The Facts about Tax Progressivity

This is a guest post from political scientist Lucy Barnes, Prize Postdoctoral Research Fellow at Nuffield College, Oxford:

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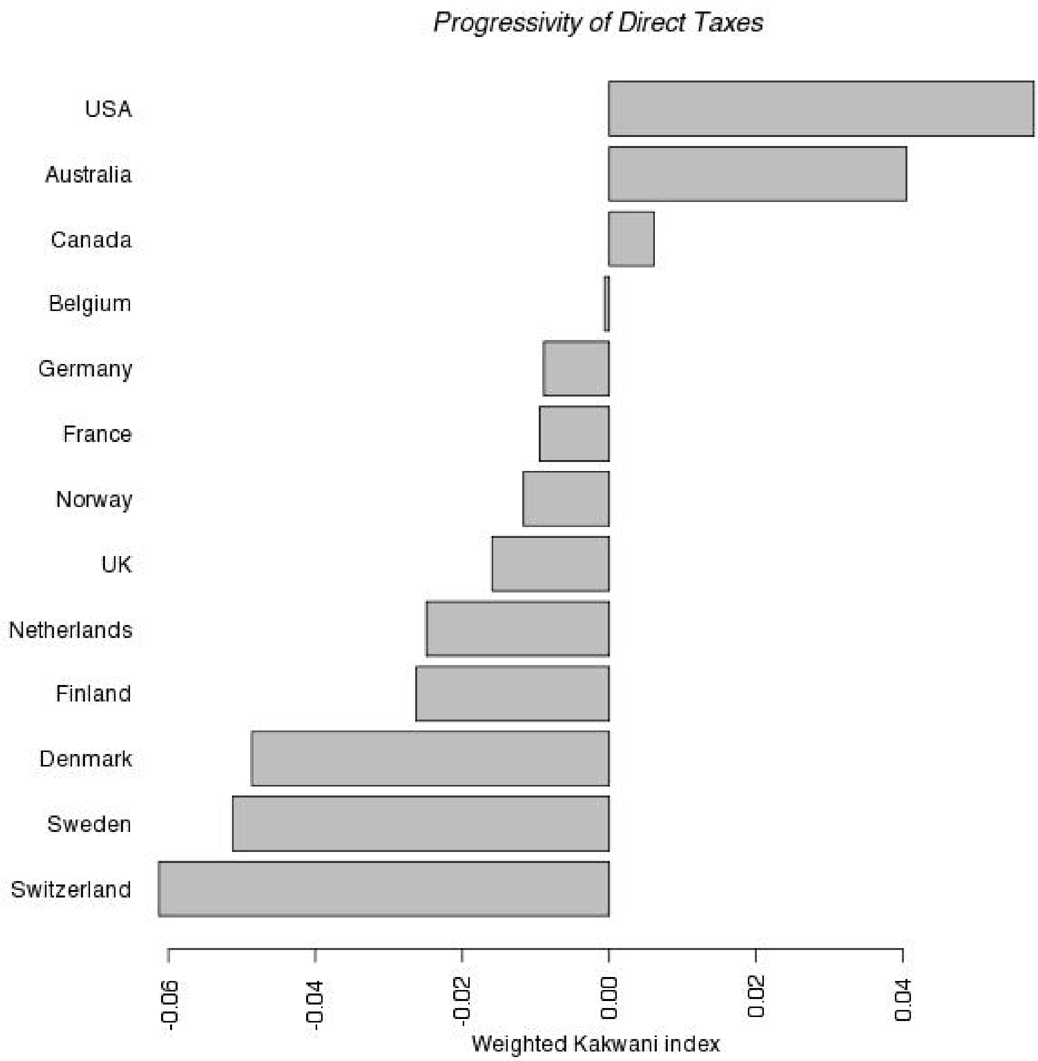
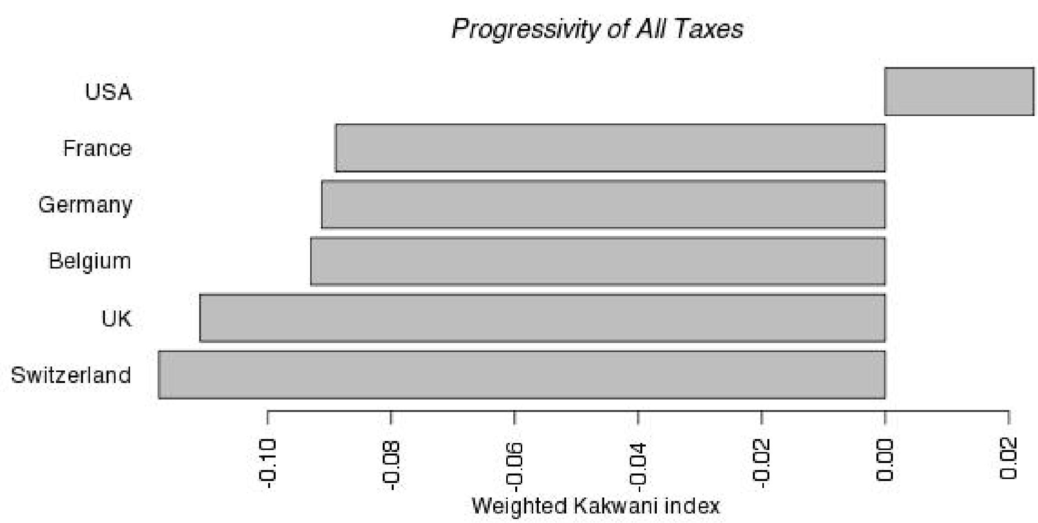
The recent exchange between Jonathan Chait and Veronique de Rugy over the progressivity of the U.S. tax system in comparative context, and subsequent contributions (e.g. from Brad de Long) exemplifies the widespread confusion over what tax progressivity actually means. The distribution of the tax burden is obviously a politically loaded question, where those on the right tend to have an interest in claiming that the US tax system is already (too) progressive, while those on the left wanting to increase the share of the burden shouldered by the rich. However, the question of how progressive the system is an empirical question. In fact, the system of taxation in the United States is relatively progressive. What makes this fact surprising is that tax progressivity and fiscal redistribution (the reduction of inequality by government action) are often conflated, and it remains true that redistribution in the US is low, due mainly to the relatively small size of the US government. The American case typifies one pole of a robust negative relationship between tax progressivity and overall redistribution, the cause of which remains a contested question in the literature on comparative political economy.

