Tax Design and Redistribution

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Principles of good taxation

- Equity
- Efficiency
- Simplicity or, relatedly, administrability

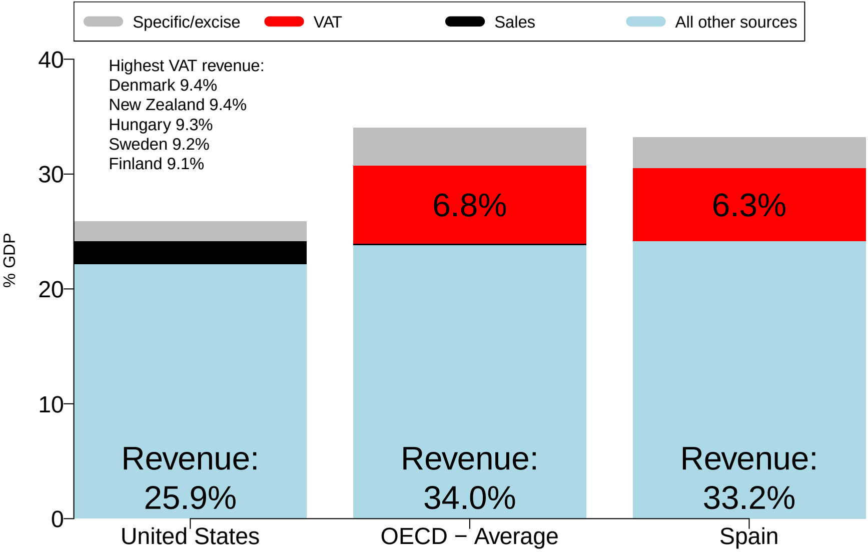
What do we use tax policy for?

- to pay for things
- to redistribute
- to incentivize (e.g., R&D, pricing externalities, paternalistic policies)
- to stabilize

Taxation and redistribution

- Approach 1: Tax system alone, assign tax liabilities depending on some notion of ability to pay. In practice, proxied by some notion of income. Equity-efficiency trade-off.
- Approach 1': ...the point of taxation is reducing inequality rather than just increasing social welfare; willing to tax at the top even if it is inefficient/revenue losing (but, perhaps, it can be reconciled by presuming negative externalities from aspects of inequality).
- Approach 2: Separate taxation and redistribution: redistribution occurs through a separate transfer system; the point of taxation is to finance it.

Revenue sources (OECD data, 2019)



See Kopczuk, "Reflections on Taxation in Support of Redistributive Policies", in Olivier Blanchard and Dani Rodrik (eds.), "Combating Inequality: Rethinking Policies to Reduce Inequality in Advanced Economies", 2021

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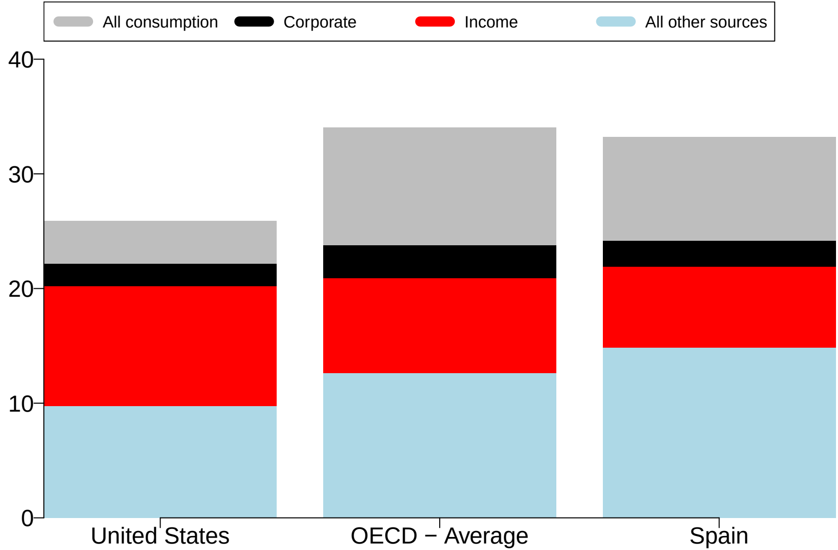

