More on the Taxation of Capital Income

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Discussion by Iván Werning

BFI Conference in honor of Bob Lucas 2016
Taxation

- Ramsey Linear Taxation
  - representative agent
  - heterogenous agents

- Nonlinear Mirrlees Taxation
  - inequality
  - uncertainty

- Frictions?
- Time Inconsistency
Taxation

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Straub-Werning

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Ramsey Results

- Can expropriate...
  - explicitly
  - implicitly
    - consumption taxes
    - investment allowances or dividend taxes
      Abel (2007)
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  expropriate that capital!
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- Cannot expropriate (Chamley 1986)
  - constraints in all periods
   Straub-Werning, 2007
  - constraint at \( t=0 \) only
    e.g. Werning 2007
- constraint at \( t=0 \) only in marginal utilities
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    - positive tax even possibly in long run
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  ➔ tax initially, but no tax on future capital
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This paper position

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Positive tax even possibly in long run
Issues with Ramsey

- Unrealistic…
- Why not lump sum taxation? (or expropriate leisure?)
  - The Original Sin: some restrictions needed from outside the model
    - which one?
    - where do they come from?
    - caution: prescriptions mimic that which we ruled out.
Issues with Ramsey

- **Taking Ramsey literally**…
  - why not add lots of instruments? Why constrain them?
  - but then why not confiscation? why not lump sum? why not first best?
  - taking literally, Ramsey model is a joke

- **Options**…
  - **patch**: use judgement to adopt some constraints
  - **1/2 solution**: Ramsey heterogenous agents (Werning, 2007)
  - **full solution**: drop Ramsey and model what we need: nonlinear taxation, heterogeneity, incomplete markets, other frictions etc.
  (… hence, maybe Judd over Chamley)
Patch: What Constraints?

- **Tax evasion?** Underground economy, migration etc.
  - some applies to wedges or return, not how tool used to achieve it
  - levels of taxes and evasion e.g. high consumption taxes

- **Time inconsistency…**
  - at $t=0$ expropriate partially explicitly or indirectly…
  - … but at $t=1$ why not do it again!?

- **Chamley stationary constraints for all $t$:**
  - motivated by these considerations?
- Not necessarily my style, but name of the game in Ramsey
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we do not tax capital in long run, but either...
we have expropriated it by then,
or we are not taxing labor either!
Ramsey Medicine

- **Regardless** of these choices over constraints...
- Ramsey tax theory allows you to prescribe
  - very high taxes on capital in short run, zero eventually
  - or taxes on capital forever

- Does **not** allow you to prescribe
  - low or zero taxes on capital forever, starting now!
  - Note: prefer some positive constant tax to zero

- Embrace it or leave it.