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Reevaluating Ethical Justifications for Discriminatory Tax Rates in the Global Economy

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Abstract

The ethical justification of unequal tax rates remains a heated debate, with recent studies presenting contrasting views. This paper employs utilitarian and deontological perspectives to assess the ethical grounding of discriminatory tax systems. It critically reviews the historical arguments and integrates recent insights to assess the ethical grounding of such systems. After examining the matter from a number of ethical angles, especially considering the most recent studies, the author concludes that there is no definitive moral justification for charging different prices to different individuals. However, newer perspectives highlight the complexities involved in the debate. This paper also explores the practical implications of these ethical perspectives, offering insights for policymakers in designing equitable tax systems in a globalized economy.

Keywords: Tax Ethics, Tax Rates, Discriminatory tax rates, Ethical Justifications

Introduction

Tax systems, inherently political and economic constructs, hold profound ethical implications. In an increasingly interconnected global economy, understanding the ethical implications of tax systems becomes crucial for international policy coherence. The design of a tax system, whether it employs uniform or discriminatory rates, significantly impacts both domestic and international economic landscapes. This paper explores the ethical dimensions of tax systems with a focus on discriminatory tax rates. It employs utilitarian and deontological perspectives to assess the ethical grounding of these systems, critically reviewing historical arguments and integrating recent insights. The paper also examines the practical implications of these ethical perspectives, offering insights for policymakers in designing equitable tax systems in a globalized economy.

We begin by examining the choices in tax system design: differential rates, flat rates, and poll taxes, each with its unique implications. The discussion then delves into the ethical underpinnings of these systems, contrasting utilitarian and deontological perspectives with contemporary global practices. By comparing tax systems across different nations, we highlight the diversity of approaches and the ethical considerations they entail. Finally, we critically analyze the graduated tax structure, weighing its ethical justifications against practical outcomes.

It is possible to design a tax system with either uniform or discriminating rates. Basically, there are three choices. One possibility is a tax with differential rates. Taxes that discriminate take more from some groups than from others. A graduated personal income tax, which takes a higher proportion of marginal income from those who make more and a lower percentage from those who earn less, is an example of a discriminatory system. As an illustration, a progressive system would deduct 10% of taxable income from zero to $10,000, 15% from $10,001 to $20,000, 25% from $20,001 to $35,000, and 40% from taxable income over $35,000. Depending on the income level, such a system can be reasonably simple with only two or three rates, or it might be relatively complex with ten or more rates.

Discriminatory taxes, as discussed by Kalleitner and Bobzien (2023), can be seen as instruments to achieve redistributive aspirations, aiming to address societal inequalities. However, such systems often receive criticism for penalizing certain economic classes. Kalleitner and Bobzien (2023), however, offer a worldwide viewpoint on redistributive goals that justify these kinds of progressive tax arrangements.

A uniformly rated tax is the second alternative. The income tax with a flat rate is an illustration of a tax with a consistent rate (Hall and Rabushka, 1985, Murray; 1988; Alasfour et. al., 2016; Popescu et al., 2019). The flat tax has the benefit of being quite easy to calculate. It does not have several rates. The rate is the same for all[1]. A taxpayer with $10,000 in taxable income will pay $1,000 if the flat rate is 10%, and a taxpayer with $1,000,000 in taxable income will pay $100,000. As a result, even though their percentages are the

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[1] Many taxes that purport to be flat are not really flat because they have exemptions for those whose income falls below some level. These taxes are really graduated because they charge different rates for different levels of income -- 0% for those whose income falls below some minimum and more than zero percent for those whose income is higher than some minimum.

identical, the rich will pay more overall than the poor. Another option that is praised for its simplicity is a uniformly graded tax, as mentioned by Abatemarco and Dell'Anno (2020), who contend that more sophisticated structures may be necessary due to today's ethical concerns. Abatemarco and Dell'Anno (2020) argue, the ever-evolving global economic environment necessitate systems that can adapt to nuanced complexities, which a single rate might not address adequately.

