Economic Studies
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Raising The Top Income Tax Rate Would Not Significantly Reduce Inequality, Brookings' Gale, Kearney and Orszag Find

An increase in the top tax rate leads to an almost imperceptible reduction in overall income inequality, even if the additional revenue is explicitly redistributed

Fairly substantial increases in the top personal income tax rate would have a very small effect on overall income inequality in the U.S., even with explicit redistribution to lower-income households, according to a new paper released today by three Brookings economists.

In "Would a significant increase in the top income tax rate substantially alter income inequality?" Brookings Senior Fellow and Co-director of the Urban-Brookings Tax Policy Center William G. Gale and Nonresident Senior Fellows Melissa S. Kearney and Peter R. Orszag use a microsimulation model to examine how the distribution of post-tax income would change under three tax scenarios: by raising the top individual income tax rate from the current 39.6 percent to 45 percent and also to 50 percent; and raising the top individual income tax rate to 50 percent for income greater than $1 million for joint filers and $750,000 for single filers.

The research builds on a prior analysis by Kearney, Larry Summers and Brad Hershbein, showing that while increasing the share of men with a college degree would reduce inequality in the bottom half of the earnings distribution, largely by pulling up the earnings of those near the 25th percentile, the change would not significantly reduce overall inequality. Given those findings, Kearney, Gale and Orszag explored using tax policy – raising the top rate and then redistributing the pot to those at the bottom of the income ladder -- as a way to reduce inequality.

Simulated impacts of top tax rate increases on Gini coefficient

Before tax income	**0.610**
After tax income – Current law	**0.574**
After tax income – Top rate to 45%	**0.573**
After tax income – Top rate to 50%	**0.571**
After tax income – Top rate to 50%, at $1M/$750K	**0.572**

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They found that increasing the top income tax rate to 45 percent would increase the income tax burden of households in the 95-99th percentiles of income (as defined before taxes are paid) by an average of $3,508. For households in the top 1 percent, the increased tax burden would be an average of $58,233 more; those in the top 0.1 percent would experience an average income tax increase of $297,582. Raising taxes to 50 percent would mean an additional $6,464 in taxes owed for households in the 95-99th percentiles of income and an additional $110,968 for households in the top 1 percent; those in the top 0.1 percent would experience an average income tax increase of $568,617.

The authors then looked at how these after-tax income reductions would affect overall income inequality, using the Gini coefficient – an index commonly used by economists to measure inequality levels. They found that increasing the top marginal tax rates had a "trivial effect on overall income inequality," even smaller than the impact that increasing the share of the population receiving a college degree had on pre-tax earnings inequality, per the prior research.

Even redistributing the new taxes raised equally to the bottom 20 percent of all American households also had surprisingly little impact on improving inequality, though it would appreciably increase the incomes of those at the lower end. The increase to the 45 percent rate would bring in an additional $49.4 billion in revenue, which, if divided evenly among the 36.1 million households in the bottom income quintile, would give each of them an additional $1,370 in post-tax income; increasing the top rate to 50 percent would bring in an additional $95.6 billion in revenue, leading to an additional $2,650 in post-tax income for the bottom fifth; and applying a new top rate of 50 percent to income above $1 million for married filers and above $750,000 for single filers would bring in an additional $63.5 billion in revenue, which would result in $1,760 in additional post-tax income for households in that lowest quintile.

"The reduction in income inequality resulting from each of these tax and redistributive plans is quite modest," the authors write.

"That such a sizable increase in the top income tax rate leads to a strikingly limited reduction in income inequality speaks to the limitations of this particular approach to addressing the broader challenge," Gale, Kearney and Orszag write. "To be sure, there might be good reasons to increase top income tax rates for other purposes beyond reducing income inequality—for example to raise much needed revenue for the federal government. In addition, the tax-and-transfer policies analyzed would provide substantial benefits to low-income households if the revenue were explicitly redistributed. Thus, our results do not speak to the desirability of the tax-and-transfer policy, just to the fact that even a significant tax increase on the highest-income households and transfer to low-income households has a small effect on overall inequality."

"This analysis, coupled with the previous one, in turn leaves us with the open and important question: if neither a substantial expansion in education nor a big increase in the top marginal tax rate would significantly affect measured income inequality, what would?" they ask.