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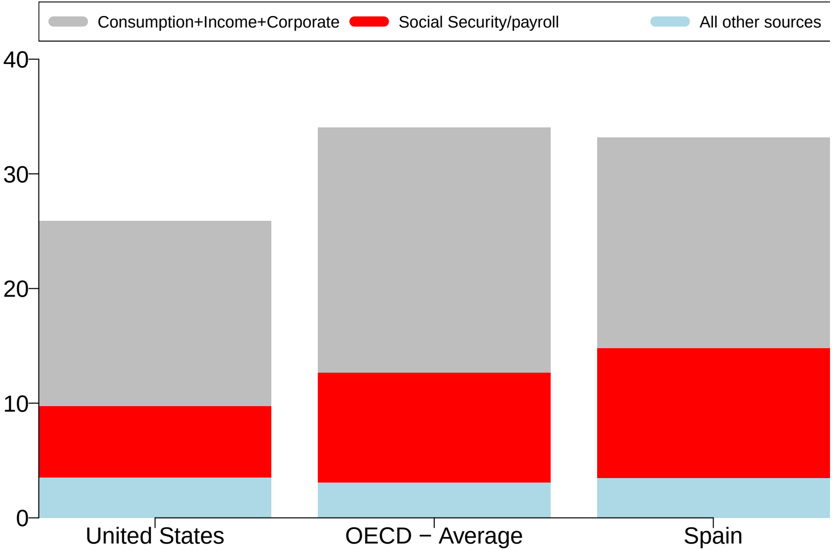

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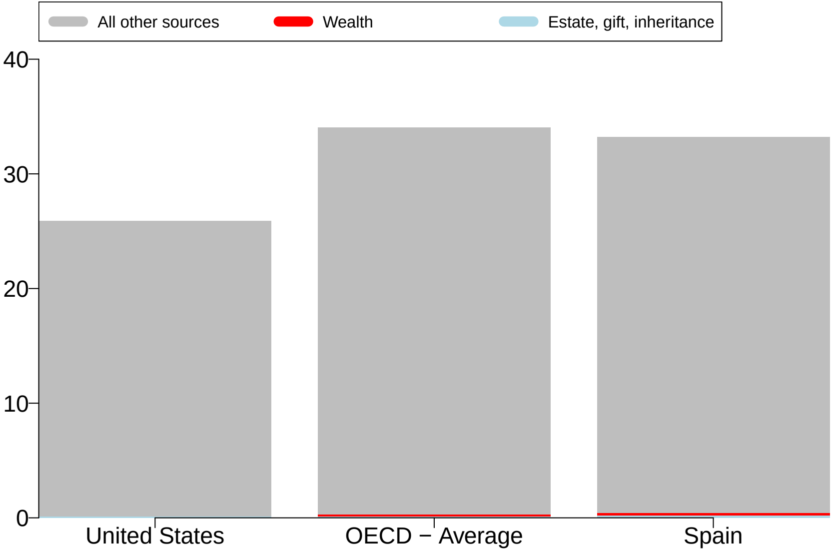
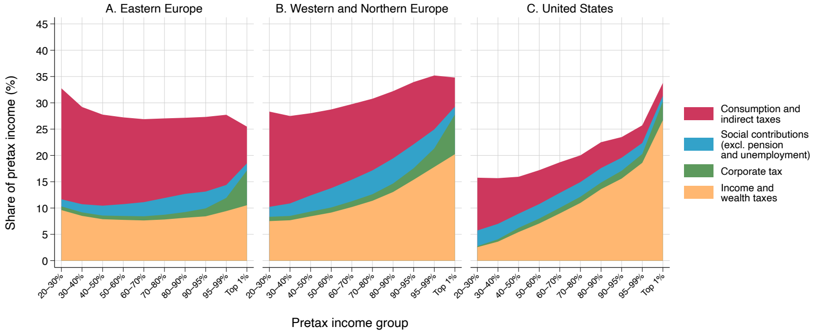


Progressivity of tax systems

Figure V
The Distribution of Taxes in Europe and the United States

(a) Non-contributory Taxes Paid as a Share of Pretax Income



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Blanchet et al. "Why Is Europe More Equal than the United States?", American Economic Journal: Applied Economics, 2022.

Limitations of taxation based on ability to pay

All taxes are ultimately paid by people, but making sure that we precisely link tax liability with the ability to pay is difficult

- Income is difficult to measure, especially (1) at the top (avoidance, international issues) and (2) when it comes from business activity
- Why? Observability and administrability:
    - location
    - timing
    - realization
    - assigning to individuals
    - liquidity

How can we design taxes based on ability to pay?

