American Inequality: Taxation and the Rise of Economic Inequality

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Abstract

What is the relationship between the American taxation system and the rise in economic inequality? This paper will seek to examine, highlight, and identify the impact of United States taxation levels on inequality levels throughout history. This paper will focus on two main periods in American history. The first period is the progressive era from the 1930s - 1970s. This period is known for its high progressive tax rates and low inequality levels. The second period is new gilded age era starting post 1970s marked by tax cuts, and higher levels of inequality. This paper applies qualitative and quantitative research to define tax brackets and the increasing inequality levels in the United States. This paper will examine past literature to help support, provide, and categorize the history of taxation and inequality in the United States. Finally, this paper will explore solutions and reforms in the tax code to decrease inequality levels.

Introduction

In a 1789 letter to Jean-Baptiste LeRoy, Benjamin Franklin said, “in this world nothing can be said to be certain, except death and taxes.” Taxation has a direct link to the welfare and well-being of the governed through social services, protection, and infrastructure. The consent of the governed allows for taxation through the social contract which the governing and governed rely on. President Madison believed the excessive contraction of fortunes, wealth and income, were poisonous for democracy and the people, in his view “Of all the enemies to public liberty war is, perhaps, the most to be dreaded…. In war, too, the discretionary power of the Executive is extended; its influence in dealing out offices, honors, and emoluments is multiplied; and all the means of seducing the minds, are added to those of subduing the force, of the people. The same malignant aspect in republicanism may be traced in the inequality of fortunes...” (Archives, N.). This extreme concertation of fortunes is power. Power to influence the Republic, power to override the voices of the people, power to change government, and the power to shape discourse. This power erodes the basic argument of the social contract: protecting the people.

Taxation is a major topic in economics, from who bears the brunt of the tax to how the tax will affect government revenue flows. One major gap, that is now being more widely researched, in the literature on taxation is how it affects the concentration of wealth and income and how it changes the measured levels of economic inequality. The focus of this paper is to better understand the relationship taxation has with inequality. In this paper economic inequality will refer to two different forms: income inequality and wealth inequality. Income inequality is the degree to which income is distributed in unequal proportions within a population; where income is the money a person receives from wages/salaries, housing, profit from a business, and capital gains. Wealth inequality is the unequal distribution of wealth among a population where wealth is the assets a person owns minus their debts – assets include homes, cars, personal belongings, businesses, and savings. Additionally, taxation will primarily refer to effective tax rates and marginal tax rates. This paper will mainly look at income, corporate income, capital gains, estate, and wealth taxes. The effective tax rate is the overall percentage that an individual pays in taxes. This is often lower than the marginal tax rate. The marginal tax rate is the tax rate an individual will pay on any additional dollar of income, the marginal tax rate increases as income increases. For the analysis of economic inequality this paper will primarily focus on the effective tax rates of individuals and their pre-tax income levels.

In this paper I will attempt to show the negative relationship between marginal tax rates and the levels of inequality in the United States. I do not intend to prove that taxation is the root problem of inequality, rather I intend on demonstrating how the tax system has been used to allow for the unnecessary excessive concentration of wealth and income in the United States. To do this I intend to highlight the progressive era high marginal tax rates compared to the new gilded age era marginal tax rates. I will propose a new era of tax justice aimed at decreasing inequality levels through government policies with taxation at the forefront.

This paper contributes to the literature on taxation and inequality through investigating the effects of taxation on inequality. This paper is part of a new era of analyzing taxation on members of society and their social mobility and ability to accumulate income and wealth. Within taxation, this paper will examine past federal tax legislation and the subsequent rise or fall of inequality levels in the United States. This paper will seek to highlight where the research on taxation and inequality can improve. Additionally, this paper will provide potential policy recommendations and their feasibility for reducing inequality levels in the United States. This study seeks to create a larger discussion of the harms of low tax rates, the subsequent rise of inequality, and how the United States can stop being the Western leader in inequality levels.

Literature Review

American Taxation

How have the changes to the American tax system influenced the growing concentration of income and wealth? Taxes in the United States take many different forms but for this paper, the focus will center around taxes on what individuals earn, taxes on corporations, and taxes on what individuals own. The most useful of these taxes to analyze are income taxes – corporate and individual – capital gains taxes, property taxes, estate and inheritance taxes, and wealth taxes.

