Critics of the Bush Administration’s tax reduction plan fault it on two principal counts: too large, and “unfair” because the resulting benefits accrue disproportionately to high-income earners.

According to the critics, tax cuts should be more selective (that is, “targeted”)—hence “fairer”—and smaller, thereby allowing more of the estimated future budget surpluses to be used to pay down the federal government’s $3.4 trillion of publicly-held debt over the next 10 years. The implication is that accelerated debt reduction—which would be possible if tax reductions were smaller—would be “fairer” than would the larger, across-the-board cuts in tax rates and tax revenues envisaged by the Bush plan.

On the issue of whether larger tax reductions, or accelerated debt reduction is “fairer,” the critics are plainly wrong: the benefits of debt reduction are no less concentrated on high-income earners than are the benefits of tax reduction. The underlying issue of how fairness should be judged is more debatable, more difficult, and probably un-resolvable because it is inherently subjective.

To be sure, cutting marginal tax rates by equivalent percentages across the board will disproportionately reduce the dollar tax liabilities of high-income earners. A 5 percent reduction in the marginal

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tax liability of a taxpayer whose tax rate is 39 percent reduces tax obligations by much larger dollar amounts than does the same 5 percent reduction for a taxpayer whose marginal tax rate is 15 percent because the 39-percent taxpayer typically has more dollars exposed to the higher tax rate.

But the same disproportion arises in the relative dollar benefits that would accrue to high-income earners (hence, high taxpayers), as a result of paying down the federal debt. Reducing federal debt relieves future taxpayers of the burden of servicing and redeeming the debt. Hence, high-income earners—who bear a disproportionate share of this burden through the higher tax rates that they pay—would realize the same disproportionate benefits from this relief as those they would realize from across-the-board tax reduction.

About 200 years ago, economist David Ricardo made essentially this same point when he analyzed the distributional effects of the comparable, although opposite, choice between incurring government debt now to be serviced in the future, or increasing tax revenues now to avoid budget deficits that would necessitate future debt service. Paying down the debt is no less skewed in favor of high-income earners (hence, high taxpayers), than is ratcheting marginal tax rates downward! So, it doesn’t make sense to criticize the latter as “unfair” without attaching the same label to the former.

While the issue of tax reduction versus debt reduction can be dealt with and disposed of in economic terms, this is not true of the fairness issue. “Fairness” is complex, multifaceted, and highly subjective. It depends on which among many plausible but conflicting concepts and criteria one adopts for judging, let alone measuring, it.

For example, according to Harvard legal philosopher John Rawls, fairness requires that priority and precedence should be given to providing benefits to the less fortunate (read, “low-income”) public before according any distributinal benefits to the more fortunate (read, “high-income”) public. A similar inference follows from the familiar Marxist precept: “from each according to ability, to each according to needs.”

Economic theory suggests a very different view of fairness. Here, the touchstone of fairness is productivity. A “fair” distribution of benefits (from wages, or profits, or any distributive share), is one that recog-
nizes the recipient’s productivity and rewards it accordingly. Since high taxes paid by high-income earners typically reflect relatively high productivity, so too should the benefits from tax reduction recognize their productivity and reward it accordingly. In this view, it is entirely “fair” that a high share of dollar tax remissions should go to high taxpayers.

This view corresponds closely to what is sometimes referred to as “vertical equity”: namely, treating unequally-situated taxpayers (read, high- and low-taxpayers), in appropriately different ways (for example, by tax reductions that provide differing amounts of dollar recompense to taxpayers in accord with the differing amounts of taxes they have paid).

Finally, it is worth noting that, when marginal tax rates are reduced by about the same number of percentage points across the board (as proposed by the Bush plan), the proportional reduction in the lowest tax bracket is much larger than the corresponding reduction in the highest bracket—33 percent and 14 percent, respectively.

This is not to say that any distribution of tax cuts is as fair as any other, but rather that there are many reasonable criteria for judging fairness. To argue that the only fair distribution of benefits from tax reductions is one which denies high taxpayers an equivalently high share of the benefits resulting from tax reductions is unconvincing.

Whether this argument may nonetheless have appeal on political grounds is a separate question.

Postaudit

The concept of “fairness” is complex and subject to many interpretations. When applied to judging the pros and cons of changing marginal tax rates, it should not be assumed that the easiest interpretation is the most appropriate one.