

Guy Laroque's comments
on

Optimal Household Labor Income Tax and Transfer
Programs

Mike Brewer, Emmanuel Saez, and Andrew
Shephard

Plan

- 1) The paper itself
- 2) Some intertemporal thoughts

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On the UK income tax system

The paper provides a wealth of material on wage taxation in the UK. I am in broad agreement with the analysis that it contains, while I differ somewhat on its main recommendation.

Taxes in the UK, seen from France, are notable by their simplicity and transparency. There are only three brackets and most taxpayers, with an annual taxable income between £7 185 and £38 335, face a marginal rate of 22% (fiscal year 2006-2007). The marginal rate on higher incomes is 40%.

On the UK income tax system, continued

Aligning the National Insurance Contribution bands, as suggested in the reform proposal (page 36, second paragraph), would make things even simpler.

The Pay-As-You-Earn scheme is particularly impressive: of the 29.5 million taxpayers, less than 9 million complete a return.

Intitulé	Base	Taux	Montant	Part employeur		Période
Rémunération fixe	9,00	11,100	99,90			Charges salarié
Rémunérat variable			1 855,69			-387,76
Tot.heures payées	9,00					Charges employeur
Acpte pr.précarité	1 955,59	0,100	195,55			-991,87
Cumul ac.pr.precar	195,55		195,55			Charges totales
Total pr.précarité	1 955,59	0,100	195,55			-1 379,63
Indemnité CCP	2 151,14	0,100	215,11			Cumuls
Prime vacance	215,11	0,100	21,51			Avantages nature
BRUT			2 387,76			Brut
						2 387,76
FISCAL			2 387,76			Abattement
Maladie	2 387,76	0,750	-17,91	12,800	-305,63	
Contrib. autonomie	2 387,76			0,300	-7,16	Brut fiscal
Vieillesse Tr A	447,00	6,650	-29,73	8,300	-37,10	2 387,76
Vieillesse	2 387,76	0,100	-2,39	1,600	-38,20	Net imposable
Alloc.Familiales	2 387,76			5,400	-128,94	2 067,51
Accident Travail	2 387,76			1,100	-26,27	
FNAL Tr A	447,00			0,100	-0,45	Plafonds
FNAL	2 387,76			0,400	-9,55	447,00
Transport	1 193,88			2,600	-31,04	Charges salarié
Chomage Tr A	447,00	2,400	-10,73	4,000	-17,88	- 387,76
Chomage Tr B	1 341,00	2,400	-32,18	4,000	-53,64	Charges employeur
F.N.G.S.	1 788,00			0,150	-2,68	- 991,87
Cips Tr.1	447,00	3,000	-13,41	4,500	-20,11	Charges totales
Cips Tr.2	894,00	8,000	-71,52	12,000	-107,28	- 1 379,63
AGFF TrA NC	447,00	0,800	-3,58	1,200	-5,36	Base tranche A
AGFF Tr 2 NC	894,00	0,900	-8,05	1,300	-11,62	447,00
Prev.empl.TrA	447,00	0,350	-1,56	0,350	-1,56	Base tranche B
Prev.empl.Tr.B	1 341,00	0,540	-7,24	0,540	-7,24	1 341,00
Prev.empl.Tr.C	599,76	0,540	-3,23	0,540	-3,23	Base tranche C
Taxe 8% patronale	12,03			8,000	-0,96	
CSG non imposable	2 327,79	5,100	-118,72			Base tranche D
Taxe Apprentissage	2 387,76			0,680	-16,24	
Part. Formation	2 387,76			1,620	-38,68	Assiette GMP
Part.Format.CDD	2 387,76			1,410	-33,67	
Assurance	2 387,76			3,210	-76,64	Base GMP
Part.Construction	2 387,76			0,450	-10,74	
TOTAL RETENUES			-320,25		-991,87	
IMPOSABLE			2 067,51			Congés payés
CSG non déduct.	2 327,79	2,400	-55,87			00,00 jours en acquisition
CRDS	2 327,79	0,500	-11,64			00,00 jours acquis exercice
						00,00 jours pris exercice
						00,00 jours restants exerc.

A conserver sans limitation de durée

NET A PAYER**2 000,00 EUR**par: Chèque
le: 31-03-2007

à : MR LAROQUE Guy

Banque :

Guichet :

N° compte :

Analysis

The labor supply elasticities have been computed for lone parents. Empirical evidence on the behavior of married mothers would be most welcome.

Referring to Adam[2005], the authors state that "the effective marginal tax rates facing lone parents are beyond the Laffer bound" (page 24, end of section 4). Since this seems to be an important motivation for the reform proposal, some more details might be worthwhile:

1. Is there a change in relative incentives between raising lone-parent and two-parents families? Can it induce behavioral responses?
2. Does the Laffer inefficiency result hold when the children are very young, or only when the children are of school age?

Reform proposal

The proposed reform is wide ranging: it integrates family benefits with the income tax schedule.

The current taper rate of benefits is very high, while the proposal makes it equal to the standard 22% tax rate: this is a major change, which can only be financed by increasing the overall tax burden.

Can the authors sketch a Pareto improving proposal?

Also it would be useful to make more explicit who are the winners and who are the losers in the current proposal, in particular the transfers, if any, between two parent and lone parent families.

Insurance and intertemporal smoothing

Suppose that the benevolent tax authority has a welfare objective based on the per period expected life time utilities of the participants in the economy:

$$\begin{aligned} \max E \sum_{t=1}^T \tilde{\beta}_t u(c_t, l_t, \tilde{\alpha}_t) \\ a_t + c_t = a_{t-1}(1 + \tilde{\rho}_t) + \tilde{\omega}_t l_t \\ a_0 \text{ given.} \end{aligned}$$

$(\tilde{\alpha}, \tilde{\beta}, \tilde{\omega})$ are preference and productivity shocks.
 $\tilde{\rho}$ is the random return on capital.

An optimal tax and benefit system would most probably involve some mutualization of risks.

As in the authors' proposal, any welfare system implies the joint design of benefits and taxes, here in an intertemporal setup.

Return on capital

Currently basic savings in Individual Savings Accounts (up to the annual ceiling of £7000 of accrual to deposits) are exempted of all taxes on interest income, dividends or capital gains.

Pension contributions are deductible from current taxable income, but the pensions themselves (and therefore the returns on the pension contributions) are subject to income tax at retirement time.

Is this difference of treatment justified?

Towards a closer intertemporal integration of taxes and benefits?

Choose one state variable (instead of the full history that would be recommended by theory, or the complicated scheme associated with pensions): for instance a measure of credit/debit towards society.

Then keep the simple shape of the income tax scheme, but let its parameters (the brackets and rates) vary with the level of the state variable, i.e. taxes are reduced for people who have contributed a lot in the past.

Possible applications: income tax smoothing or unemployment insurance (valuable if income becomes more variable); pensions (accumulated 'rights' become a major determinant of the pension level). But the devil is in the details.

Pros: allow more individual choice in the timing of work life, etc.. This type of development is made possible by the information society.

Cons: Can the government commit? The implementation of actual benefits is very complicated.