Taxes: Crash Course Economics #31

Crash Course: Economics
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Hi, I'm Adriene Hill. This is Crash Course Economics, and today we're gonna talk about taxes. We're gonna talk about why we have taxes, what they do for us, and why you should go ahead and take that raise that's gonna bump you into the next tax bracket. Also, rebellions and the British Empire's bad judgment when it came to taxing colonies.

(Intro)

While your struggles with taxes and the tax code may seem particularly unpleasant to you today, people have been paying and complaining about taxes for a long time, way longer than any of us have been alive. Or our parents. Or our grandparents. Ancient Mesopotamians paid taxes in the form of livestock and labor. There are ancient Egyptians texts and tomb scenes showing evidence of taxes, tax collectors, and even tax shelters. Taxation and tax collectors also show up in the Bible, over and over. Taxes appear in scripture as a necessity, like, "Render therefore unto Caesar the things which are Caesar's." And tax collectors are in there as sinners right up with prostitutes. More recently, in 1927, U.S. Supreme Court Justice Oliver Wendell Holmes wrote, "Taxes are what we pay for civilized society. Maybe it's time we forgive tax collectors, too."

So we've had taxes pretty much as long as we've had records of organized society. But why? What are the goals of taxation? At the most basic level, taxes raise money for government services. Taxes are used to promote the well-being of society- at least well-being as defined by the government in power. They help us afford services markets might not pay for on their own, things like public safety and national defense and education. Taxes can be used to protect the environment. They can help a country implement fiscal and monetary policies meant to push along economic growth.

Taxes can be used as a way to redistribute wealth in a society from people who have more to people who have less. This can happen in a couple of ways, some more direct than others. An income tax system that taxes high income earners at a higher rate than low income earners is one example. And we'll come back to that. Government subsidies and vouchers like food stamps and housing programs also shift wealth. So do luxury taxes, basically an additional tax bill on expensive items like jet planes, expensive furs, and that really annoying diamond ring space on the Monopoly board.

Governments can also use taxes to try to change people's behavior. Sin taxes on not-good-for-you products like cigarettes and alcohol are meant to reduce consumption of unhealthy products. Gasoline taxes are meant to encourage people to drive less. France passed soda taxes to try to get people to drink fewer sugary drinks. Denmark passed, and then got rid of, a fat tax on foods that were relatively high in saturated fat. A handful governments, including those in British Columbia, Ireland, and Chile, have instituted carbon taxes. These carbon taxes basically charge businesses and sometimes households for the amount of polluting greenhouse gases they use or create. These carbon taxes take different forms around the world. Residents of British Columbia, for example, pay an extra 6.67 cents per liter of gasoline as a carbon tax. For those of us in the U.S., Myanmar, and Liberia who don't use the metric system, that's about 25 cents per gallon. In Chile, power plant operators pay five dollars for every metric ton of carbon dioxide that they release into the air.

When economists talk about taxes, they sometimes divide them into direct taxes and indirect taxes. Direct taxes are paid by a person or organization to the government body that imposes the taxes. These include property taxes and income taxes, where there's no intermediary, and I can't pass off the tax burden to someone else. value added taxes and sales taxes aren't exactly the same thing. But they're both good examples of indirect tax. They're collected by a store or a seller or producer of goods, but they're actually paid by consumers. They're taxes that all consumers have to pay, regardless of how much money they make. A pair of socks at the mall down the street is gonna cost me exactly the same as when a billionaire buys that pair of socks at the same store. Some economists say indirect taxes distort market prices and lead to one of the things most dreaded by economists, the Voldemort of economic outcomes: inefficiency.

Economists also characterize taxes as regressive, progressive, and proportional. Let's start with regressive taxes. Regressive taxes are typically applied across the board, and on their face, they might seem equitable because everyone pays the same amount. But regressive taxes take a higher toll on people with lower income than high income earners. Sales taxes, especially on essential items, are considered regressive. That's why some places exempt food and prescription drug purchases from sales taxes. Some economists argue that fees for things like hunting licenses, toll roads, and driver's licenses are also regressive. Why? Well imagine two drivers go to the department of motor vehicles to get a new license. One makes $200,000 a year, the other makes $20,000. Both will pay exactly the same amount for their driver's license. The license fee is a much bigger hit for the lower income driver. And that's why regressive tax takes a disproportionate toll on people with lower incomes.