A tax wherein each person pays the same amount would be the third choice. A poll tax, the third option, has had difficulties in the past but is consistent with the benefits received idea. A poll tax or a head tax are two examples (Cullis et al., 1991; Partelow, 2019). For instance, each person in a community of 10,000 would pay a $100 tax if the entire cost of delivering government services in that community was $1,000,000. This type of taxation adheres to the benefits received theory. If public services are equally beneficial to everybody, then all citizens ought to contribute the same amount, regardless of their income. In contrast, there are parasites and freeloaders. The poll tax, the third type discussed, has always been polarizing. Historically, its attempts at implementation have sparked civil unrest, mainly due to perceptions of inequality and potential burdens on certain societal sections.

The closest thing to a market system is this type of tax. When you go into the supermarket to buy a loaf of bread, for instance, the person behind the counter does not inquire about your income before giving you a price quote. The cost of the bread is not determined by a portion of your earnings. Regardless of one's earning level, the price is the same for everybody. This also applies to the poll tax. However, because some people get more from government services than others, the poll tax is not impartial. Furthermore, why even has a poll tax if everyone got $100 worth of benefits in return for a $100 poll tax? Why not just do away with taxes and let people pay for services directly, cutting out the middleman (the government) in the process? Even though a poll tax is the most equitable of the three possibilities, attempts to implement one have traditionally gone wrong. When Margaret Thatcher attempted to implement a poll tax in England, the populace reacted angrily. A plan to impose a poll tax on those who would have to pay extra was met with loud (and occasionally violent) protests. People knew exactly what they were paying because the poll tax is a direct charge and is apparent rather than hidden, which contributed to the issue. People are less likely to object when the whole cost of the tax is concealed since they are unaware of what they are actually paying. Therefore, it would seem that there is an unresolvable conflict between practicality and fairness when it comes to enacting a poll tax, particularly if certain groups of people (such as the underprivileged, jobless, or retired) are unable to pay it.

In exploring the complexities of global tax systems, recent studies offer insightful comparisons and highlight the diversity of tax structures across nations. Mgammal et. al. (2023) provide a detailed analysis of the effects of VAT rate increases in Saudi Arabia, underscoring how changes in tax policy can significantly impact corporate financial metrics, especially in non-financial sectors. Complementing this, Pippin's (2020) comprehensive comparison of tax systems worldwide reveals striking differences in tax burdens, tax mixes, and the level of government tax collection among various countries. These findings emphasize the intricate balance governments must maintain in tax policy, impacting everything from economic stability to social equity. Such diverse global tax practices raise important ethical considerations, particularly in the context of a globalized economy where tax policies can have far-reaching consequences.

Ethical Problems with the Graduated Tax

An ethical analysis of a problem can be done in essentially two ways[2]. Either a rights-based or utilitarian approach can be adopted. The greatest good for the greatest number is the fundamental tenet of all utilitarian systems, however there are many variants on this theme (Shaw, 1999; Woodard, 2019, Alasfour, 2019). Atria (2023) delve into the psychological perceptions of progressive taxation, while Sheehan (2012) explores the role of innate moral intuitions in shaping views on tax ethics. However, Atria (2023) provides a comprehensive analysis of psychological perceptions, suggesting that public acceptance of tax rates is, in part, determined by perceived fairness.

As we delve into the Utilitarian and Deontological perspectives on tax ethics, it's crucial to consider their application in modern contexts. The study by Frecknall-Hughes et al. (2017) explore the two primary schools of Western ethical philosophy that are pertinent to the job of tax practitioners are explored in this paper: consequentialism and deontology, although distributive justice and virtue ethics are also taken into consideration. It conducts an empirical investigation of the degree to which tax practitioners handle moral challenges using a consequentialist or deontological framework.

However, from a deontological perspective, as detailed in Philosophy Now (2023), the debate centers on absolute duties such as respecting property rights. Deontologists argue that taxation, being a transfer of property, can conflict with individual rights. However, they also posit that

[2] Some authors use more than two categories (for a discussion see Piketty & Saez., 2007; Amlie & Gibney, 2023). Yet, when one breaks down the analysis, one is usually left with some form or utilitarianism.

using public resources obligates individuals to contribute towards their upkeep, aligning with property rights and social responsibilities.

Conversely, virtue ethics offers a character-based viewpoint. As discussed in Philosophy Now (2023), it suggests that tax rates should encourage virtues like charity and self-reliance. Moderate taxation might boost these virtues by allowing individuals greater financial freedom to engage in charitable activities, whereas excessive taxation could suppress them (Bruce-Twum, 2023).

