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# Introduction to the State of Federal Income Taxation: Rates, Progressivity, and Budget Processes

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# INTRODUCTION TO THE STATE OF FEDERAL INCOME TAXATION: RATES, PROGRESSIVITY, AND BUDGET PROCESSES

JAMES R. REPETTI\*

Other than the power to declare war, a democracy's power to assess taxes affects the largest percentage of its citizens in almost every aspect of their lives. Given the major tax legislation in the past four years, it is appropriate that a Catholic Jesuit Law School, dedicated to seeking justice, should sponsor a symposium exploring the state of federal income taxation.

We are pleased to present some of our nation's leading tax experts to explore issues pertaining to a just income tax system. Professor Martin J. McMahon, Jr. begins this Symposium by examining whether the current income tax exacerbates the inequality between rich and poor in *The Matthew Effect and Federal Taxation*.<sup>1</sup> This title is based upon a passage in Matthew 25:29 that essentially states that the rich get richer while the poor get poorer. In his article, which the prominent journal, *Tax Notes*, has called a "tour de force,"<sup>2</sup> Professor McMahon presents compelling evidence that the rich have indeed become richer, while the poor have become poorer, and that the federal income tax is contributing to the problem. In her Commentary, Professor Deborah H. Schenk takes issue, however, with Professor McMahon's suggestion that increasing tax rates on the super-rich will help to remedy the problem.<sup>3</sup> She suggests that it is not possible to decrease income inequality without increasing tax rates on a broad range of taxpayers and that this may be politically unacceptable. Pro-

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<sup>1</sup> Martin J. McMahon, Jr., *The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 993 (2004).

<sup>2</sup> Joseph P. Thorndike, *Neither Fair nor Adequate: The Unhappy State of Federal Taxation*, 105 TAX NOTES 309, 310 (2004).

<sup>3</sup> Deborah H. Schenk, *The Luke Effect and Federal Taxation: A Commentary on McMahon's The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 1129 (2004).

fessor Richard L. Schmalbeck also points out in his Commentary that increasing the top marginal tax rates on the super-rich may adversely affect economic output.<sup>4</sup>

Next, Doctors William G. Gale and Peter R. Orszag, both of the Brookings Institution, analyze the effect of tax cuts that occurred during the period 2001 through 2004 in *Tax Policy in the Bush Administration, 2001–2004*.<sup>5</sup> They show that the tax decreases make high-income households better off at the expense of all other households when the impact of financing the tax cuts is taken into account. Specifically, most families with children and most small businesses will be worse off than they would have been without the tax decreases. Commenting on the article by Doctors Gale and Orszag, Professor Paul R. McDaniel considers alternatives for financing the deficit created by the tax cuts.<sup>6</sup> He compares the option of decreasing Social Security benefits by forty-eight percent in 2014 to decreasing all tax expenditures by forty percent. In her Commentary, Professor Linda Sugin suggests that Congress should adopt a “pay as you go” budget rule to impose fiscal discipline that also contains a bias against tax cuts that increase income inequality.<sup>7</sup> She further suggests that present value concepts should be used in budget analysis to clearly present the impact of provisions that increase revenues in the short run at the expense of future revenues.

Professor Daniel N. Shaviro then attempts to identify the rationale for recent tax cuts in *Reckless Disregard: The Bush Administration's Policy of Cutting Taxes in the Face of an Enormous Fiscal Gap*.<sup>8</sup> He suggests that the tax cuts may be seen as a way of decreasing the future size of government without paying a current political price. He argues, however, that this policy is doomed to failure because it in fact increases the role that government plays in wealth redistribution. He states that the tax cuts represent a large wealth transfer by the government from

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<sup>4</sup> Richard L. Schmalbeck, *The Death of the Efficiency-Equity Tradeoff?: A Commentary on McMahon's The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 1143 (2004).

<sup>5</sup> William G. Gale & Peter R. Orszag, *An Economic Assessment of Tax Policy in the Bush Administration, 2001–2004*, 45 B.C. L. REV. 1157 (2004).

