avoid using products harmful to the environment. Kymlicka and Norman, 104 *Ethics* at 360 (cited in note 51).

are meaningfully included in society, tax policy must more explicitly address both negative and positive responsibilities.¹⁹⁰

Recognizing that the poor have some positive responsibility to the greater social good does not necessarily lead to the conclusion that the state should coerce the poor to contribute their labor in order to attain full citizenship. A number of possibilities exist for enabling even the poorest and most disadvantaged individuals to contribute on a voluntary basis to society. Consider market participation. Judith Shklar has argued that American citizens have found the marketplace to be an important aspect of citizenship. The right to earn a living wage has been integrally linked with independence, freedom, and status.¹⁹¹ Market participation has also been viewed as a social and cultural obligation. Many theorists have argued that individuals have a duty to avoid dependence as well as a positive duty to contribute as much as possible to the productive output of society.¹⁹² In short, earning a wage is widely viewed as "a necessary quality of genuine, democratic citizenship."¹⁹³

Political and economic theorists have begun to recognize the possibility of using the Federal Tax Code to encourage poor individuals to undertake this social duty. The notion that one has an obligation to work in the waged labor market is reflected in the EITC, as discussed in Part III. The credit is available to those individuals who work in the waged labor market, indicating that the right to the credit is integrally tied to the responsibility to work.¹⁹⁴ In this sense, the

190. This neglect is at once both surprising and predictable. It is surprising in the sense that taxation is fundamentally about social obligation and thus we should expect any theory of taxation to address the responsibilities of *all* citizens. At the same time, many of the moral and economic theories upon which tax theorists have based their proposed tax reform have also completely neglected any consideration of social obligation. See Carens, 14 *Pol. Theory* at 31 (cited in note 92) (noting that moral theorists, including Rawls and Nozick, have failed to discuss the ethic of social duty); Mead, *Beyond Entitlement* at 2 (cited in note 14) (noting that economists have almost uniformly failed to explore the idea of social obligation). Of course, as my colleague Jack Schlegel points out, the incomplete discussion is not a surprise if traditional tax theorists are in fact primarily concerned with the rights of the wealthy.

191. Judith N. Shklar, *American Citizenship: The Quest for Inclusion* 62-101 (Harvard U., 1991).

192. Although this view is widely associated with the New Right, it is also consistent with the socialist ideal, "from each according to his abilities, to each according to his needs." See Mead, *Beyond Entitlement* at 2 (cited in note 14) (arguing society must ask the poor to contribute through workfare programs); Carens, 14 *Pol. Theory* at 31 (cited in note 92) (arguing that the socialist ideal, "from each according to his abilities, to each according to his need," reinforces the idea that citizens have both rights and responsibilities to society).

193. Shklar, *American Citizenship* at 92-93 (cited in note 191).

194. Alstott, 108 *Harv. L. Rev.* at 536-544 (cited in note 14) (noting that the EITC is intended to support working individuals).

EITC could be viewed as a tax provision that imposes a positive duty upon poor individuals and thus embraces a policy that seeks to ensure the cultural and social integration of the poor into society as valuable citizens.¹⁹⁵ Indeed, advocates of the policy have applauded the EITC for just this reason.¹⁹⁶

Although the adoption of the EITC represents an important advance with regard to recognizing the rights and obligations of the poor, the provision does nothing to ensure that the poor actually have the opportunity to participate in the market economy. Indeed, as Ann Alstott has noted, the program creates unambiguous work *disincentives* for some individuals.¹⁹⁷ Moreover, the EITC ignores the fact that many individuals are unable to participate in the market because of personal responsibilities in the private sphere, lack of education and training, and the general lack of employment opportunities.¹⁹⁸ In short, tax theorists have made the market economy, the sphere in which the poor are least successful, the only site where the poor can satisfy their positive responsibility to the greater social good. Without ensuring universal work opportunities, the exclusive focus on the market imposes a threshold to citizenship that is virtually impossible for some individuals to meet.¹⁹⁹ It also ignores a variety of other approaches that tax theorists could use to facilitate the satisfaction of one's responsibility to the state.

