

Progressive Taxation and Risky Career Choices

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Resumo/Abstract:

Occupations differ in their degree of earnings uncertainty. Progressive taxation provides insurance to risk-averse workers against adverse earnings outcomes. As a result, progressive tax systems distort the price of risk and influence the mobility and sorting of workers across occupations. This paper proposes a theory to understand the effect of the degree of tax progressivity on workers' career choices when markets are incomplete. We quantify the distortion and we find that tax progressivity incentives young workers to take risk, thus partially completing the insurance markets. Hence, we provide a new perspective on the welfare cost of uninsurable earnings risk. To that end, we employ micro-data on occupational mobility and earnings from the United States and Germany to estimate a model of occupational choice and uninsurable earnings uncertainty. The model predicts that, as observed in the data, everything else equal, were US workers to face the relatively more progressive earnings tax function of Germany, a larger fraction of young workers will take risk and they will end up working into safer occupations.