



The promise of positive optimal taxation: normative diversity and a role for equal sacrifice[☆]



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ABSTRACT

A prominent assumption in modern optimal tax research is that the objective of taxation is Utilitarian. I present new survey evidence that most people reject this assumption's implications for several prominent features of tax policy, instead preferring tax policies based at least in part on a classic alternative objective: the principle of Equal Sacrifice. I generalize the standard model to accommodate this preference for a mixed objective, proposing a method by which to make disparate criteria commensurable while respecting Pareto efficiency. Then, I show that optimal policy in this generalized model, calibrated to the survey evidence and U.S. microdata, is capable of quantitatively matching several features of existing tax policy that are incompatible in the conventional model but widely endorsed in the survey and reality, including the coexistence of substantial redistribution and limited tagging. Together, these findings demonstrate the potential of a positive theory of optimal taxation.
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1. Introduction

Modern tax theorists have a workhorse model. Created by Mirrlees (1971) more than four decades ago, that model has been used to study countless aspects of tax policy. It provides the benchmark guidelines against which policy proposals are often judged, and its recommendations form the basis of prominent policy advice.

When this standard model has been used to generate quantitative lessons for policy, theorists commonly have imposed a strong assumption: the objective of tax policy is Utilitarian, either in its simplest form as a sum of individual utilities or in a more general form as the sum of a concave transformation of individual utilities. Mirrlees (1971) himself introduced this assumption with little explanation, but virtually all optimal tax research in the last four decades has adopted it¹. To the

extent that this assumption has been relaxed, it has usually been to allow for a more redistributive normative criterion, such as the Rawlsian priority on the least advantaged. The conventional case for Utilitarianism is usually traced to Harsanyi (1953, 1955).

Some theorists have taken a more agnostic approach by examining only whether policies are optimal given some set of weights on individuals' welfares; that is, Pareto efficient. An open question in that approach is what weights to use when choosing between a wide range of Pareto-efficient policy options; in practice, Utilitarian (or Rawlsian) weights are typically the default assumption.² The relatively little attention paid to the Utilitarian assumption and its alternatives, as opposed to its policy implications, is especially surprising given that optimal tax theory is one of few forthrightly normative fields in economic research.

The first contribution of this paper is to present evidence of wide disagreement with this core assumption, at least in the United States. I design and implement a novel survey in which respondents are asked to choose between sets of feasible and incentive compatible tax policies for a society with the income distribution of the current United States. First, I ask them to choose between two policies: one based on the standard (simple sum) Utilitarian criterion and the other based on the principle of Equal Sacrifice, a less redistributive and historically prominent alternative criterion for optimal tax design. In that case, nearly 60% of respondents prefer the Equal Sacrifice alternative over the conventional Utilitarian objective. Disagreement with the conventional Utilitarian

[☆] A number of technical details, footnotes, contextual information, and clarifications omitted from this published version can be found in the working paper version of this paper and its Appendix, Weinzierl (2014), at the author's website. Portions of this paper incorporate and build on material from Weinzierl (2012), which was entitled "Why do we Redistribute so Much but Tag so Little?" I am grateful to Alan Auerbach, Felix Bierbrauer, Kim Clausing, Raj Chetty, Mihir Desai, Rafael di Tella, Amy Finkelstein, Victor Fleischer, John Friedman, Alex Gelber, Mikhail Golosov, Caroline Hoxby, Bas Jacobs, Louis Kaplow, Wojciech Kopczuk, Camille Landais, Benjamin B. Lockwood, Greg Mankiw, Yoram Margalioth, Joe Mazon, Jean-Baptiste Michaud, Jeff Miron, Dina Pomeranz, Alex Raskolnikov, Meg Rithmire, Julio Rotemberg, Emmanuel Saez, Bernard Salanie, Larry Samuelson, Florian Scheuer, Eytan Sheshinski, Ali Shourideh, Stefanie Stantcheva, Alain Trannoy, Aleh Tsyvinski, David Weisbach, Glen Weyl, John Weymark, Danny Yagan, and several anonymous referees for their helpful discussions.
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¹ Harsanyi (1953) provides the classic discussion of the applicability of Utilitarianism in this context.

² See, e.g., Stiglitz, 1987; Werning, 2007; Rothschild and Scheuer, 2012, and Saez and Stantcheva, 2014. In addition, specific normative limitations of the conventional model have been addressed directly (see Section 1.4 and Weinzierl, 2014).

assumption is even more striking when I give respondents a range of choices, including options that are based in part on Utilitarianism and in part on Equal Sacrifice. I find that 81% of individuals prefer policies other than the pure Utilitarian or Rawlsian policies, and nearly half most prefer policies based on a combination of Utilitarianism and Equal Sacrifice.³ Of course, these responses may be due to a variety of factors other than an affinity for Equal Sacrifice, so I use additional questions in the survey to test for more direct evidence on the relevance of Equal Sacrifice. When asked explicitly how “sacrifice” from paying taxes should be distributed, respondents prefer a distribution between that implied by Utilitarianism and Equal Sacrifice. And the more enthusiastic a respondent is about Equal Sacrifice, the more likely he or she is to reject tagging, the taxation of personal characteristics that is a feature of Utilitarian-optimal tax policy but that is rejected by Equal Sacrifice.

This evidence is admittedly far from definitive. The survey respondents are not a random representative sample of Americans, and many variations in the survey's design, framing, and implementation are possible and could have large effects (see McCaffery and Baron, 2004, for example). Nevertheless, the results are robust across subsamples, and the survey is designed to guard against a number of potential design concerns. In the end, the survey evidence suggests that a number of features of tax policy implied by the Utilitarian objective of conventional theory may not be, in the terminology of Diamond and Saez (2011), “socially acceptable.” That is, a large majority of individuals appear to place substantial value on an alternative normative principle – Equal Sacrifice – that rejects some of the conventional objective's policy implications.

