The Discriminative Effect of Income and Firm Taxes

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Abstract

How can we reduce gender and racial discrimination? One answer is that we can do it by relying on the invisible hand. Another answer is that since people in the marketplace have racial preferences, we need to have anti-discrimination laws in order to decrease discrimination. The surprising answer this paper proposes is that we can reduce gender and racial discrimination by reducing income and firm taxes. When the gains from discrimination are untaxed, a higher tax will lead to more discrimination. We are going to show this proposition, and then we are going to explain, why it is realistic to think, that discrimination gains are untaxed.

1. Motivation

Those who support “Left wing” views usually back anti-discrimination law and high taxes, while those who support “Right wing” views usually resist anti discrimination law and back low taxes. In this article, we maintain, that by using the reasoning of game theory, and integrating the fields of discrimination and taxation, we arrive at counter intuitive conclusions, which challenge current discourses on discrimination and taxation. In other words, we will show that game theory leads to the conclusion, that when the gains from discrimination are untaxed, a higher tax will bring about further discrimination. This proposition challenges the understating of taxes as a mechanism of progressive redistribution that promotes the interests of weak parties. Our article does not maintain that high taxes do not have this progressive effect, of which existence supporters of "Left wing" views are so certain. However, we point out that taxes have another effect, a discriminative effect that people are not aware of. Actually, higher taxes strengths the different kinds of generic discrimination: like race discrimination and gender discrimination. It is important to understand this in order to find the best mechanism to reduce racial and gender discrimination in the marketplace.

2. Introduction

Gary Becker confronted the question of discrimination in the marketplace, and claimed that a rational market would neutralize discrimination (Backer 1957). Becker actually claims that since discrimination is irrational, and since the marketplace leads to rationality, discrimination will not survive the marketplace. The conclusion from Backer may be that it is better to rely on the invisible hand than on regulation in achieving our goal of abolishing discrimination. The main critique of Becker's proposition maintains that discrimination will survive the rational marketplace, since it is not true that rational employers will not discriminate. In contrast to Becker's assumption, the critics say, employers are not only profit maximizers, they also have taste-based discriminative preferences, and therefore rational employers will discriminate. (see Welch 1967, see also Arrow 1972, 1973, 1998)). For example, employers may prefer to work only with beautiful people, people belonging to their race and religion, etc. Taking these preferences into account, rational people will engage in discriminating behavior.

Eventually, Becker's model does not structure the "real marketplace" correctly, since it ignores the fact that employers have discriminative preferences, and therefore the conclusion that rational employers will not discriminate is not valid in an actual marketplace. Furthermore, even rational profit maximaizer and blind colors employers have the incentive to discriminate if their employees or customers are racists. When you assume that discrimination is simply not rational, you cannot fully understand the phenomena of discrimination (see Aumann 2005). We accept this critique, and assume that employers have taste-based discriminative preferences. However, we try to examine the impact of tax on generic discrimination, as opposed to current literature in this field which has always treated this as a constant, rather than as a variable.

We accept Welch and Arrow's assertion that there will be discrimination in the marketplace against members of certain groups, such as blacks, women, Muslims, etc.

However, we do not believe that the degree of discrimination will depend only on the discriminative preferences or the anti-discrimination regulation, but also on the variable of tax. We agree with the diagnosis of Arrow, racial and gender discrimination is a caner that may happen also in the marketplace, and we now ask how to treat it. How can we reduce racial and gender discrimination? The answer of Backer was that we should rely on the marketplace. The opposite answer is that we should have anti-discrimination law. We wish to propose the answer that in order to reduce racial and gender discrimination, we should reduce income and firm taxes. Our analysis reveals that that tax has a discriminatory effect, which is influenced by racist preferences, and that discrimination of groups that suffer from racism is a function of the rate of tax. Hence, in order to reduce gender and racial discrimination, we should decrease taxes. We wish to make it clear that we do not speak about the discrimination of the people who prefer money on time, but on the racial and gender discrimination.

