

TOWARDS A BETTER UNDERSTANDING OF HORIZONTAL EQUITY

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ABSTRACT

The coefficient of variation (CV) is a commonly used measure of horizontal equity, but, as this paper demonstrates, it has several important flaws. Comparing CV for income groups with different average incomes is problematical because groups with larger incomes will be biased towards lower CV values. Further groups of unequal width are not comparable because of differences in standard deviation. Traditional CV measures can also overestimate inequity since they don't distinguish between variation in tax liability due to differences in income within a comparison group from variations in tax liability due to the tax system. To remedy these flaws we propose a new measure of horizontal equity: the ratio of the CV of tax liability to the CV of expanded total income for groups of equal width. The advantages of using this ratio of CVs are demonstrated using SOI data from the 1992 Individual Model File.