Taxation has been a controversial issue in America since the Thirteen Colonies and the protests of taxes on printed paper and tea by the English Crown (Saez & Zucman, 2019a). This early tax on the colonies, and the people's disdain for them, gave birth to the renowned phrase "no taxation without representation." The first tax approved by the new Congress of the United States in 1791 came in the form of an excise tax on distilled spirits, this was a tax-per-gallon on whiskey. This first tax was coined the "Whiskey Tax" and marked the beginning of levying taxes on goods and services in the New Republic (Krom & Krom, 2013). Taxes in the United States would continually change, but it was not until 1861 that Congress imposed the first personal income tax through the Revenue Act of 1861 – this tax was later repealed in 1872. The next major tax passed by Congress was the Wilson-Gorman Tariff Act of 1894 that lowered the rate of tariffs, but imposed taxes on income, corporate profits, gifts, and inheritance to recover the lost revenue due to lowering the tariff rate. The Tariff Act of 1894 was subsequentially challenged and in the landmark Supreme Court case *Pollock v. Farmers' Loan & Trust Co.*, the Supreme

Court ruled that "the unapportion of income taxes on interest, dividends and rents imposed by the Income Tax Act of 1894 were, in effect, direct taxes, and were unconstitutional because they violated the rule that direct taxes be apportioned" (*Pollock v. Farmers' Loan and Trust Company*, n.d.). In response to the Supreme Court ruling, Congress proposed the 16th Amendment, ratified by the states in 1913. This amendment gave Congress the power to levy income taxes without the apportionment of the taxes among states and their populations (*Pollock v. Farmers' Loan and Trust Company*, n.d.). The ratification of the 16th amendment had drastic effects on American taxation and how the federal government would collect revenue and apportion funds. The 16th amendment gave rise and credence to the personal income tax and permitted Congress to pursue more progressive forms of taxation. In 1913, Congress levied another income tax that was a 1 percent tax on personal income above $3,000 equivalent to $80,514[1] in 2021 (Martin, 2014). Analysis suggests that approximately 60 percent of Americans were exempt from this tax (Solman, 2013). By 1918 the top rate for personal income had ballooned to 77 percent on income above $1,000,000 to help finance World War 1 (Martin, 2014). In 1922, the top marginal tax rate was cut from 77 percent to 58 percent. It was further cut to 25 percent in 1925 to 24 percent in 1929. In 1932, the top marginal tax rate was drastically increased to 63 percent. During the Great Depression and World War II, it would progressively increase to a record high of 94 percent in 1944 (Haden, 2011).

The United States was not the first to adopt progressive taxation and mainly used the revenue for war funds until President Roosevelt. Progressive taxes are taxes where the rate increases as the taxable amount increases. Germany, Sweden, and Japan were the first, during the late 1800s, to create a progressive income tax that was not just for funding war. However, the

[1]Calculated using the Bureau of Labor Statistics CPI Inflation calculator for $3,000 in January 1913 to February 2021 https://www.bls.gov/data/inflation_calculator.htm

United States was innovative in how quickly and steadily progressive forms of taxation were adopted. In 1913 the top marginal tax rate was only 7 percent, but by 1917 it had increased by sixty percentage points to 67 percent, this high-income tax was abnormal as no other country had taxed the wealthy so heavily (Saez and Zucman 2019). Through its creation until the mid-1930s, the main purpose of the individual income tax was the collection of revenue and respective appropriations. However, that changed under President Roosevelt when he added a new goal of income taxation: cap the amount of money a single person can make. Roosevelt wanted income taxes to be able to "confiscate excessive incomes." To achieve this, Roosevelt, alongside Congress, increased the top marginal tax rate to 79 percent in 1936 and further increased to 81 percent in 1940. From the 1930s until the 1970s the top marginal income rate was 70 percent or higher. This period is known as the progressive era, spotlighting one of the government tools to fight runaway income accumulation – the confiscatory top marginal tax rate (Saez and Zucman 2019).

Taxation in America has drastically changed since the 1970s. Since the beginning of the 1980s, the top marginal tax rates in the United States have consistently fallen over time to a low of 28 percent during 1988 to 1990. The new Gilded Age began in the 1980s under the guise of "trickle-down economics" and the rollback of the federal government. This era was kicked off with the Economic Recovery Act of 1981 (ERTA), also known as the "Kemp-Roth Tax Cut." One of the main purposes of the ERTA was a slash in federal income tax rates for all earners, representing the single largest tax cut. The top marginal tax rate fell by 20 percentage points from 70 percent to 50 percent. The act also cut estate taxes, capital gains taxes, and corporate taxes (Tempalski, 2006). Proponents of the tax cuts were predominately supply-side believers, such as Arthur Laffer, who thought that the tax cuts would bolster the economy. Laffer developed the theory of taxation, known as the Laffer Curve, that excessive taxes decrease government revenue. This theory is unsupported by evidence and will be further discussed in the *"Tax Myths"* section. The ERTA by 1985 saw a decrease of 4.5 percent of revenue as a percentage of GDP, this is the largest decrease in GDP from any tax bill from 1968 to 2006. Additionally, by 1985 the ERTA was the source of $176.7 billion in lost revenue for the government (Tempalski, 2006). This trend would continue with the Tax Reform Act of 1986, signed by President Reagan. This act further decreased the top marginal income tax rate to 28 percent and decreased the corporate income tax to 34 percent. The act, like the ERTA, cut government revenue across the board (Tempalski, 2006).