While my finding of a preference for a mixed objective is foreign to the optimal tax literature, it is consistent with a large body of existing research showing that most individuals are not normative purists. In that research, whether individuals are asked to evaluate income distributions, answer conceptual questions, or participate in allocation games, few appear to use a single normative criterion. As Scott et al. (2001) write: “Experimental research reveals that distributive justice judgments usually involve several distinct allocation principles.”

How should we respond to this evidence? One possible response is to ignore it. We may decide that a normative theory ought to choose its objective based on philosophical reasoning regardless of popular opinion. An alternative approach is to incorporate as much evidence as possible on the way the agents included in these models think about these very same issues. In their important synthesis of “empirical social choice” research, Gaertner and Schokkaert (2012) make a strong argument for the value of eliciting public attitudes toward such issues. In optimal tax research, incorporating key aspects of reality into the conventional model has been a hallmark of major contributions such as Diamond (1998), Saez (2001, 2002), Golosov and Tsyvinski (2006), and Farhi and Werning (2010), and often these efforts have improved the match between the theory's recommendations and real-world policy. Diamond and Saez (2011) suggest a similar effort with regard to the normative aspects of the model, advocating a requirement of “social acceptability” under which real-world normative beliefs would constrain the set of relevant policy results.⁴ My paper falls in this tradition and proposes that we go one step further: it gathers formal evidence about people's views and interprets that evidence as motivation for constructing a *positive* optimal tax theory. The broad aim of this positive optimal taxation project is, then, to pursue empirically-supported generalizations of the standard optimal tax model to better match the way in which real societies appear to evaluate tax policy. Specifically, this paper's survey evidence, and a large body of prior work, suggests that we generalize the standard model to include a mixed policy objective.

The second main contribution of this paper is to formally develop a generalized model that can be used for positive optimal tax analysis. The generalized model combines multiple normative criteria into a single policy objective while retaining both Pareto efficiency and the remainder of the familiar formal apparatus of conventional optimal tax theory. In this way, I am following up on a suggestion made more than three decades ago by Martin Feldstein (1976), that “optimal tax design involves a balancing of conflicting criteria.” This generalization of the standard theory requires addressing long-standing concerns about commensurability of different normative criteria. In keeping with the survey evidence, I develop in depth the specific case of an objective that combines Utilitarianism and Equal Sacrifice.

A complementary approach to generalizing the conventional model's objective – part of the Pareto-efficient optimal tax approach mentioned above – can be found in contemporaneous research by Saez and Stantcheva (2014). They focus on the role of marginal social welfare weights in the aggregation of a given tax reform's effects on individuals. By allowing these weights to take any non-negative values, they include the possibility that they may be based in part on normative criteria other than Utilitarianism.⁵ Their approach and this paper's can be seen as two sides of the same coin: one might translate a mixed objective function into a profile of marginal social welfare weights or vice versa. Each approach has applications for which it is more naturally suited, and both contribute toward the broader goal of constructing a positive theory of optimal taxation.

One attractive feature of this paper's approach is that it requires a clear statement of each component of the set of criteria by which policy is judged. This requirement acts as a second test of the theory (in addition to its ability to match observed policy features), in that criteria lacking intellectual coherence can be rejected and we can avoid the risk that fully-flexible welfare weights lose any explanatory power. More generally, under the Pareto-efficient optimal tax approach, assumptions on the welfare weights are often made in the interests of deriving more powerful results. One way to interpret my contribution in the context of that approach is that I look for evidence on the normative criteria that seem to hold in reality and that, therefore, might inform the values of those weights that society would endorse. Specifically, I am able to use the principle of Equal Sacrifice as a disciplined way to give weight to a point on the Pareto frontier that appears to matter to the public but has been largely ignored by modern tax theory.

This paper's approach has a number of limitations. Positive optimal tax theory as developed here is not a positive tax theory, i.e., I have not modeled the political economy that translates the public's preferences into policy. While recognizing that establishing such a link is essential for a full understanding of how any normative principles affect real-world allocations, that task is outside the main objective of this paper. At the same time, positive optimal tax theory is not normative optimal tax theory, and we may reject the implications of the former if we believe the public is – at any given time – subject to biases or mistaken beliefs. It is because of this very real and important risk that I emphasize the search for recognizable, and at least arguably defensible, philosophical principles in the development of the model. Moreover, it is important to clarify that positive optimal tax theory is not a substitute for traditional normative optimal tax theory based on considered judgments of what society's objective function ought to be.

The third contribution of this paper is to show that this generalized model, when calibrated to this survey evidence, can reconcile a number of features of tax policy that are incompatible in conventional theory but endorsed in the survey evidence as well as in reality. In particular, I simulate optimal policy using the survey respondents' most-preferred

³ A note on terminology: from this point on I will use “Utilitarian” to refer to the simple sum of individual utilities, not the more general version in which transformations of those utilities are made prior to aggregation.

⁴ Gaertner and Schokkaert (2012) provide a lucid and insightful discussion of the relationship between normative and positive analyses of social preferences.

⁵ Saez and Stantcheva also note that welfare weights could be derived from existing policies or survey evidence. Bourguignon and Spadaro (2012) take the former approach to calibrating the welfare weights in a standard model, as do Spadaro et al. (2012); Bargain et al. (2011, 2013); Zoutman et al. (2013a, 2013b); Hendren (2014); and Lockwood and Weinzierl (2014).

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