Discussion of *Efficient Redistribution*

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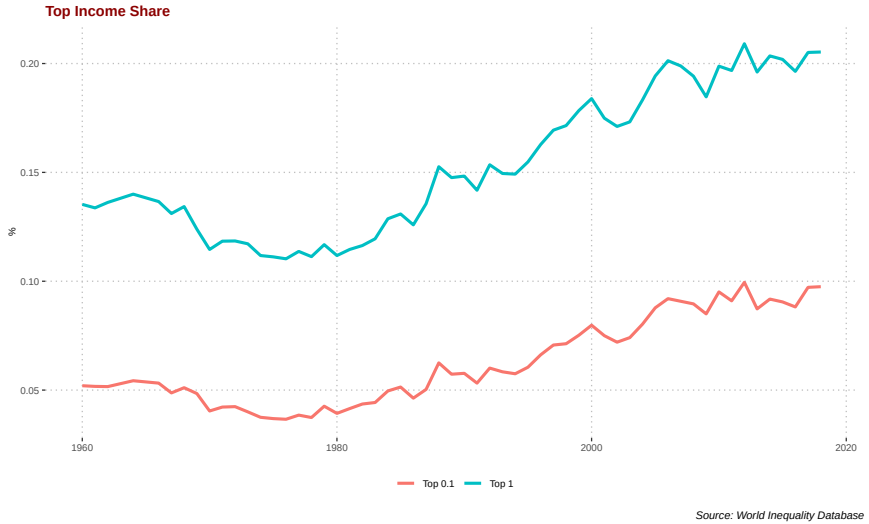
October 2020

The Paper: Main Theme

- Fact: Large Increase in Earnings-, Income and Wealth Inequality
  $\Rightarrow$ Calls for redistribution $\Uparrow$ (Occupy Wall Street, Piketty, Young)



From Omer Koru's JMP

- Question: How much redistribution, how to finance optimally?
- Answer: Flat income tax with large transfer (UBI) $\approx$ optimal!
  - Additional tax progressivity not very helpful
  - Wealth tax not very helpful
- Method: Optimal tax transition in model of top income & wealth inequality.

Paper in Nutshell I: Model of Top Income Inequality

- Period utility

$$u(c,h) = \log(c) - \frac{1}{3}h^3$$

- Budget constraint

$$\begin{aligned}(1+\tau_s)c + a' &= (1-\tau)\frac{(i)^{1-\xi}}{1-\xi} + \iota + a - \frac{\tau_a a^{1+\xi_a}}{1+\xi_a} \\ i &= W \cdot e \cdot h + r \cdot a\end{aligned}$$

- Stochastic productivity process: $e \in \{E_n, \bar{e}\}$
  - If $e \in E_n$, productivity follows log-normal AR(1) ($\mu = 1$, yearly)

$$\log e' = 0.986 \log e + 0.171u$$

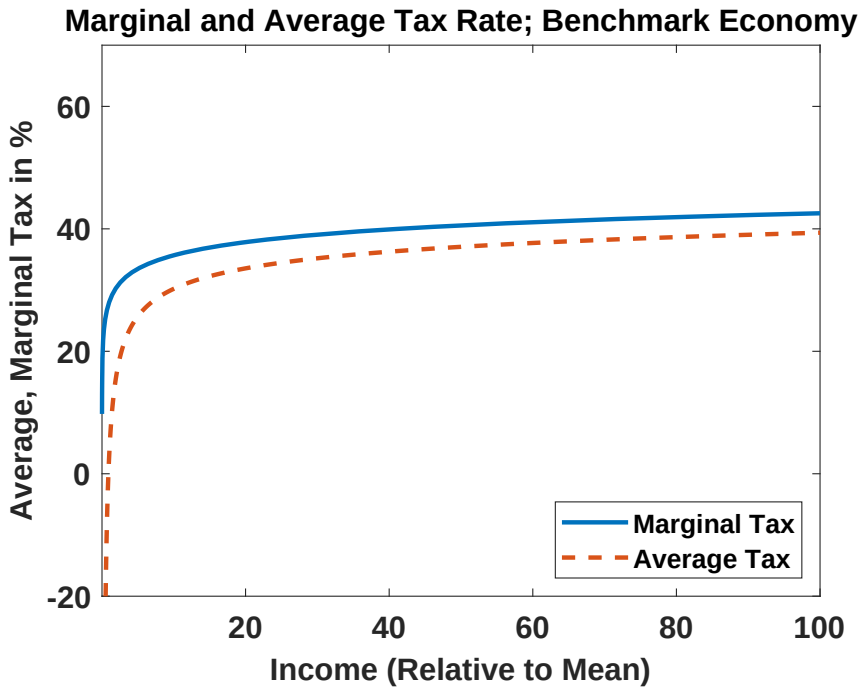
  - Transitions into superstar (Castaneda et al., 2003) state $\bar{e} = 404$

$$\begin{bmatrix} 0.99999 & 5.3e^{-6} \\ 0.025 & 0.975 \end{bmatrix}$$

  - Superstars: 0.02% of pop. Make 10% of all earnings, 8% of wealth.
  - Being a superstar is highly persistent (expected duration 40 years).

