**ED 5: Fiscal Policy + Direct Taxes**

**Best Uses:**

* Connects Fiscal polidy with Equity in distribution of income. It is therefore a development issue.
* Progressive taxation key to improved distribution of wealth in a country
* Useful diagram to highlight connection between role for government and development

*Essential Diagrams 3.4 Taxation: distributing income fairly*

***Progressive, regressive and proportional taxation (for direct taxation)***

* **Use this diagram to explain different types of taxation for section 2.4**
* **Use this diagram to show the appropriate type of taxation to promote economic development i.e. a better distribution of income using progressive taxation in section 5.1**

***Fig2. Progressive, regressive and proportional taxation ( for direct taxation)***

 ***Total Tax paid***

 ***T6 Prog***

 ***T5 Reg***

 ***T4***

 ***T3***

 ***Proportional***

 ***T2***

 ***T1***

 ***O***

 ***y1 y2 y3 (Y)=income***

 ***P = progressive as average rate of tax increases as income Y increases Oy1 to Oy2 the tax paid increases from 0t1 to 0t2***

 ***R= average rate of tax decreases as income Y increases. Total tax paid increases from 0t3 to 0t4***

 ***Prop = average rate of tax remains unchanged as Y increases***

***Note: this system is progressive because the income earner who increases income from 0y1 – oy2(red line segment) pays t1 T2 taxes (orange) and not t3T4 (green) as would be the case in a regressive system.***

***Task: explain the progressive tax impact of an change of income from y2 to y3***

**Points to note:**

(1)Government aim to improve distribution should focus on a direct tax system based on the red line (P)

(2)The blue line which is proportional is unfair for lower income earners e.g

 if the average rate of tax is 45 % then lower income earners are disadvangtaged

(3) You should be aware of how taxes are calculated via tax **rates** and tax **bands as these affect the slope of the lines in fig2**

(4)If the government does not get its progressive tax system equitable then it runs the risk of more:

* Black market activity
* ‘brain drain’
* capital flight