<sup>6</sup> Paul R. McDaniel, *Assessing the Bush Administration's Tax Agenda: A Commentary on Gale and Orszag's An Economic Assessment of Tax Policy in the Bush Administration, 2001–2004*, 45 B.C. L. REV. 1253 (2004).

<sup>7</sup> Linda Sugin, *Sustaining Progressivity in the Budget Process: A Commentary on Gale and Orszag's An Economic Assessment of Tax Policy in the Bush Administration, 2001–2004*, 45 B.C. L. REV. 1259 (2004).

<sup>8</sup> Daniel N. Shaviro, *Reckless Disregard: The Bush Administration's Policy of Cutting Taxes in the Face of an Enormous Fiscal Gap*, 45 B.C. L. REV. 1285 (2004).

future generations to the current generation, because future generations will have to pay the deficit. In his Commentary on Professor Shaviro's article, Professor Lawrence Lokken expresses concern about the fact that 40 percent of our government's debt is held by foreign investors.<sup>9</sup> He observes that a sudden loss of confidence by foreign investors would be traumatic for the U.S. economy and for world capital markets. Professor David Ira Walker argues in his Commentary that political-economy theory suggests that it is unrealistic to expect fiscal austerity in the form of tax increases and spending cuts to address the looming deficit problem.<sup>10</sup> Focusing on Social Security and Medicare, he suggests that Medicare is a significantly greater problem than Social Security and that the focus should be on controlling the costs of medical care.

In the last principal article, *Progressive Taxation and Happiness*, Professor Thomas D. Griffith proposes a new method for identifying welfare gains that arise from a progressive tax-rate structure.<sup>11</sup> He suggests that recent psychological studies of what causes people to be happy support the view that income has declining marginal utility and, therefore, that redistribution of income from the rich to the poor can increase total welfare in a society. He further observes that the studies on happiness suggest that welfare gains arising from tax cuts for the "middle class" are likely to be less than gains that would be achieved from using the same tax revenue to provide basic services for the poor or collective goods, such as environmental clean-up or better police and fire protection. Given the support that these studies lend to a progressive rate structure, Professor Marjorie's E. Kornhauser explores in her Commentary why opposition to progressivity seems to have increased in recent years.<sup>12</sup> She attributes the increased opposition to misleading rhetoric and suggests that efforts be undertaken to inform the public about the relationship of a progressive tax rate structure to basic American ideals. Lastly, Professor Diane M. Ring, in her Commentary, cautions that using happiness as a measure for utility can present significant measurement problems.<sup>13</sup> Nevertheless, she suggests

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<sup>9</sup> Lawrence Lokken, *A Tax Lawyer's Observations on Scary Numbers, Politics, and Irresponsibility: A Commentary on Shaviro's Reckless Disregard*, 45 B.C. L. REV. 1335 (2004).

<sup>10</sup> David Ira Walker, *The Social Insurance Crisis and the Problem of Collective Saving: A Commentary on Shaviro's Reckless Disregard*, 45 B.C. L. REV. 1347 (2004).

<sup>11</sup> Thomas D. Griffith, *Progressive Taxation and Happiness*, 45 B.C. L. REV. 1363 (2004).

<sup>12</sup> Marjorie E. Kornhauser, *Educating Ourselves Towards a Progressive (and Happier) Tax: A Commentary on Griffith's Progressive Taxation and Happiness*, 45 B.C. L. REV. 1399 (2004).

<sup>13</sup> Diane M. Ring, *Why Happiness?: A Commentary on Griffith's Progressive Taxation and Happiness*, 45 B.C. L. REV. 1413 (2004).

that the studies can help formulate policy, and she poses the provocative question whether a non-progressive tax system might create less hostility for a redistributive public-spending program.

These articles contribute significantly to the debate about the appropriate future direction of U.S. tax policy. Recognizing the problems that lie ahead, they advance our knowledge and open new and promising avenues for solutions.