

WHICH TAX RATE DO PEOPLE USE: AVERAGE OR MARGINAL ?

by

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ABSTRACT

I investigate by experiment the tax rate used by individuals when making marginal economic decisions. I find that there are at least as many individuals, who use the average tax rate "as if" it is the marginal tax rate, as individuals who use the true marginal tax rate. The reason individuals use the average tax rate is shown to lie in the presentation of the tax table: almost all individuals use the true marginal tax rate if the tax table is redesigned to stress the marginal rate. The use of the average tax rate is shown to lower the excess burden of a typical household by approximately 40%.

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