On the other end of the taxing spectrum, there are progressive taxes. Progressive taxes are more or less the opposite of regressive taxes in that they shift the burden of taxation onto people who make more money and away from those who make less. In the United States, our income tax is a progressive tax, meaning individuals pay more in taxes as they make more income. But before you start worrying about whether making an extra $100 this year is gonna bump you into a higher tax bracket, it's worth understanding how the progressive income in the United States works. When the IRS calculates how much you owe in taxes, it use marginal income tax brackets based on the amount of taxable income you earned in a year. These marginal tax rates represent the highest possible income tax rate you could pay. Right now, there are seven tax brackets. But no matter which tax bracket you find yourself in, you're not going to pay that rate for your entire income. Instead, your taxable income gets divided up into chunks that correspond to each tax rate, and you pay the associated rate on each of those chunks. For example, say you made $37,450 as a single filer last year. That would put you in the 15% tax bracket, but you'd still pay the lower 10% rate on the first $9,225 you made. So if you took the extra $100 and made $37,550, you'd be bumped up to the 25% tax bracket. But again, you'd only pay 25% on that $100. Your effective tax rate would be lower. The other thing you gotta keep in mind with U.S. income taxes is there are a huge number of tax credits, tax exemptions, and tax deductions that reduce the amount people owe. So your tax bill will never be as painful as that 25% tax bracket may make you think.

Many countries around the world have their own progressive income tax systems. But it turns out it's difficult to measure just how progressive any country's total tax system is, especially compared to another country. It's not as easy as looking at countries with the highest marginal tax rates and deciding they have more progressive tax policy because so many other taxes and tax breaks come into play. In the U.S., some economists argue the progressiveness of our income tax code offsets the regressiveness of many other taxes we pay. If progressiveness and regressiveness are even words. So we've covered regressive and progressive taxes.

The third type of taxes are proportional taxes. Proportional taxes require the same percentage of income from all tax payers, regardless of how much they make. A flat tax is an example of a proportional tax. You'll here politicians touting flat taxes, in part because they're relatively simple compared to the U.S.'s current incredibly elaborate tax code and because they kind of feel fair. Imagine a flat tax of 10%. The woman making $200,000 ends up sending $20,000 to the government, while the guy making $20,000 sends only $2,000. They both feel a 10% pinch. Economists who oppose the flat tax say that feelings have no place in the tax code. They argue a flat tax isn't as simple or as fair as it seems. For one, they say that getting rid of all the tax deductions and exemptions and credits we mentioned earlier could change a whole lot of the economic decision-making that happens, from saving for retirement in tax-protected accounts to home ownership and donating to charities. All of those activities are encouraged by the tax code we have now. Like we mentioned before, there are economist who argue the progressive income tax in the U.S. offsets some of our other more regressive taxes. They say a flat tax would shift the total tax burden away from the wealthy to the lower and middle taxes, actually making our broader tax policy more regressive. All of this is complicated, even if it sounds simple. Before you buy into anyone's plan to reform the tax code, take the time to really read into what it might mean to the economy, and make sure you're comfortable with all the implications.

Speaking of implications of tax policy, they can be incredibly serious and fascinating. A poor tax choice by a government can and has resulted in rebellions. Let's go to the Thought Bubble. One tax rebellion is the American Revolution. After the Seven Years War ended in 1763, Great Britain had a huge debt to pay off. It needed to raise revenue for somewhere and looked toward the colonists in America. In 1764, the British Parliament started taxing molasses sales. In 1765, they enacted the Stamp Act, which added taxes to paper and legal documents. Colonists grew more and more frustrated with British officials, both with tax policies and other interventions. Anyway, you know how it goes. No taxation without representation, Boston Tea Party, a big war, the French get involved, and we end up with a free America with taxes and representation (except in Washington D.C.). More recently, in India there was another super interesting tax rebellion called The Salt March. In 1930 India, the British were in charge, and they had laws in place that outlawed Indians from collecting or selling salt. Instead, they had to buy it from a British monopoly, which collected an 8.2% salt tax. Mohandas Gandhi decided to defy the salt tax by walking 240 miles to the coast of the Arabian Sea to gather tax-free salt. Along his route, more and more Indians joined him in the peaceful civil disobedience. He got to the beach, picked up a piece of salt, and broke the law. Thousands of others followed his lead, making and selling non-British salt in a nonviolent resistance. The salt march was extensively covered in news reels and newspapers, and it brought international attention to the largely non-violent Indian struggle for independence. All that because of taxes. Thanks Thought Bubble.

Of course, there are other ways to get around paying taxes you don't want to pay. Other than fighting or starting a mass civil disobedience movement. Based on historical documents, we know people have been running away from paying taxes for years. Some literally picking up and leaving their homes. Other people have discovered career paths that get them out of tax bills. Historians think that some European men became monks during the Middle Ages to avoid being taxed. There's proof that some Chinese men joined Buddhist monasteries to get out of paying taxes. There is plenty of room for disagreement over how big government should be and what it should and shouldn't be doing. All those discussions matter to you as a tax payer, and as someone who benefits from taxation and government services. But as we said time and time again, there are some services the market just won't provide, some protections it won't guarantee. No one likes paying taxes, but we do like what they do for us. Thanks for watching. We'll see you next week.

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