3. Example

A lawyer needs an intern. He needs to choose between two ladies who have applied for this position. The first candidate, who is more efficient, will provide him with a product of 100, while the second , who is less efficient, will provide him with a product of 70. However, the second candidate is younger and more attractive, so the lawyer is expected to gain an additional benefit of 20 from that candidate's appearance. For example, he enjoy from looking on her during work, maybe he enjoy from being a boss of a pretty lady since his self esteem is improved from this.

In a tax free regime, she will choose the first candidate, because his total benefit (product + appearance benefit) is 100, whereas the total benefit of the second candidate is only 90.

In a regime of 50% income tax, however, she will choose the second candidate. This is because this time the product will be taxed, whereas the beauty benefit will be tax free. Therefore, the total benefit from the first candidate is 100*0.5=50, whereas the total benefit from the second is 70*0.5 + 20*1=55.

we have shown that in this example when we shift from a tax free regime to a 50% tax regime, we shift from a non discriminative choice of the employer to a gender and age discriminative choice of the employer. In this particular example, the critical point is a tax of 33.33334%[1]. If the tax is lower than 1/3, the employer will choose the first worker, whereas if the tax is higher than 1/3, he will choose the second worker. This means that in our example, a utility maximizer advocate will discriminate if and only if the tax is higher than 1/3.

4. The model

We have employer and two candidates [J, K] to a particular Job

The set of options of the employer is [J,K]

U(i): - The utility of the employer from candidate i

D_i – discriminative gains (like the enjoyment from working with a pretty lady)

P_i – expected product by the candidate

T- Tax

The utility function of the employee from a particular employer is:

$U(i) = (1-T)P_i + D_i$

The employer is rational.

$P_k =/= P_j$

There is discrimination in the choice of the employer iff

1. $P_j > P_k$, and $U(K) >= U(J)$

or

2. $P_K > P_j$ and $U(J) >= U(K)$

Hence,

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[1] $100(1 - T) = 70(1 - T)+20$
$30(1 - T) = 20$
$30 - 30T = 20$
$10 = 30T$
$T=1/3$

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$U(J) = (1\text{-}T)Pj + Dj$

$U(K) = (1\text{-}T)P_k + D_k$

If $P_j > P_{k,}$ there is discrimination iff

$U(J) < U(K)$

Which means

$(1\text{-}T)Pj + Dj <= (1\text{-}T)P_k + D_k$

$(P_j – P_k)(1\text{-}T) >= D_k - D_J$

$1 - T <= (D_k - D_J)/(P_j – P_k)$

$T >= 1 – (D_k - D_J)/(P_j – P_k)$

If $P_k > P_{j,}$ there is discrimination iff

$U(J) >= U(K)$

$(1\text{-}T)P_k + D_k >= (1\text{-}T)P_j + D_j$

$(P_k – P_j(1\text{-}T) >= D_j - D_k$

$1 - T >= (D_k - D_j/(P_k – P_j$

$T >= 1 –(D_k - D_j)/(P_k – P_j)$

This shows that in every case in which we choose between two people, with no equivalent P, there is a critical T that if T is big enough there will be discrimination.

In the racist discrimination case, in which $P_j > P_{k,}$ and $D_J < D_{K,}$ there is discrimination iff $T <= 1 –$ deltaD\deltaP, and this critical point is lower than 1. Sometimes in order to prevent discrimination, we need to have a negative income tax. This is the case when deltaD is bigger than deltaP For example, if the first candidate give a product of 100 o discriminative gains, and the second candidate give a product of 80 and 30 discriminative gains, we need to have a tax of -50% in order to prevent discrimination).

However if $P_j > P_{k,}$ and $D_k < Dj$, there can be discrimination in the sense that the candidate with the bigger P will not be chosen, if and only if the tax is big enough, bigger than a number that is bigger than 1.

5. Discussion and Explanation

A high tax encourages the employer to choose the worker whose product is untaxed. Since discrimination gains are untaxed, the employer is encouraged to hire the candidate who is expected to give her more discriminative gains, i.e. the one who fits her preferred racial, religious, ethnic and gender preferences. These gains simply become more attractive. They are untaxed, while other gains are taxed.

Actually, when there is a tax of T, the taxed product P is worth only (1-T)P, whereas the untaxed discrimination gain D is still worth D. This means, that when the tax is T, the attractiveness of the untaxed (discrimination) gains increases in 1/(1-T).