The latest major tax reform legislation was signed into law in 2017 by President Trump -- the Tax Cuts and Jobs Act (TCJA). On paper the TCJA seems great, it lowered both the individual income and corporate income taxes, while decreasing the estate and gift tax for every percentile. Decreases in the marginal tax rate for income and corporate income were a major goal of the TCJA. Proponents of the legislation cite the projected increases in incentives to work and investments that would further grow the economy (Li & Pomerleau, 2018). The TCJA reduced the top marginal tax rate from 37 percent to 29.6 percent. Another goal of the TCJA was to increase after-tax income for taxpayers, early analysis seems to prove this to be true. However, the growth in after-tax income is heavily skewed towards the top 1 percent of earners. Analysis of the 2018 distributional impact found that the bottom 20 percent of earners will only see a 0.8 percent increase in their income, compared to the 3.8 percent increase in income for the top 1 percent. By 2025 the bottom 20 percent of earners will only see a 0.7 percent increase in their income, compared to the 2.1 percent increase in income for the top 1 percent (Li & Pomerleau, 2018). In terms of dollar amount increase in income from the TCJA the bottom 10 percent would receive a $50 tax cut and the top 1 percent would see a $34,000 tax cut in 2019 (Scott & Chang, 2017). Due to the passage of the TCJA, 2018 marked the first time since in 100 years that the wealthiest in America paid a lower tax rate than the working class (Saez and Zucman 2019). Figure 1 displays the average tax rate by percentile using 2018 data. With the implementation of the TCJA the American tax system has turned into one giant flat tax that is regressive at the top.

Figure 1: Effective Tax Rates for 2018

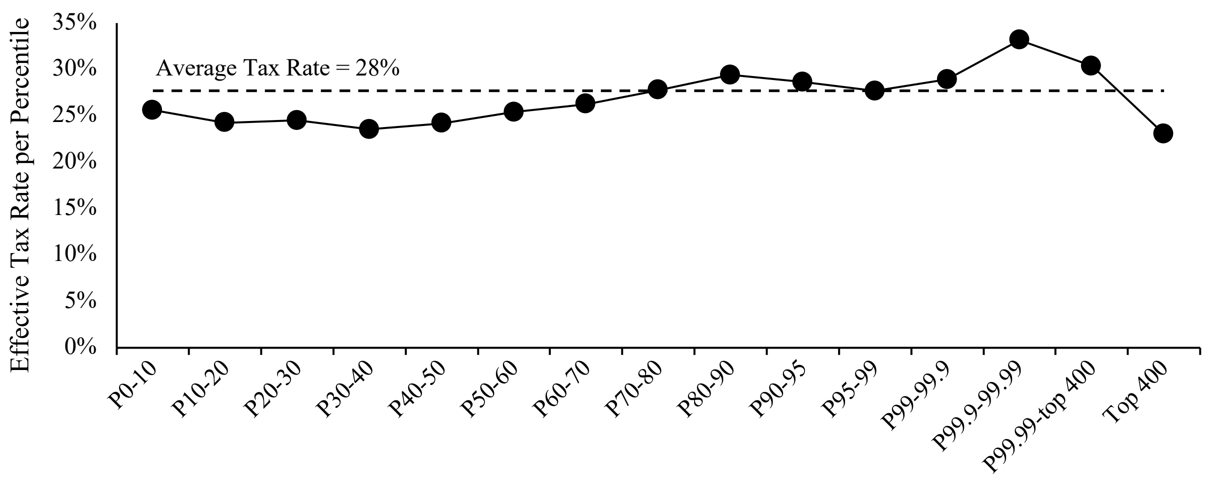

Figure 1: This figured used data compiled from statistics available from the World Inequality Database (https://wid.world/country/usa/).

Tax Myths

An ever-increasing belief in the United States is that if we reduce the tax burden on the rich the economy will perform better. The rationale centers on supply-side arguments that through tax cuts the economy will be able to grow, increase capital investments, decrease the unemployment rate, maximize revenue, and the benefits will "trickle-down." However, many of these claims are not based on reality.

New analysis displays the weak link that many of these arguments are predicated on. Reductions in tax rates for the top 10 percent of earners have little to negligible impacts on the economy over a standard business cycle. The best way to stimulate the economy is through targeted tax breaks on the bottom 90 percent (Zidar, 2015). Furthermore, the reduction in taxes on the rich do not have any meaningful impact on economic growth or unemployment. However, the reduction in taxes on the rich do lead to higher levels of income inequality through increased concentrations of income at the top (Hope & Limberg, 2020). These arguments are furthered supported by an analysis of the reductions to the top marginal tax rate over the past 65 years. These reductions do not show correlative impacts on economic growth (Hungerford, 2012). The data and past trends show that, on average, tax cuts do not have the impact that many proponents claim – often time they prove worse for the overall health of the economy. However, the reductions in the top marginal tax rate appear to be correlated with the concentration of income (Hungerford, 2012).

A source of contention provided by supply-side policy believers is that government revenue is maximized at a certain top marginal tax rate. What is the highest income tax rate that would maximize government revenue? A 100 percent income tax would not work, since people would stop working once all their earnings were taken by the government or they would utilize their efforts to hide and conceal their true earnings from the federal government. We know the answer lies somewhere between 0-100, this point is referred to as the *Laffer Curve*, which indicates the point where tax revenues peak. Most notably, there is no consensus on what the revenue-maximizing number is. Economist Thomas Piketty argues that this point is around 80 percent, whereas the UK chancellor of the exchequer argues it is closer to 40 percent (Aldred, 2019). Moving beyond this point would result in less government revenue, which would defeat the purpose of having a high tax rate. However, the Laffer Curve is a highly contested thought experiment, without prominent agreement and there are sufficient reasons to move beyond the point of maximum revenue, most notably to reduce inequality.