Yet, practically all economists are utilitarians[3]. If there are more winners than losers in a positive sum game, they view a policy as being excellent. Morality and efficiency are seen as complementary aspects of each other. If something is effective, it is moral; if it is ineffective, it is immoral (Posner, 2014; Floridi, 2019; van Brederode, 2020). Utilitarian arguments, which suggest that the collective good should be paramount, form the cornerstone of many economists' positions (Posner, 2014; Floridi, 2019; van Brederode, 2020). However, Yamamura (2017) cautions that behavioral responses to taxation, such as behavioral adjustments to avoid indirect taxes, can skew perceived benefits. Yamamura (2017) suggests that behavioral responses to indirect taxes, like VAT, also have significant ethical implications. By adjusting for a range of country-specific and personal factors, the primary conclusions drawn were that individuals from nations with higher levels of education in 1870 tend to be less supportive of redistribution policies and progressive tax systems. Additionally, these individuals are more inclined to view income inequality as less significant. Chudárková (2019) extends the debate to the corporate realm, rethinking the ethics of corporate tax avoidance in the context of the global economy. Critics argue that graduated tax structures hinder economic growth and disincentivize high earners (Posner, 2014; Floridi, 2019; Al-Asfour & Abu Saleem, 2023). But this criticism is challenged by modern interpretations. For example, Dubljević (2021) showcase how digital economies defy traditional taxation logic, suggesting that a single model can't fit all sectors, especially with the advent of digital services and e-commerce.

Higher earners are discriminated against under a graduated tax structure. As argued by Dubljević (2021), societal context can play a crucial role in determining the ethical acceptability of various tax structures. However, the paper still underscores that a tax with graded rates might be less ideal than one with a uniform rate for all individuals. Instead of the benefits received concept, such a system is based on the ability to pay premise (Kendrick, 1939; Bizioli & Reimer, 2020). A tax with graded rates is less ideal than one with a uniform rate for all individuals because the

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[3] Some exceptions that come to mind are Block (1998) and Murray (1988).

benefits received principle should take precedence over the ability to pay principle[4]. This is the case not just because it is fundamentally fair but also because it is simpler, and complexity should be avoided in favor of simplicity (Paul, 1997; McGee, 2003; Ghani et al., 2020).

Numerous utilitarian arguments have also been made by economists against the graduated income tax (Blum and Kalven, 1951; Pechman, 1990; Adam and Miller, 2021). It eliminates the motivation of the most productive individuals, to start with (Posner, 2014; Floridi, 2019). Furthermore, a progressive tax will impede economic growth by decreasing the quantity of capital available for investment, as the most productive individuals are the ones that save, invest, and create jobs.

"The most common objection to progressive taxation … is that it causes an inefficient substitution of leisure for work by increasing the price of work relative to that of leisure." (Posner, 2014, p 544). Some criticisms include the following: it discourages taking risks (Posner, 2014, p 545), rich taxpayers invest in tax schemes (with the help of pricey tax attorneys and accountants) to lower taxes rather than to create wealth (Posner, 2014, pp 545-546), and it lessens the taxpayer's incentive to use resources wisely because (some) expenses are deductible. After taxes, every $100 spent by an individual or corporation in the 40% tax bracket only costs $60. This defense could be used against graduated tax rates at the higher tax bands as well as against excessive tax rates in general.

It may be argued that since the rich have more property to defend than the poor do, it is only right that the rich pay more overall (Posner, 2014; Adam and Miller, 2021). It would seem reasonable that individuals with more property would pay more overall for government services than those

[4] The ability to pay principle and the benefits received principle are based on two different and conflicting views of government. Under the ability to pay principle, government is viewed as the master and the people as servants. Those who can afford to pay more are forced to pay more. The most productive members of society are exploited, forced to pay for benefits that others receive. They are treated as means, not as ends in themselves. Thus, the ability to pay principle is morally bankrupt.

