Some Thoughts on Incidence Analysis

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Basic elements of "applied" incidence

Start with:

- Pre-tax/pre-transfer income of unit *h, or* I_h
- Taxes/transfers programs T_i
- "Allocators" of program *i* to unit *h*, or S_{ih} (or the share of program *i* borne by unit *h*)

Then, post-tax/post-transfer income of unit h (Y_h) is:

$$Y_h = I_h - \sum_{\mathrm{i}} T_i S_{ih}$$

All of this seems easy, and answers the key question:

Who pays the taxes (or gets the transfers)?

But: there are lots of questions that must be answered.

- What is the "unit" (e.g., individual versus household)?
- What is "income"?
  - Comprehensive income?
  - Annual versus lifetime measure?
  - Market versus non-market measure (including tax evasion)?
  - Uses side versus sources side?
- How are components of income measured (e.g., capital income)?
- Should "consumption" be used instead of "income"?
- What is the time frame of analysis (e.g., annual versus lifetime)?
- What programs are included?
- What are the allocators – is there a consensus on incidence?
- What happens when individuals change "ranks"?
- How can the results be easily summarized?
- Is there an overall "best practice"?

And some additional considerations…

- Analyzing one part of the tax/transfer system in isolation of another can give misleading results: the incidence of a single tax depends upon both its features and those of all other taxes.
- Analyzing the effects of taxes/transfers at the “top” and at the “bottom” is especially difficult.
- “Taxes” are not the same thing as “contributions”.
- Horizontal equity is as important as vertical equity.
- What about behavioral responses?

- Don't forget government subsidies.
- Don't forget user charges.
- Don't forget <u>local</u> government taxes/transfers.
- Don't forget country-specific institutions and practices.

- And: One can <u>never</u> know the distribution of income that would have existed in the absence of the taxes/transfers.