Taxes that exceed maximum revenue for the government are not new. From 1930 to 1980 the top marginal income tax rate averaged 78 percent and from 1951 to 1963 it exceeded 90 percent. When faced with a marginal tax rate of 90 percent most rational people would be unenthusiastic about increasing their income. This was the goal – they destroyed income concentration. President Roosevelt and his successors deployed confiscatory marginal tax rates to reduce the concentration of income among the ultra-rich and level the income distribution. It is important to stress that these high confiscatory tax rates did not apply to everyone, they exclusively applied to individuals with unusually high levels of income. The goal was achieved with confiscatory marginal tax rates being deployed. From 1930 to 1970, income inequality fell. "The share of pre-tax national income earned by the top 1 percent was reduced from 20 percent in the 1930s to 10 percent in the 1970s" (Saez and Zucman 2019). The United States was not alone in its use of confiscatory marginal tax rates. The United Kingdom used these high levels of tax rates and saw the concentration of income and wealth dramatically fall in the 1940s and reach a historic low in the 1970s. If the goal is lowering the levels of inequality, confiscatory top marginal tax rates should be adopted.

Economic Inequality

Economies change over time and we have developed tools to allow us to accurately measure the health and growth of the economy. The most notable mechanism used to measure the economy is the gross domestic product (GDP). When discussing how healthy that economy is performing experts rely on economic indicators such as the growth rate, unemployment rate, and the overall price stability of the economy. However, using these economic indicators fails to capture one of the most vital parts of the economy, the people. These indicators omit how the people of the economy are doing, it fails to measure the wellbeing of the people within the economy. One such measure to see the well-being of the people is through the economy's inequalities. Economic inequality refers to a variety of different inequalities in the economy. This paper will be focusing on the two main types of economic inequality, the unequal distribution of income and wealth.

The focus on the extensive hoarding of wealth and income is nothing new. In his 1919 address to the American Economic Association, economist Irving Fisher refuted what he saw in America as an "undemocratic concentration of wealth" (Saez & Zucman, 2019a). But how do we measure this concentration of wealth and income? One of the main obstacles in determining how unequal society has become is the lack of universal statistics to measure the growth rates of income and wealth inequality. When measuring inequality there is no equivalent to GDP. There is no government-run documented, standardized, or efficient methodology to compile these measurements. One of the more widely used tools for measuring inequality is the GINI index – a measurement between 0-100, where 0 is perfect equality and 100 is perfect inequality. As of 2016, the United States has a GINI index of 41.1 denoting a large gap in income shares in the U.S. The GINI index has increased from 34.5 in 1979, the second to last year where top marginal tax rates were greater than or equal to 70 percent.[2] While the GINI index is a good measure of inequality levels in a country, it does not provide the context of how well members of society are doing.

A new groundbreaking methodology has been created to measure levels of inequality – through national income and wealth accounts – by pioneering economists such as Avaredo, F., Chancel, L., Piketty, T., Saez, E., Zucman, G., and many others. To measure both the levels of inequality and well-being this paper will mainly focus on pre-tax national income levels for

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[2] World Bank, GINI Index for the United States [SIPOVGINIUSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SIPOVGINIUSA

different percentiles. To measure the average income of American adults we need to use national income – the measurement of all income that accumulates in a given year. In 2019, the U.S. national income was $18.5 trillion, when divided by the 245 million adults, the average income is close to $75,000. However, this drastically decreases when we focus on the 122 million Americans that compose the bottom half of all incomes. The average income for the American working class is *only* $18,500. The $18,500 that working Americans is drastically less than the $75,000 that the average American works but is even radically less than the average income for the top 1 percent. In 2019, the top 1 percent had an average national income of $1.41 million (Saez and Zucman 2019).

In the United States, the allocation of income has grown distinctly unequal since the 1980s. Analyzing the percent share of total national income to see the increasing concentration of income at the top started to occur in the 1980s after the top 1 percent hit a floor of about 10 percent during the 1970s. Using data compiled by the World Inequality Database the bottom 50 percent had a larger share of total pre-tax national income than the top 1 percent from 1943 to 1996 – during this time the share that the bottom 50 percent earned would peak in 1969 at 21.4 percent. This trend would continue until 1997 where the top 1 percent earned 15.8 percent of national income compared to the 15.2 percent that the bottom 50 percent earned. In 2019 the top 1 percent earned a total of 18.7 percent of national income. 2016 marked the lowest share of national income earned by the bottom 50 percent since 1913 at 13.1 percent. Figure 2 displays the share of national income between the top 1 percent and the bottom 50 percent from 1913 to 2019.