Eventually, taxation violates the meritocracy of the market in the sense that it reduces the impact of the merit of the employee on the employer's benefit, whereas the discriminative gains remain the same. Hence, the impact of the merit relatively to the racial elements is decreased. Therefore, the meritocracy of the marketplace is decreased, when the income and firm taxes rates are increased.

It is important to remember that there is no difference between discrimination gains and discrimination losses, so a high tax will also strengthen the discrimination of candidates who are perceived to be dangerous because of their race, religion, or sexual tendency. Xenophobia is more significant, when the tax is high.

An employee is also expected to choose the employer, who gives her discriminative gains, for example, the ability to work with people of a preferred race. So, if this gain is untaxed, the employer (the firm) will exclude employees of unpopular races when the tax is high. Hence, in order to fight discrimination, we should reduce income and firm taxes.

The question of how to reduce racial and gender discrimination is a very important one. Gender and racial discrimination is inefficient and violates human dignity and the basic values of humanist society. Discrimination may lead to the exclusion of particular groups from the marketplace. Discrimination of people distorts also their incentives to invest in their competitiveness, which would end in reducing market competitiveness, productivity and decency.

In the current discourse there are two major opinions. The first is that of free market supporters who propose to rely on the invisible hand. The second is that of the regulation supporters who propose to have state intervention by anti-discrimination law. Their opinion is based on the assumption that people in the marketplace do not behave as if they are rational profit maximiazier players, but as if they have racial preferences. This paper accepts the critical assumption that people in the marketplace have racial preferences, but come to the conclusion that in order to decrease discrimination, we should reduce income and firm taxes, which is considered to be anti-interventional solution. Surprisingly, the adoption of anti-free market assumption, leads to free market policy recommendation.

It is also important to emphasize that we may combine the proposed solution of reducing taxes with the solution of Anti-discrimination regulation. Actually, the anti-discrimination laws cannot solve the problem, by themselves, since there are many kinds of gender and racial discrimination which cannot be proved and hence cannot be prevented by those laws. The Anti-discrimination laws may discourage discriminative *visible* behavior, while decreasing income and firm taxes may discourage *invisible* discriminative behavior.

Of course, there will be price for decreasing taxes, like reducing the capacity of society to offer social services or to make redistribution. However, in order to choose the right policy, we should understand all of its results. We should know that when we increase taxes, we may not only discourage people from work in the level which is desirable to society, but we may also increase discrimination. Now we need to ask what our desirable result from all the optional ones is, taking into account the discriminative effect of high income and firm tax we pointed out. Understanding the discriminative effect of high income and firms tax, may lead us also to conclusion that it is better to have alternative ways of taxing, like having property tax.

Why is it realistic to think that discrimination gains are untaxed?

We have seen the examples of discrimination based on age or looks, and of phobia discrimination. The reason why there are so many kinds of discrimination, which are untaxed, is that those gains are not recognized by the state. The state does not see the satisfaction of discriminative tastes as taxed profits (profits that should be taxed as income). In addition, the mind of racist people is influenced by a variety of racist feelings, phobias, and tastes, which are not recognized by the taxing authorities, "for the LORD seeth not as man seeth; for man looketh on the outward appearance, but the LORD looketh on the heart"[2].

Furthermore, it is very difficult to prove discrimination, and this is obvious when we examine the anti-discrimination suits. The difficulty stems from the fact that discrimination usually occurs behind closed doors, and without a formal contract. Actually, in a legal regime that bans discrimination, the recognized discriminations which survive the market are those which are most difficult to prove.

6. Conclusion

We have shown that reducing income and firm tax will reduce also discrimination. The usual answers to the question, how to reduce discrimination, are to rely on the invisible hand or to have anti-discrimination law. We propose additional answer: we can reduce discrimination by reducing income and firm taxes. When the gains from discrimination are untaxed, a higher tax will lead to higher discrimination. It is realistic to think that discrimination gains are untaxed, so it is realistic to think that a higher tax will lead to further discrimination. By adopting anti-free market assumptions, we have reached a conclusion held by free market supporters.

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[2] Samuel 1, 17, 7, King James Version. 5

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