Ideas:

- comprehensive measures of income that account for labor and capital, using accrual rather than realization approach
- measure consumption rather than income, tax in a progressive fashion (X-tax, cash flow taxes)
- rely on other proxies for ability to pay (such as perhaps wealth)

Taxing firms

- A simple approach to taxing firm income that implements ability to pay taxation: pass-through. Annual profits of the firm are aggregated with other income of the owners. Used to tax sole proprietors everywhere, it is used to tax some types of larger/more complicated businesses in some countries (eg US, Germany, Japan)
- But, not used for all businesses anywhere. Why not? Two problems:
  - large and international firms with a lot of shareholders
  - nontaxable or hard to tax investors (tax exempt, foreigners)
- A corporate tax addresses it, but with a drawback: corporate tax liability is not allocated to individuals based on ability to pay
- A potential solution: corporate tax integration. A corporate tax as a withholding tax, providing credit on individual tax return when (taxable) distribution occurs

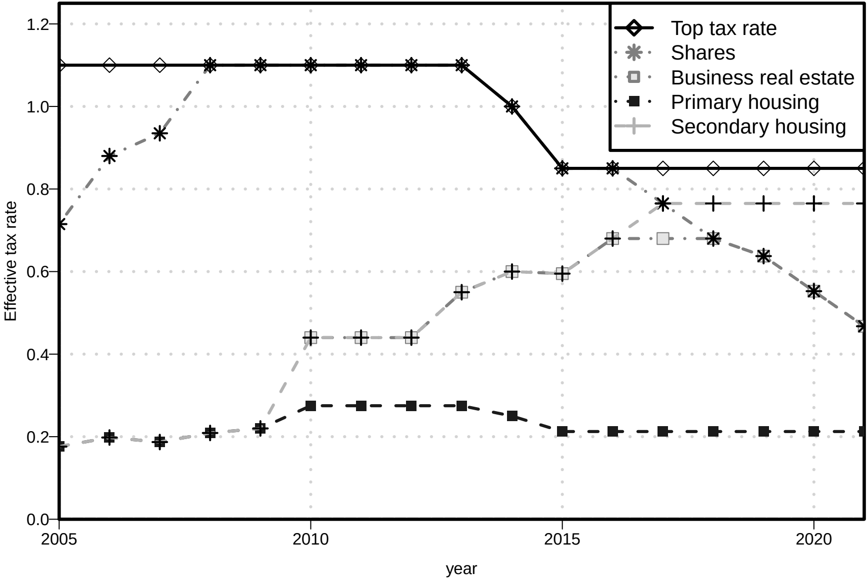
Taxing consumption

- appeal: not distorting saving; transition
- progressivity possible but measuring consumption on individual level does share some issues with measuring income and adds new ones
- flat anonymous consumption taxes (like VAT) easier and very effective but progressivity an issue, at least when viewed on the annual basis

Wealth as a proxy for ability to pay

- well, it is not really a good proxy, except (maybe) at the top of the distribution — it reflects saving/investment/consumption decisions and the past (eg, age) rather than current/future ability to pay
- but perhaps it is easy to measure?
- ...to an extent, but not exactly — some assets are observable, some are observable but complicated and politically difficult (housing), some are very hard to measure (private businesses)
- liquidity and ownership distortion
- practical wealth taxes often vary tax treatment/inclusion depending on the type of asset, which makes the case for them much weaker
- compared to a tax on capital income (rather than a tax on the principal that generates income), the wealth tax undertaxes extraordinary/excess returns (rents, labor income disguised as capital)
    - why? Compare a 20% on 5% return vs about revenue-equivalent 1% tax on the principal

Structure of the Wealth Tax in Norway



Alstadsæter et al. "Saving effects of a real-life imperfectly implemented wealth tax: Evidence from Norwegian micro data" AEA Papers and Proceedings, 2022, forthcoming.

Is wealth tax good for anything?

- Yes, when you can think about it as doing something distinct from being just an alternative tax on returns (capital income)
- One-time, unexpected, immediate tax is (theoretically) non-distortionary
- Historically, a tool to finance emergencies or imposed to tax ill-gotten gains (Colombia after drug wars, Netherlands after WWII)
- A tax on externalities? What are the externalities from wealth concentration? Are there more direct tools to target them?

What are we trying to accomplish?

