

Direct Taxation: how do you draw progressive taxation?

Progressive taxes result in proportionately higher taxes as income increases

Progressive Direct Taxation

Government aiming to improve income distribution should focus on a direct tax system based on the red line (P). This represents progressive taxation. Example: as Y increases from y_2 to y_3 direct tax paid increases from T_2 to T_6 . Now look at the regressive example below.

Regressive Direct Taxation

Government aiming to implement regressive income distribution will focus on a direct tax system based on the green line (R). This represents regressive taxation. Example: as Y increases from y_2 to y_3 direct tax paid increases from T_3 to T_4 . Now look at the progressive example above.

(The argument here is that regressive taxation will result in a 'trickle down' effect as higher income earners invest/spend more creating incomes elsewhere in the economy. No evidence for this however.)

Best Uses:

- ⊙ Connects Fiscal policy with Equity in distribution of income. It is therefore a 'development' (poverty reduction / equity issue).
- ⊙ Progressive taxation key to improved distribution of wealth in a country
- ⊙ Dig. below is useful diagram to highlight connection between role for government and development

Progressive + Regressive Taxation

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

