

**Discussant Comments:
Personal Income Tax Structure –
Theory and Policy**

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Optimal Tax

- Efficiency
 - Minimise distortion in choice (work vs. leisure, savings vs. investment etc.)
 - e.g: working less hours, investing in housing
 - Depend on labour elasticity (responsiveness of workers to wage rates)
- Equity
 - Society weights utility loss of different individuals differently

Optimal Tax : welfarist approach

- The problem: raise government revenue
minimising weighted aggregate welfare costs
- Weights:
 - Egalitarian: poor are weighted more
 - Utilitarian: all are weighted equally

This paper

- Takes a welfarist view
- Develops a very simple model
- Asks whether given the current tax structure a small change in one piece of the piecewise linear rate will change welfare and revenue
- Argues for a micro-simulation model which would take the elasticity of labour supply into account

Does Treasury Need a Micro-simulation Model for Taxation?

- What is a micro-sim model?
 - Builds a simple behavioural model of the tax transfer system
 - Inputs estimates of labour elasticities
 - Estimates the effect on work hours, Labour force participation, income inequality from changes to the tax structure
 - Differs from taxmod in that it is behavioural. Taxmod simply calculates the static effects of tax/benefit reforms using HES data
 - Does not consider the effects on behaviours
 - E.g. Effect of child benefit regime on fertility.
- Pros:
 - Enables policy makers to summarize the effects of complex tax policy changes
 - Identifies the data and research that is necessary to understand the policy implications of changes

Does Treasury Need a Micro-simulation Model for Taxation?

- Cons
 - Problem of being used by naive policymakers
 - Very difficult to obtain parameters of interest
 - Junk in – junk out
- Conclusion
 - Not a fan of micro-sim models
 - Better to not know, than to not know but think we know!

What Micro-sim Models Ignores

- Tax design is a problem in political economy
 - The most efficient tax is a poll tax, yet we don't use it , clearly because of political reasons
 - Need to understand *positive* theories of taxation
 - E.g. Brennan (1973)
- Tax design and the “new” happiness research
 - Layard (2006) “Economic Journal”