Taxing by Design

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Atkinson/Stiglitz Theorem

- If household utility is

  $u(a(x), z, n, h),$ where

  $x = $ allocation of consumer goods,

  $z = $ labour (multi-dimensional),

  $n = $ unobservable type,

  $h = $ 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!