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The Business Journal

The taxing question of our times

People sure love arguing about taxes. The poor think the rich should pay more, and for many years, the rich didn’t disagree. More recently, the rich have begun to say that the poor should pay more.

Economics informs this debate by categorizing taxes as progressive, proportional or regressive. A progressive tax is one for which the percentage of income paid in taxes rises with income, while a regressive tax is the other way around. A proportional tax is the dividing line between the two.

Proportional taxation doesn’t mean that everyone pays the same tax rate. After all, sales taxes are regressive because low-income people spend a greater share of their incomes on taxable items, which means they pay a greater share of their income on sales tax.

The federal income tax, with its increasing marginal tax rates, is progressive. The Social Security portion of the federal payroll tax is regressive, while the Medicare portion is proportional. Federal excise taxes are regressive as state and local sales taxes. State income taxes are a mixed bag.

When one takes taxes at all levels into account, the U.S. tax system is slightly progressive. Factoring in government transfers, i.e. payments ranging from food assistance to Social Security, doesn’t change this at all, but the system used to be more progressive, but changes in tax rates and cuts in government transfers have moved the system closer to proportionality.

The question of how progressive taxes should be is often framed as an economic question. But the structure of taxes matters less for economic performance than many believe. The relative distributive effects of different taxes are real but empirically small. Therefore, tax progressivity is more of a political issue than an economic one.

It’s also an issue that is increasingly relevant, as various states are considering restructuring their taxes toward the sales tax. North Carolina is one of them. The Republican leadership in the General Assembly has embraced a Civitas Institute report that advocates eliminating corporate, rich and income taxes and replacing them with, among other things, an expanded sales tax.

The expansion would include many services that are currently exempt from sales tax, but in order to be revenue-neutral, it would also raise the tax rate to approximately 8 percent. Expanding the taxable base of the sales tax is something many observers, both liberal and conservative, have supported. However, such support is usually paired with other changes that offset the increased regressivity.

No such offset is part of the state Republicans’ proposal. And as a result, it would cause a significant shift in the tax burden. The Institute on Taxation and Economic Policy periodically assesses state tax systems. Its current report finds that North Carolina has a moderately regressive system. Non-elderly taxpayers in the lowest 20 percent of incomes pay state taxes in an amount equal to 9.8 percent of their incomes, while those in the top 1 percent pay 6.5 percent.

But according to an analysis by the N.C. Justice Center, the state Republican proposal would mean that the lowest 20 percent would see their taxes rise by almost 4.8 percent of their incomes. That’s a huge change. In contrast, the top 1 percent would see their taxes fall by 4.5 percent.

The claim that changing the tax system in this way would spark an economic revival in North Carolina is highly dubious. But the distrubutional effect is obvious. As a political question, we need to ask: Is this the kind of state we want to be?

Andrew Brod is a senior research fellow in UNCG’s Center for Business and Economic Research and a member of The Business Journal’s Editorial Board of Contributors. Reach him at (336)-707-6439 or AndrewBrod@uncg.edu. An archive of his columns is available at http://cher.uncg.edu.

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Other
5%
Woolworth
12%
Hostess
15%
Oldsmobile
6%
PanAm
7%
Wachovia
16%
Piedmont Airlines
36%

Based on 332 responses. Numbers do not total 100 due to rounding.

Opinion

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VIEWPOINT

ANDREW BROD

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