Theorists could easily devise a variant of the market-oriented approach to promote meaningful participation in political and social

195. Mead, *Beyond Entitlement* at 240 (cited in note 14); Lawrence M. Mead, *The New Politics of Poverty: The Nonworking Poor in America* 13 (Basic Books, 1992) (arguing work is essential to enable the poor to function as citizens).

196. See, for example, Ellwood, *Poor Support* at 115 (cited in note 117) (asserting that the EITC helps the working poor to avoid the stigmatizing and degrading welfare system).

197. Alstott, 108 Harv. L. Rev. at 549 (cited in note 14). Because the value of the credit phases out as one's level of income increases, Alstott argues the credit works much like a tax by reducing the money reward for extra work. Although the tax does not add to the government fisc, the worker keeps less than a dollar for each additional dollar earned. Consequently, the structure of the tax may discourage work effort like any other tax by reducing the net wage. *Id.*

198. Staudt, 84 Geo. L. J. at 1579-92 (cited in note 24) (noting that women's responsibility for household labor often keeps them from participating in the waged labor market to a significant degree); Desmond S. King, *The New Right: Politics, Markets, and Citizenship* 186-91 (MacMillan, 1987) (noting that most individuals on welfare prefer not to be). Indeed, the emphasis on self-reliance underlying the EITC not only prevents many individuals from entering mainstream society, it imposes a double bind. For example, if women stay home to care for their children, they fail to live up to their duty to be self-supporting and if they participate in the waged labor market they can be accused of failing to live up to their family responsibilities. Kymlicka and Norman, 104 Ethics at 358 n.9 (cited in note 51).

199. See William Julius Wilson, *When Work Disappears: The World of the New Urban Poor* (Knopf, 1996) (arguing that ghetto joblessness promotes serious social, cultural and economic marginalization which ultimately works to prevent the poor from achieving full membership in society and maintains class and racial divisions through society).

institutions for those who are unable to work in the waged labor market and who have no ability to pay income taxes. Indeed many political and moral theorists have argued that the responsibilities and virtues of citizenship are found outside the context of the market. Michael Walzer has argued, for example, that a democracy is not necessarily achieved when all citizens work in the market for a wage. The "civility that makes democratic politics possible," Walzer argues, "can only be learned in the associational networks" of society.²⁰⁰ Mary Ann Glendon further argues that it is in community organizations that "human character, competence, and capacity for citizenship are formed."²⁰¹ In lieu of market participation, therefore, theorists could explore the possibility of tying a tax credit to one's participation in voluntary organizations found throughout civil society such as a church, union, ethnic association, environmental group, or any other socially worthwhile organization.²⁰²

Giving recognition to one's contribution to community organizations is not entirely unfamiliar to traditional tax theorists. The Tax Code currently recognizes the importance of individual participation in community-centered activities. Section 170 of the Code, for example, permits a taxpayer to deduct monies donated to a charitable organization.²⁰³ This charitable deduction, in effect, conveys Walzer's and Glendon's notion that an individual who has voluntarily contributed to a community organization has satisfied at least part of her responsibility to the greater good. By allowing the taxpayer to deduct charitable contributions, the legislature recognizes that one's social responsibility can be satisfied either by giving to a worthwhile community organization or by giving directly to the government coffers.

While section 170 is valuable for its non-market focus, the poor are unable to contribute income to a community organization just as they are unable to carry the burden of income taxation. That only monetary contributions are tax-deductible, however, reinforces the idea that the Tax Code is set up to enable the relatively wealthy to meet their social responsibilities. Congress, however, could expand

200. Michael Walzer, *The Civil Society Argument*, in Chantal Mouffe, ed., *Dimensions of Radical Democracy: Pluralism, Citizenship and Community* 104 (Verso, 1992).