- Is the objective equalizing income or poverty reduction and safety net?
- If the latter, then your priority should be efficient taxes collecting a lot of revenue and nitpicking about finely tailoring tax liability at the top of the distribution needn't be a priority
- Arguably, that's the Scandinavian approach — large VAT, broad income tax, attempts to keep capital income distortions low (while sacrificing some progressivity)

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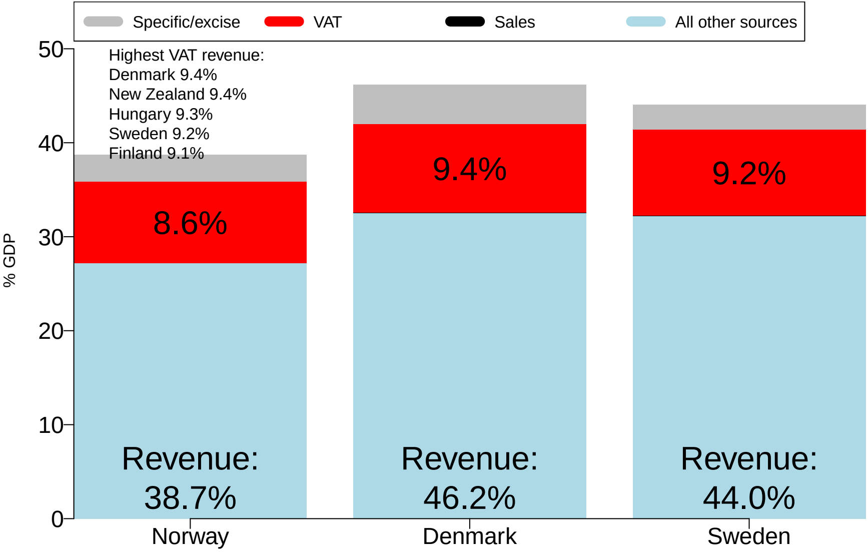

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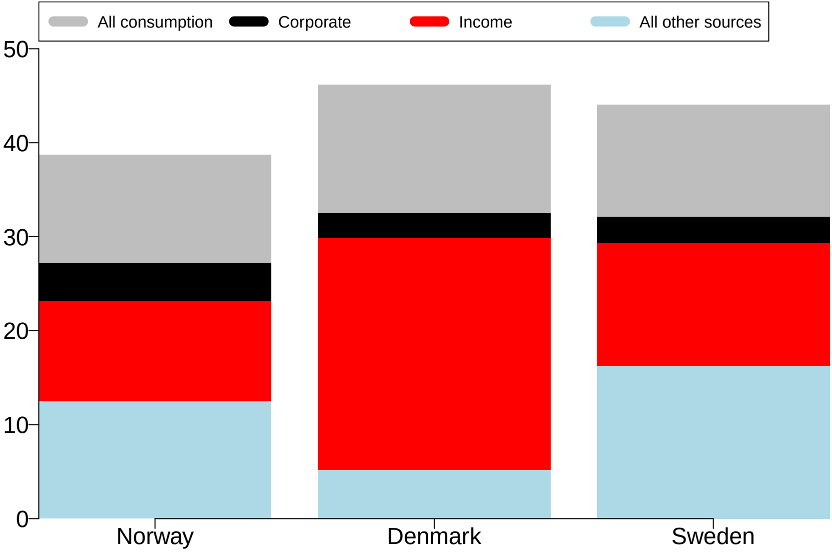

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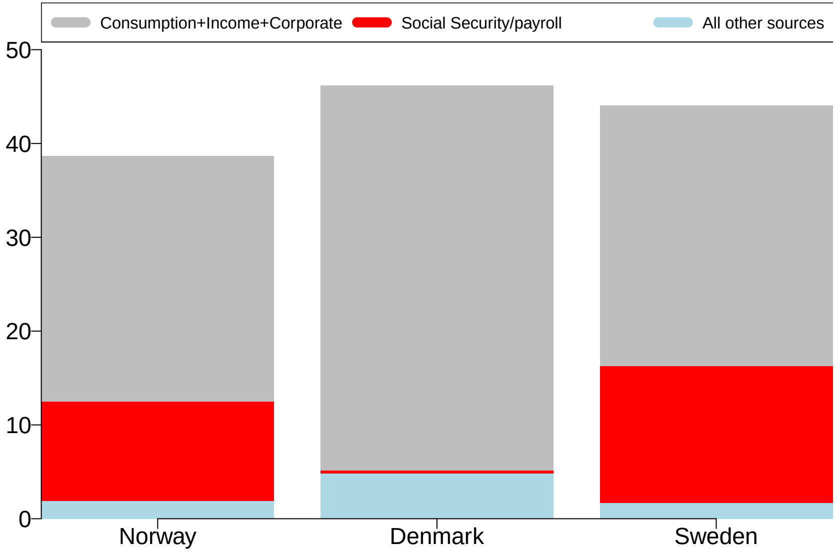

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