The benefits received principle is based on the belief that the government is the servant and the people are the masters. Government provides services and people pay for the services through taxes. In an ideal system, people pay for the services they receive and are not forced to pay for services that they do not receive. Of course, the real question, one that is almost uniformly overlooked, is whether people should be forced to pay for any government services, since, if the services were actually demanded, they could be provided for by the market but better and cheaper, since the market always performs better than government. We will leave discussion of this point for another day.

with less, as government is tasked with safeguarding property. On the surface, this line of reasoning appears to make sense. But when this line of thinking is examined more closely, issues begin to arise. One possibility is that there might not be any correlation at all between the quantity of property that has to be secured and the cost of doing so. Protecting ten acres of property worth $10,000 can be more expensive than safeguarding a bank vault holding $100 million (Murray; 1988; Popescu et al., 2019). However, a graduated tax is based on the principle of exploitation, whereas a flat tax at least attempts to achieve equity[5].

The principle of diminishing marginal utility serves as the foundation for yet another defense of graded taxation. This idea states that it hurts less to take $100 from a rich guy than it does to take $100 from a poor one. However, a thorough analysis of the marginal utility theory completely refutes this claim (Posner, 2014, pp. 555-504)[6].

A single, flat rate also has the benefit of not penalizing productivity, meaning that incentives and capital development are less negatively impacted (particularly if the rate is low)[7]. Since it does not set one class against another—the rich against the poor—it also has less of a negative impact on social cohesion.

The fact that the graduated income tax sets one class against another—the rich minority against the poor majority—is another moral justification for opposing it. It is therefore inappropriate for the government to intensify class conflict. Governments ought to serve the interests of all citizens, not just one class of individuals. The socialist governments of Eastern Europe, the CIS, and China, as well as the populist governments of

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[5] I am not saying that the graduated income tax should be replaced with a flat tax. There are economic and ethical problems with a flat tax as well. Another option would be to abolish the graduated income tax and replace it with nothing. If government merely got out of the redistribution business and the areas where the market could provide better services, there would be no need for any income tax. The federal government functioned quite well without any income tax before 1913. There is no reason to expect that it could not do so again.

[6] One of the problems with the theory is that there is no way to measure interpersonal utilities, so it cannot be determined whether a shift in income from a rich person to a poor person would increase total utility, especially when one takes into account the fact that the rich person knows in advance that the wealth transfer will take place. Rich people may alter their behavior to reduce their income and increase their leisure if they feel that they are being exploited. Thus, total wealth is decreased. What does that do to total utility? (Answer: It reduces it.)

[7] This statement is not quite accurate. It would be more precise to say that the rich are not penalized any more, percentagewise, than the poor. But all groups who earn income are penalized in the sense that a portion of their income is taken from them.

Mussolini, Hitler, and Peron, all adopted the class struggle theory as standard operating practice. It doesn't take much research to determine how effective such governments were.

Concluding Comments

The ideology of envy and the debunked notion that taxing a rich person more heavily than a poor person increases overall utility serve as the foundation for discriminatory tax rates[8]. Chudárková (2019) highlights how global economies are reshaping this discourse, with digitalization adding another layer of complexity (Dubljević, 2021). A review of reasons against graduated tax rates, especially when contextualized with the latest research, suggests a more multifaceted and nuanced view than previously believed. Thus, while the ethical justification of discriminatory tax rates remains debated, new perspectives introduce complexities that merit further examination. Moreover, discriminatory tax rates, while based on historical perspectives of utility and fairness, now face a crossroads. The globalized, digital economy demands a more nuanced approach.

The idea that the government is the master, and the taxpayers are the servants, to be exploited, is the foundation of discriminatory tax rates. Because they do not treat all taxpayers equally and because the system is economically inefficient, discriminatory tax rates cannot be morally justified. A review of the reasons for and against graduated tax rates produced a number of convincing arguments against charging different taxpayers at different rates, but it was unable to discover a single legitimate justification in favor of discriminatory tax rates. Therefore, no philosophy of ethics can justify tax rates that are discriminatory. While there may not be a single "one-size-fits-all" ethical justification for or against discriminatory tax rates, it's evident that a synthesis of historical rationale with contemporary insights provides a more rounded perspective. Such a synthesis underscores the importance of re-evaluating and adjusting tax systems in line with societal progress and economic transformations.

Future research could explore the impact of digital economies on traditional tax structures and the ethical implications thereof. This analysis suggests a need for policymakers to consider both ethical theories and practical outcomes when designing tax systems

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[8] Even if it could be proven that taxing a rich man more than a poor man increases total utility, it does not logically follow that it should be done because such a policy is exploitative, and thus morally bankrupt.

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