Figure 2: Share of Income for the Top 1% and Bottom 50%

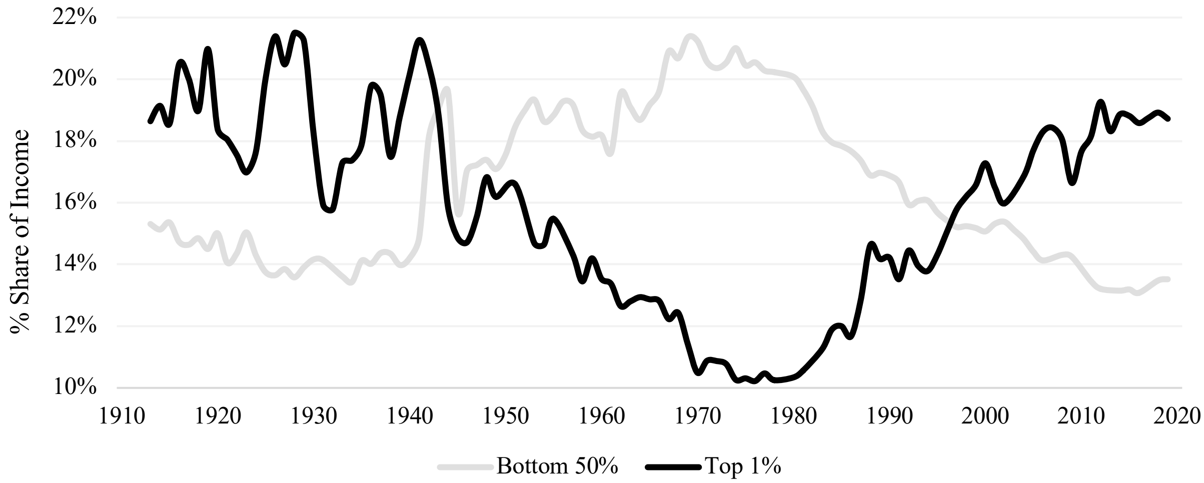

Figure 2: This figured used data compiled from statistics available from the World Inequality Database (https://wid.world/country/usa/).

Wealth is another example of extreme concentration at the top. Figure 3 displays the total share of wealth between the top 1 percent and the bottom 50 percent. The average market-value for national wealth in the United States for 1960 was a total of $13,417. In 2019 that number has skyrocketed to $390,170, a 2,808 percent increase. Between 1980 and 2020 the top 1 percent saw their wealth increase 200 times faster than median wages (Beer, 2021). During the same time the tax obligations, as a percentage of wealth, of the top 1 percent decreased by 78 percent (Goldin & Muggah, 2020). However, in 1936 the bottom 50 percent had an average net wealth of 2.5 percent compared to the 28.3 percent from the top 1 percent. In 2019 the bottom 50 percent represented only 1.5 percent and the top 1 percent represented 34.9 percent, a decrease of 40 percent and an increase of 23 percent, respectively (Beer, 2021).

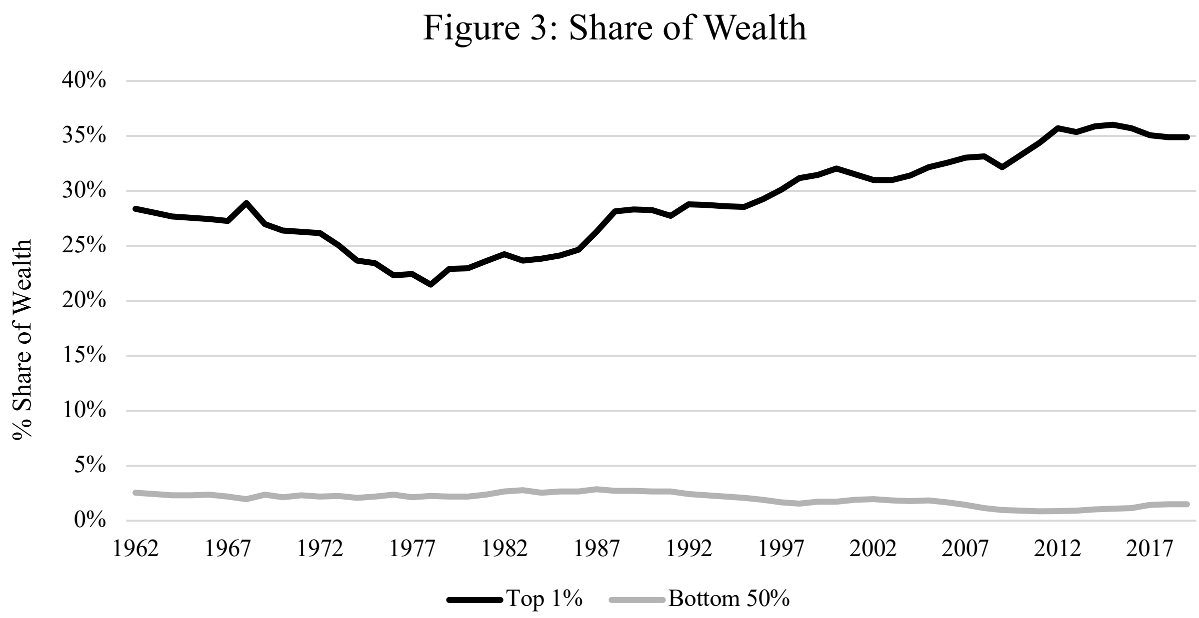

Figure 3: This figured used data compiled from statistics available from the World Inequality Database (https://wid.world/country/usa/).

