Taxing by Design

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Atkinson/Stiglitz Theorem

• If household utility is
  \[ u(a(x), z, n, h), \]
  where
  \[ x = \text{allocation of consumer goods}, \]
  \[ z = \text{labour (multi-dimensional)}, \]
  \[ n = \text{unobservable type}, \]
  \[ h = \text{observable type}, \]
  and marginal costs are denoted by \( p \),
  Then \( p \cdot x = c(z, h) \) is optimal, for some \( c \).
• Demanding assumption:
  – Consumption tastes independent of labour
  – Same consumption tastes for all – independent of $n$ and $h$.

• Difficult income taxation
  – In some economies, labour income is hard to observe, but for UK, etc., we believe that is not a serious issue, except that some “capital income” is the result of labour.
  – Tax depends on income in all periods, not summed in general – except with separability.
• We (the IFS) found little evidence of specific complementarity or substitutibility of goods with labour, or with type. (Child care is one exception.)

• Therefore we recommend a uniform and universal value-added tax.

• But we do propose a tax on above-normal returns to capital, to be treated as labour income.

• Because of transitional issues, we do not recommend all tax (and subsidy) on income.
• We do not propose full integration of the subsidy system with the tax system: benefits would continue to be based on household weekly or monthly income, taxes on individual annual income; but there should be high integration within the two systems.

• Evidence is lacking on many important issues, e.g. the effect of tax on migration, or on retirement. It is therefore difficult to say what the revenue maximizing structure of high-income taxes would be. Experiment!