201. Glendon, *Rights Talk* at 106 (cited in note 176).

202. Theorists, however, must not encourage individuals to withdraw from mainstream society rather than learning how to participate in it. Moreover, theorists must consider the fact that community organizations might teach tolerance of some authorities and intolerance and prejudice against others. See Kymlicka and Norman, 104 *Ethics* at 364 (cited in note 51) (noting the limitations of Walzer's theory of a participatory democracy).

203. I.R.C. § 170.

upon the current approach. It could maintain section 170, giving a deduction to the wealthy, and at the same time amend the provision to provide a "charitable service credit" that gives a payment to individuals donating services and not income.

Traditional tax theorists will undoubtedly point to administrative difficulties associated with recognizing the value of the services donated to a charitable organization. Theorists will argue, for example, that the courts and the Internal Revenue Service are unable to distinguish between activities undertaken for individual pleasure and those undertaken due to a responsibility to the greater good. Additionally, because the value of labor is indeterminate, the legislature could not give a credit that accurately reflects its value.²⁰⁴

Moreover, it could be argued that by providing a refundable credit to poor individuals who give their labor to community organizations, the legislature will in effect transform charitable work into waged labor—which could raise two additional problems. First, asking the poor to undertake a social responsibility to the greater social good and then paying them for meeting that duty is not really asking much (in the way that imposing a tax burden is). Second, a refundable tax credit tied to charitable work is essentially publicly funded employment for all individuals without the possibility of government oversight and at the same time exacerbating the federal deficit problem.

A charitable service credit, however, could simply work as an incentive for individuals to participate in social and political institutions and at the same time give public recognition to their labor as socially valuable. Accordingly, theorists exploring the possibility of a charitable service credit need not be concerned with the actual value of the work or the possibility that the federal government will be a public employer. The credit should be a small, almost symbolic, payment subject to the same limitations imposed on the EITC.²⁰⁵

204. See, for example, *Homes v. Commissioner*, 57 R.C. 430 (1971)

The rendering of services does not constitute a proper basis for the allowance of charitable deductions because, in part, of the administrative problems associated with verifying and measuring the fair market value of personal service donations, the disparity in value of personal services among taxpayers, and the question of whether or not the donor has actually parted with anything of value.

Id. at 435. Traditional tax theorists have exempted the value of household labor from taxation for the same reasons that services are excluded from section 170. See Staudt, 84 *Geo. L. J.* at 1577-78 (cited in note 24) (discussing the traditional reasons for exempting the value of women's household labor).

205. See notes 149-57 and accompanying text (discussing the structure of the EITC). Of course, seriously considering this type of structural change in the Tax Code would require a

Moreover, if charitable service is widely perceived to be a valuable contribution to society as Walzer and Glendon suggest it is, a small payment would not necessarily offset the gain that inures to society due to the increased levels of community involvement. The combination of a charitable service credit and the EITC would convey to the poor that they too have the option to satisfy their obligation to society in a variety of ways.

Tax theorists could also explore the relationship between education and one's responsibility to participate in a liberal democracy. Countless theorists have argued that in order to participate effectively, citizens must engage in reasonable public discourse. Such discourse, however, is not simply the willingness to make one's views known but also includes "the willingness to listen seriously to a range of views which, given the diversity of liberal societies will include ideas the listener is bound to find strange and even obnoxious."²⁰⁶ Moreover, theorists have argued that publicly and freely discussing political issues does not entail excessive demands on the state but rather a reasonable and conscientious debate about one's preferences and needs. The place to learn the virtue of "public reasonableness," according to many political theorists, is through a system of education.²⁰⁷

Tax theorists, however, have failed to explore the possibility of using the Tax Code to encourage individuals to meet their social obligation to becoming responsible and deliberative citizens. Under the current Code, education costs are deductible only if they are associated with the taxpayers' market employment. The deductibility of employment-related expenses does nothing for individuals who are unable to participate in the market. Moreover, the current tax subsidy entirely ignores the notion that education is important for reasons far beyond the market. Indeed, the idea that the state could enable one to become a more informed and publicly spirited citizen has been entirely rejected. In a well-known case addressing the deductibility of education costs, for example, an employee of the

much more thorough analysis of these questions. I leave a deeper and more complete analysis for a later project.