So, what are the facts about tax progressivity? The most comprehensive scholarly work on this question to date comes from sociologists, Monica Prasad and YingYing Deng, who use data on individual incomes to calculate total tax burdens at different levels of the income distribution (gated, ungated). Their main takeaway finding is illustrated in the two figures below, which show the Kakwani index of taxation (a measure of the progressivity of the system that parses out the impact of income concentration on the concentration of the tax burden) for a number of advanced democracies.



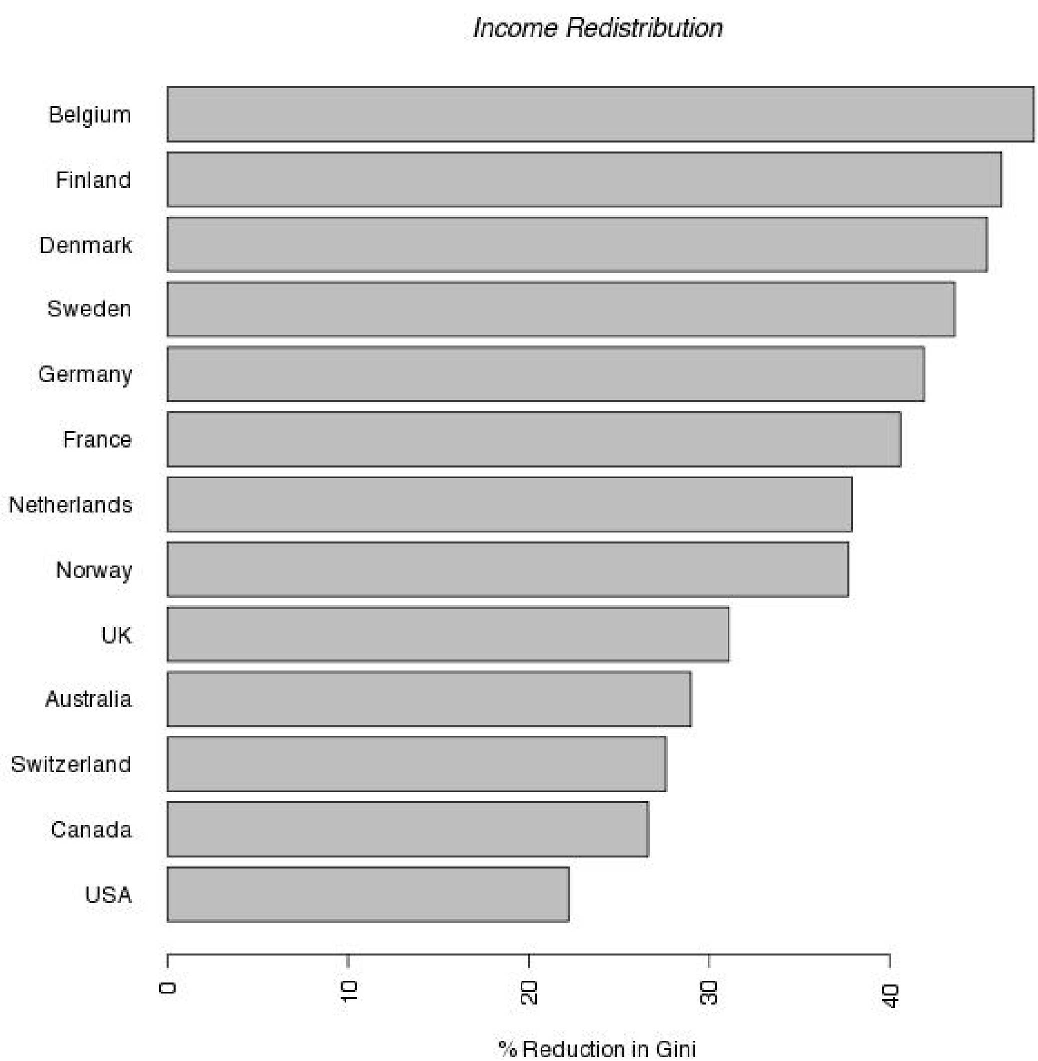


These data are from the most recent year available (around 2000 in most cases). The top figure shows those taxes that are paid directly by individuals: income, wealth, property and employee social security contributions, while the bottom figure shows measures (albeit for a smaller set of countries) that incorporate the sales tax burden based on the individual household expenditure data.