Inequality During a Global Pandemic

The COVID-19 pandemic has succinctly demonstrated the harms of runaway inequality when left unchecked. Those that are in poor health, front-line workers, and low-income have been disproportionately affected. Since the beginning of the pandemic almost 31 million Americans have contracted the virus and over half a million have died due to the virus (John Hopkins University, 2021)[3]. Low-wage jobs have been hit the hardest with a 10 percent decreases in the number of jobs from February 2020 to February 2021; high-wage hardest lowest decrease in jobs with a 3 percent decrease in jobs during the same time period (CBPP Staff, 2021). From March 21, 2020 to February 20, 2021 over 75 million have filed for unemployment insurance (United States Department of Labor, 2021)[4]. There are close to 18 million more

[3] Data from John Hopkins University & Medicine Coronavirus Resource Center on April 5, 2021. https://coronavirus.jhu.edu/

[4] Data was accessed from the U.S. Department of Labor weekly unemployment insurance claims from

unemployment insurance claims than one year ago (Bivens, 2020). Furthermore, during 2020 the poverty rate increased by 2.4 percentage points to 11.8 percentage. This increase equates to 8.1 million more Americans living in poverty (Han et al., 2021). Projections estimate the economy will not fully recover until 2025. Total employment will not return to pre-pandemic levels until 2024 and unemployment will not fall below 4 percent until 2026 (CBPP Staff, 2021).

As working Americans class were struggling during the pandemic the richest Americans saw dramatic increases in their wealth. Since March 2020 U.S. billionaires seen their collective net worth increase by $1.1 trillion, an increase of 38.6 percent. The U.S. has saw the poverty level largest annual increase in over 50 years and close to 40 percent of the labor force have filed for unemployment during the pandemic. The wealthy doing well is nothing new in the U.S. The roughly 165 million that compose the lower 50 percent of the total population have a combined net worth less than the wealthiest 660 people in America. The bottom 50 percent have a combined wealth of $2.4 trillion while the wealthiest 660 have a combined wealth of $4.1 trillion (Beer, 2021).

Throughout the pandemic the Federal Government has used economic tools to help alleviate the struggles that many Americans are facing. The stimulus packages of 2020 and 2021 — the CARES Act of May 2020, Consolidated Appropriations Act of December 2020, and the American Rescue Plan of March 2021 — have provided assistance to Americans in the form of stimulus checks, expanded unemployment insurance, rental assistance, and changes to the earned income tax credit. Through these stimulus packages an average American making less than $65,000 per year has received $3,200 in direct aid. Additionally, the American Rescue Plan, through the stimulus checks and expanded tax credits, the bottom 60 percent of American

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January 2020 to March 2021. https://oui.doleta.gov/unemploy/claims.asp households saw on average $3,450 in direct aid (O'Brien, 2021). Data from the Tax Policy Center table T21-0039 on the American Rescue Plan, and the subsequent $1,400 stimulus payment and child tax credit, will increase the after-tax income of the poorest 20 percent of Americans by 20.4 percent. The top 1 percent will receive a 0 percent change in their after-tax income. (Tax Policy Center, 2021). Analysis from the Urban Center found that the recent American Rescue Plan "would reduce the projected poverty rate for 2021 by more than one-third." The projected poverty rate without the American Rescue Plan for 2021 would be 13.7 percent compared to the 8.7 percent poverty rate projection with the American Rescue Plan. However, the Urban Center analysis for the major reduction in the poverty rate is based on the extension of unemployment insurance benefits, extension SNAP benefits, the $1,400 stimulus payments, and the increased child tax credit which are set to expire at the end of the year (Giannarelli et al., 2021). Congressional action during the COVID-19 pandemic has been beneficial in bolstering the working class, but these actions have not addressed the core issue of inequality. The excessive concentration of income and wealth continues to grow, and a new era of tax justice is needed.

A New Era

President Biden has proposed the largest tax increase since 1993 on families making more than $400,000, increasing the corporate tax rate from 21 percent to 28 percent, expanding the estate tax, and increasing the capital gains tax (Cook & Davison, 2021). The details of Biden's tax proposal are still unknown, but early estimate show that this would increase the federal revenues by $2.1 trillion through the next decade and decrease the tax burden on the lowest three quintiles (Bhatt et al., 2020). The proposed legislation would repeal the Tax Cuts and Jobs Act of 2017 and return marginal tax rates for individual earning more than $400,000 between 33 percent and 39 percent – depending on filing status as individual or married filing jointly. However, this is nowhere close to the government revenue maximizing marginal tax rate. Estimates show that a marginal tax rate on the top earners of 60 percent would maximize government revenue and significantly decrease the inequality of pre-tax income (Saez & Zucman, 2019a). A 60 percent marginal income tax would decrease the pre-tax income of the top 1 percent by 4 percentage points from 20 percent to 16 percent.