206. William A. Galston, *Liberal Purposes: Goods, Virtues, and Diversity in the Liberal State* 227 (Cambridge U., 1991).

207. Suzanna Sherry argues that in order to prepare an individual for responsible and deliberative citizenship, the individual must learn "moral character, critical thinking, and cultural literacy (that is, a knowledge of and attachment to their own culture)." Sherry, 62 U. Chi. L. Rev. at 157-207 (cited in note 174).

Chicago Police Department sought to deduct the cost of his English, Philosophy, History, and Political Science courses.²⁰⁸ The Chicago Police Department had an internal policy that encouraged officers to further their education, recognizing that their close contact with the community required some level of public reasonableness. The Seventh Circuit Court of Appeals also recognized the importance and value of a college education but nonetheless denied the deduction as insufficiently related to the officer's current employment.²⁰⁹

If tax theorists and policymakers were committed to the notion that market activities along with participation in the political process as well-educated citizens were important to society-at-large, the tax laws could easily accommodate and encourage these activities. Educational tax incentives, for example, could be devised in an effort to push individuals to seek the education necessary to learn the virtue of public reasonableness. A credit, for example, could be offered in an effort to reflect the societal value of an individual's time and energy devoted to educational activities. Indeed, by recognizing the value—and the responsibility—of education, tax theorists would enable both wealthy and poor individuals to satisfy their obligation to the public good.

Finally, traditional tax theorists' exclusive focus on income contributions as a way to satisfy one's responsibility to the greater good not only works to marginalize the poor, but might work to the detriment of wealthy individuals. Expanding citizens' social obligations beyond paying taxes would not only be more inclusive of the poor, but as Richard Pildes has argued, it would prevent the wealthy from escaping direct involvement in social and political institutions.²¹⁰ Pildes points to the manner in which the relatively wealthy express their responsibility to the welfare state. He notes that "payment of taxes is surely better than earlier Social Darwinist approaches to the poor, but it allows most citizens to escape the meaning and effects of direct involvement with their needs."²¹¹ Pildes argues that by simply paying for welfare, wealthy citizens not only break ties with whole communities, but also encourage impersonal federal programs to replace community organizations. In his view, if the system were reconstituted to encourage widespread and direct participation through the devotion of time and energy, the welfare

208. *Carrol v. Commissioner*, 418 F.2d 91 (7th Cir. 1969).

209. *Id.*

210. Pildes, 89 Mich. L. Rev. at 952-54 (cited in note 184).

211. *Id.* at 952.

state might be far more effective while at the same time encouraging stronger and more worthwhile social relationships.²¹²

V. CONCLUSION

Traditional tax theorists are deeply divided on the legitimacy of the progressive marginal tax rates. In defending their views on progressivity, tax scholars have relied upon an extremely diverse set of principles including early social contract theory, welfarist theories of distributional justice, and entitlement theories of property. These theories have led traditional tax scholars to propose a variety of marginal tax rate structures ranging from the steeply progressive to the steeply regressive. Hidden within the debate over the fairness, however, is a surprising consensus on the proper treatment of the truly poor. Scholars on all sides of the debate have argued that the state should exempt the poor from any obligation to contribute to the greater social good.

Although the exemption from taxation is perhaps an obvious policy choice given the economic constraints of the poor, the widespread agreement has caused tax theorists to focus almost exclusively upon the rights and responsibilities of the relatively wealthy. Theorists have failed to explore fully the extent to which poor individuals might have a positive claim to income or, indeed, a positive obligation to the greater social good. This Article has argued that traditional tax theorists must give a more careful consideration to the positive rights and responsibilities of all individuals, both wealthy and poor. A more complete analysis of these issues will not only subject the goals and aims of traditional tax theory and policymaking to serious deliberation, but it will also avoid the hidden costs and constraints associated with the current approach to taxation.

212. *Id.*