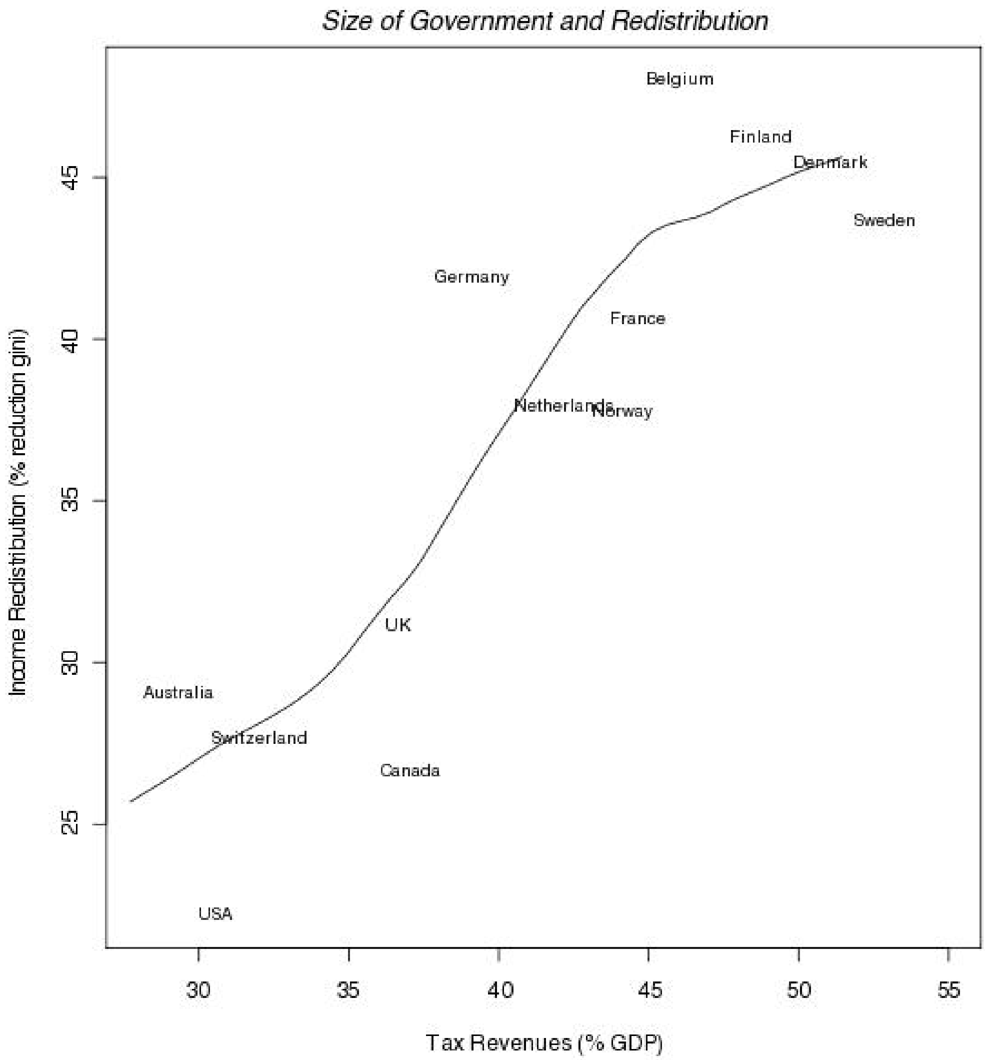
What is clear from both figures is that the United States' tax structure is more progressive than that of its peer countries. The Bush tax cuts (enacted since these measurements) will have decreased progressivity somewhat, but not enough to alter these rankings.

The main reason for this is the relatively low reliance of the American fiscal system on sales taxes, which constitute a much higher share of revenues in other countries (even when including state and local taxes in the US case, as the figures above do). General sales taxes place a disproportionate share of the tax burden on the lower end of the income distribution because expenditures are higher as a share of income as we move down the distribution. In addition, specific excises tend to be levied on goods representing a larger share of poorer households' budgets, such as taxes on alcohol, tobacco and gasoline. Again, these taxes tend to be higher in other advanced democracies than they are in the United States.