Currently, the United States is in a race to the bottom vying to become a place of low corporate income taxes. Proponents of this believe that a low corporate income tax in hopes will retain and attract multinationals to the United States and further stimulate the economy. The United States is currently experiencing a major shift in multinational profits offshores to global tax havens. In the 1960s the share of US multinational profit booked in offshore tax havens represented less than 5 percent, but in 2019 that figured has jumped to more than 60 percent. The major problem is that these multinationals are not moving capital or workers to these tax havens instead they are moving their "books." To put this into perspective almost 20 percent of multinational profits are made outside of the country where they are headquartered. Before the 2000s this was less than 5 percent. There are tools to limit the booking of multinational profits in offshore tax havens to reduce their tax burden. First, the United States could impose a tax deficit on multinationals headquartered in the US. This would be done through the United States collecting taxes that the tax haven chooses not to levy. For example, if Apple booked its profit in a tax haven that only has a 2 percent corporate tax and the United States had a 25 percent tax, the United States could collect the missing 23 percent. The United States using a tax deficit policy would remove the incentive for multinationals to book their profits in tax havens (Saez &

Zucman, 2019a). The second option is a global minimum tax – a minimum corporate tax that all agreeing countries will apply to their multinationals, wherever they operate. How a global minimum tax might work: "a business in Country A has a subsidiary in Country B. Country A's statutory corporate tax rate is 25 percent while Country B's is 8 percent. If the global minimum tax is 10 percent, then Country A would be able to tax the difference between the 8 percent tax in Country B and the minimum tax" (Bunn, 2020). A minimum tax imposed by G20 countries would result in more than 90 percent of multinational profits being effectively taxed at 25 percent regardless of where they are operating (Saez & Zucman, 2019a). Recently, this idea has become actively discussed due to President Biden and Treasury Secretary Janet Yellen proposing this idea for all OECD countries. The goal of the United States is to impose a global minimum tax of 21 percent (the international average corporate tax rate is 24 percent), the Biden Yellen plan would specifically target the worlds 100 largest multinationals (Partington, 2021).

Through restricting the tax codes the United States can reduce the excessive concentration of income and wealth among the top percentiles. This paper does not propose a threshold for a minimum marginal tax rate needed to reduce inequality. However, throughout history when tax rates are higher on the top percentiles their concentration of income and wealth decreases. It is important to understand that increase the tax rates on corporations and the ultra-rich is not the end game. While these measures will reduce the concentration of income and wealth at the top it does little to help average Americans increase their share of income and wealth. If the United States wants to significantly reduce the levels of inequality it must take a two pronged approached. First, increasing the levels of taxation on personal income, corporate income, capital gains, and establishing a wealth tax. Second, is redistributing the revenue gained from these new taxes to the bottom percentiles. It can be extrapolated through the 2021 American

Rescue Plan that policies designed to give help Americans work. If the government wants to tackle inequality head on it has to increase taxes on the top earners and redistribute the income through social programs.

Suppose a 50 percent tax on the top income bracket was imposed. This new tax would generate $95 billion in government revenue and approximately $1.3 trillion dollars in a decade. If this revenue was used in social programs targeted at the bottom fifth income earners it could reduce the United States' Gini coefficient by almost 20 percent (Aaron, 2015). Additionally, imposing a wealth tax would generate the U.S. government trillions of dollars in revenue. A 2 percent tax on net wealth above $50 million and an additional 1 percent tax above $1 billion would only affect 75,000 American household, but would generate nearly $2.5 trillion over a ten-year period (Saez & Zucman, 2019b). With this added revenue the government can expand social programs and safety nets to further reduce inequality across the board. An investment of $90 billion a year by permanently expanding programs such as the Earned Income Tax Credit and the Child and Dependent Care Tax Credit, housing assistance, and food assistance could cut child poverty in half (Mermin et al., 2020).

If the United States wants to stop leading the OECD and other Western nations in inequality levels it must take a two pronged approached through taxation and government redistribution to lower the current levels of inequality.

Analysis and Policy Recommendations

The only thing stopping the United States from acting on the extreme concentration of income and wealth and the subsequent high level of inequality is itself. Throughout this paper evidence has been analyzed that shows when tax levels are low income and wealth concentration, and inequality levels are higher. These levels of inequality are something that the government accepts and does not adequately work to lower. Since the 1970s the United States has saw a drastic increase in inequality, but it is now time for a new era. There are policies the government can take to reduce income and wealth at the top while lowering inequality across the board.