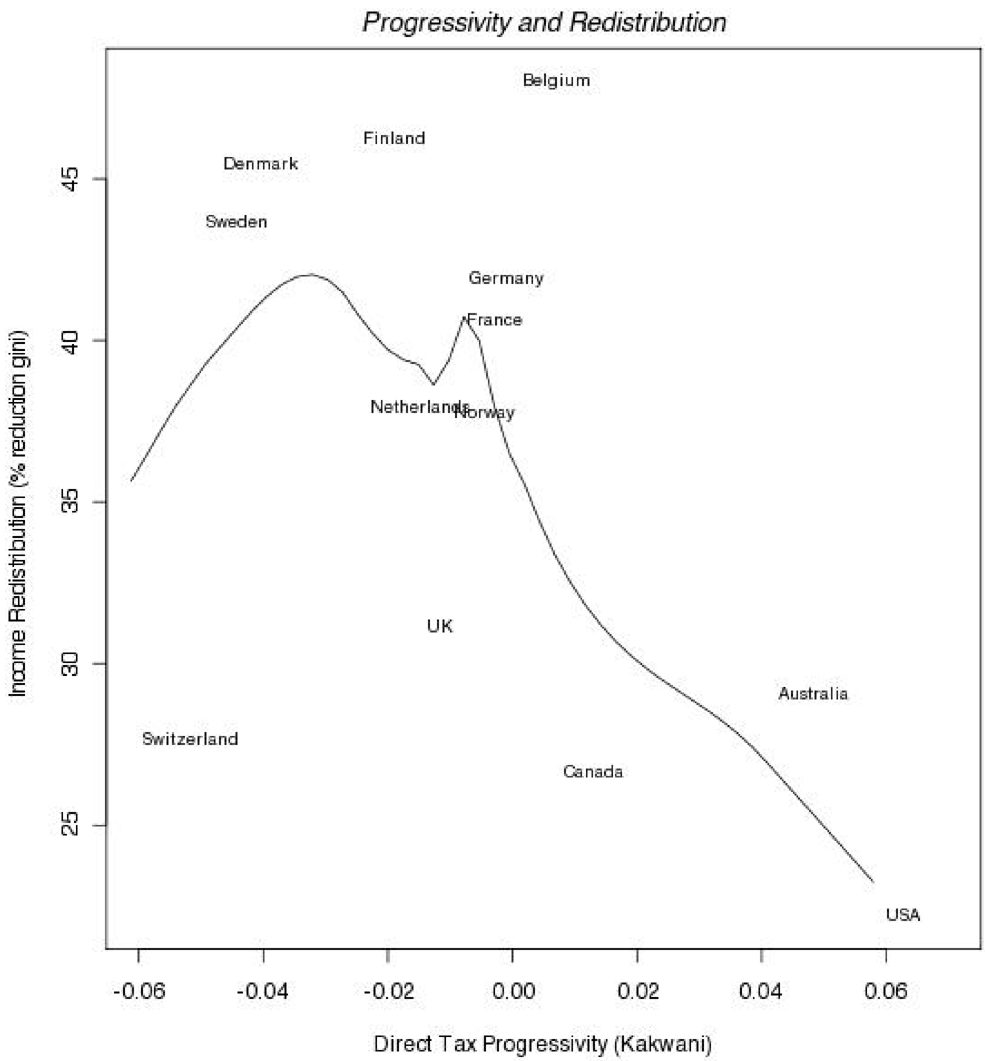
This claim, that the American tax system is progressive compared to those of its advanced economy peer countries, is hard for many (in both the US and in Europe) to accept. The conventional wisdom is that the United States intervenes comparatively little in redistributing income from rich to poor. It is not that these stylized facts are untrue: the figure below shows the reduction in inequality accomplished by government intervention (again using data from the Luxembourg income study)– both taxes and transfers.



Here the United States takes up its more accustomed place at the bottom of the pack (and it is data like these that have been used in the recent debate to refute the claim that US taxes are progressive). How is it possible that American taxes be progressive, while achieving so little redistribution? The answer is that redistribution is not driven primarily by the structure of taxation, but by its level. The next figure shows the close relationship between the level of taxation (total government revenues in GDP) and reductions in the Gini.



In fact, the association between tax progressivity and overall redistribution across countries is negative, as illustrated below .



This stylized fact is the focus of a large emerging literature on the relationship between the size of government and the structure of taxation. Why are political demands for progressivity and redistribution, widely seen as interchangeable, channeled so differently into public policy? The existing literature on the topic focuses on the economic and political constraints that high spending imposes on politicians seeking to alter tax structures (for further reading see here, here and here, to start). But the politics of taxation, as distinct from those over redistribution writ large, remain generally understudied in political science (see also here.)