One of the first tools the federal government can use is aimed at the overall concentration of income and wealth amongst the few on top. Increasing the marginal income tax rates, establishing a wealth tax, and increasing the capital gains tax is a direct way to decrease the amount and concentration of income and wealth at the very top. Additionally, the federal government would need to redistribute the revenue from new and higher taxes to fully fight inequality levels. This redistribution should occur through existing social programs and the creation of new ones. These include fully funding social programs, expanding access to Medicare and Medicaid, and expanding access to post-secondary education. For example, there are currently gaps in federal policy for economic support that exclude non-elderly adults without children. These gaps leave millions of Americans in poverty. Through government assistance the poverty rate for non-elderly Americans with children decreased by 8.9 percent from 1993 to 2017. However, the poverty rate increased by 0.8 percent during the same time frame for non-elderly Americans without children (Hingtgen et al., 2021). Additionally, expanding access to Medicaid can further reduce poverty levels by increasing access to affordable health care and lowering the out-of-pocket costs. Research has found that Medicaid has reduced poverty by 3.8 percent and reduced childhood poverty by 5.3 percentage points (Wagnerman, 2018). These are just a few policies the federal government can use to further decrease inequality in the United

States. These policies paired with new taxation can kick start a new era in the United States to fully combat the rising levels of inequality.

As displayed the United States has different tools available to fight inequality. However, there are major limitations to these policies. The first limitation is with Congressional action and the Senate filibuster. The Senate filibuster could reasonably stop each policy action from being implemented. The only way to bypass the filibuster is through Congressional Budget Reconciliation – a Congressional budget rule adopted in 1974 to allow for budget resolutions to pass Congress more quickly. The budget reconciliation is one of the few ways to bypass the filibuster, but it is extremely specific in what can be included within the reconciliation resolution (Snell, 2021). For instance budget reconciliation cannot be used for policies that would “raise the deficits in any year after the period covered by the reconciliation instructions” (Kogan & Reich, 2021). The second major limitation in policy is the “inequality trap” in the United States. The inequality trap refers to how inequality and politics are so heavily connected that the politics and political and electoral consequences of rising inequality make future reductions in inequality less probable (Kelly, 2019). When inequality is high, and Americans are outraged by the levels of inequality higher levels of inequality are likely to occur. This is due to the electoral portion of the inequality trap. Evidence exists that most Americans are not informed voters – American voters rely chiefly on their social identity rather than their policy preferences when casting their ballots. In turn, when inequality is high Americans are more likely to vote for Republicans that favor tax cuts, cutting social programs, and deregulations – the most usual policies for increasing the concentration of income and wealth in the hands of the few (Kelly, 2019).

Discussion and Conclusion

Throughout the paper a major theme emerged in that the American Dream is fading for many Americans while those at the top see their income and wealth concentration increase at historical levels. This paper sought to observe three major eras in American history. These periods are known as the progressive era, the new gilded/modern era, and a new era. The progressive era was marked by high levels of taxation on income and wealth and the subsequent low levels on economic inequality. The new gilded/modern era is the current era marked with low levels of taxation on income and wealth and increasingly high levels of inequality. The final era is the new era, a proposed era of returning to higher levels of taxation in the hopes of lowering economic inequality across the board. This paper found that the highest levels of recorded inequality occur during the new gilded/modern era where tax rates are lower are decreased over time. The hope is to enter a new era of tax justice where levels of higher taxation return and decrease the concentration of income and wealth at the top.

This paper examined the potential relationship between the levels of taxation and the levels on inequality in the United States. This potential relationship could prove to be significant in exploring policies and methods to decrease economic inequality. This paper found that the United States currently has an effective tax rate that is predominately flat across the different percentiles that becomes regressive for the top 400 earners. This is compared to the top 1 percent having the largest share of income since the 1940s while the bottom 50 percent has the lowest share of income since the 1930s. Additionally, this paper found that the share of income increase for the top 1 percent during the periods of relatively low taxation. This trend of higher shares of income for the top 1 percent coupled with lower tax rates starts in the 1980s. This paper also disputed the benefits of tax breaks on top earnings finding through compiled research that there is no meaningful benefit on economic growth or unemployment when new tax breaks are introduced. However, there is extremely limited research suggesting that these tax breaks can increase inequality levels. Moreover, this paper found that government policies that provide tax relief and direct aid to Americans can significantly decrease poverty levels. These policies paired with higher levels of taxation could be the start to decrease inequality and entering a new era of tax justice in the United States.

This paper is joining the emerging field of research focused on taxation and inequality. This research is far from over, but this paper does answer important questions on taxation and inequality in the United States. However, there are major limitations in the current literature on this topic. Chiefly, the limitation on the measurement of inequality is most blatant. Currently there is no set way of measuring inequality other than the GINI coefficient, but this does not fully capture how vast inequality is or what it means. This paper used a new way of measuring inequality by specifically looking at the share of income and wealth of different percentiles and groups across America. Furthermore, there has been no true tests on the relationship between taxation and inequality. Researchers need to find a way of measuring the effects of taxation on inequality to truly understand the impact tax rates have on inequality. When literature does mention an effect on inequality it is brief and does not show or explain how the effect was measured. Simply, this paper could not arrive at concrete conclusions on taxation and inequality because there is still a lot that the present literature does not cover, and researchers do not know. However, this paper has found a correlative relationship between the periods where low taxation and exists and the subsequent rise of inequality and the concentration of income and wealth amongst the few.

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