Paper in a Nutshell II: Tax Policy Transition

- One-time unexpected but permanent tax reform: choose $(\tau, \xi, \tau_a, \xi_a)$ once and for all.
- Calculate transition path from initial stationary equilibrium.
- Time-varying transfer ι_t adjusts to balance budget every period.
- Status Quo: $\iota = \$18,000$ and flat tax of ca. 30% ($\xi \approx 0$).



$$T'(i) = 1 - \frac{(1-\tau)}{(i)^{\xi}} \qquad t(i) = -\frac{\iota}{i} + 1 - \frac{(1-\tau)}{(1-\xi)(i)^{\xi}}$$

Paper in a Nutshell III: Social Welfare Function

- In model, households are heterogeneous. Welfare impact of policy reform is heterogeneous. How to aggregate across households?
- Step 1: For household i, transform lifetime utility V_i from stochastic processes $\{c_{it}, h_{it}\}$ into constant consumption flow ω_i

$$V_i(\{c_{it}, h_{it}\}) = \frac{\log(\omega_i)}{1-\beta}$$

- Step 2: Aggregate the ω_i in the population:
  - Average Welfare (akin to risk-adjusted GDP of Benabou, 2002, Lump-sum redistribution authority of Auerbach and Kotlikoff, 1987)

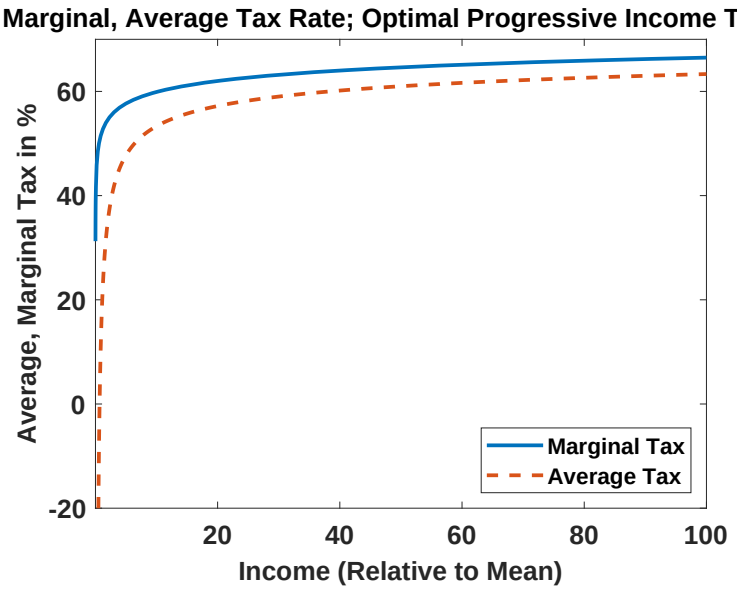
$$W^A = \int \omega_i di$$

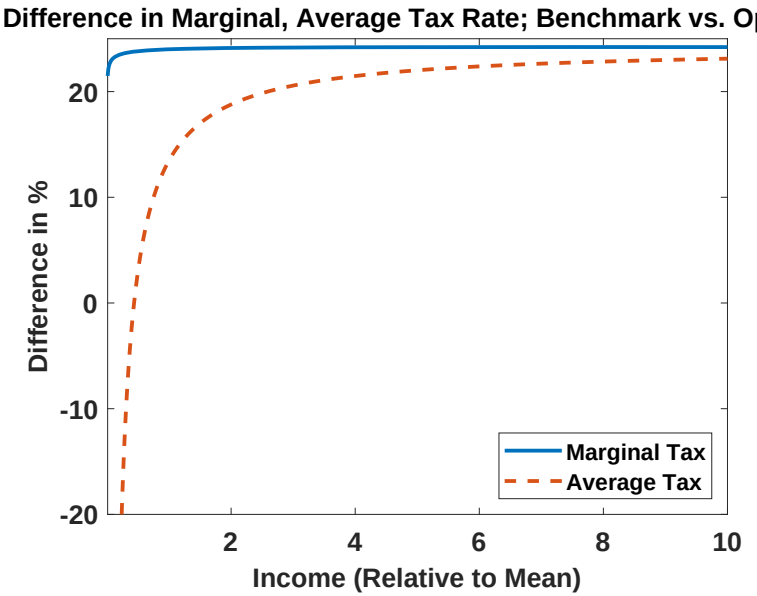
  - Utilitarian Welfare (government values redistribution, not just insurance)

$$W^U = \int V_i di = \frac{\int \log(\omega_i) di}{1-\beta}$$

Main Results: Optimal Utilitarian Tax Reform

- Significant expansion of lump-sum transfer ι (from $\approx \$18,000$ to $\approx \$26,500$). Andrew Young's proposal not generous enough.
- Big income tax increase (22%). Small increase in progressivity.
- Wealth tax used relatively little (on top of the income tax)





Outcomes	Base	$\tau \cdot i$	$T(i)$	$+T(a)$
ΔY (in %), SS		-19%	-21%	-23%
ΔW^U (in %)		7.8%	8.5%	9.5%
Gini ω_i, SS	0.38	0.30	0.26	0.21

Comments I: Social Welfare Function

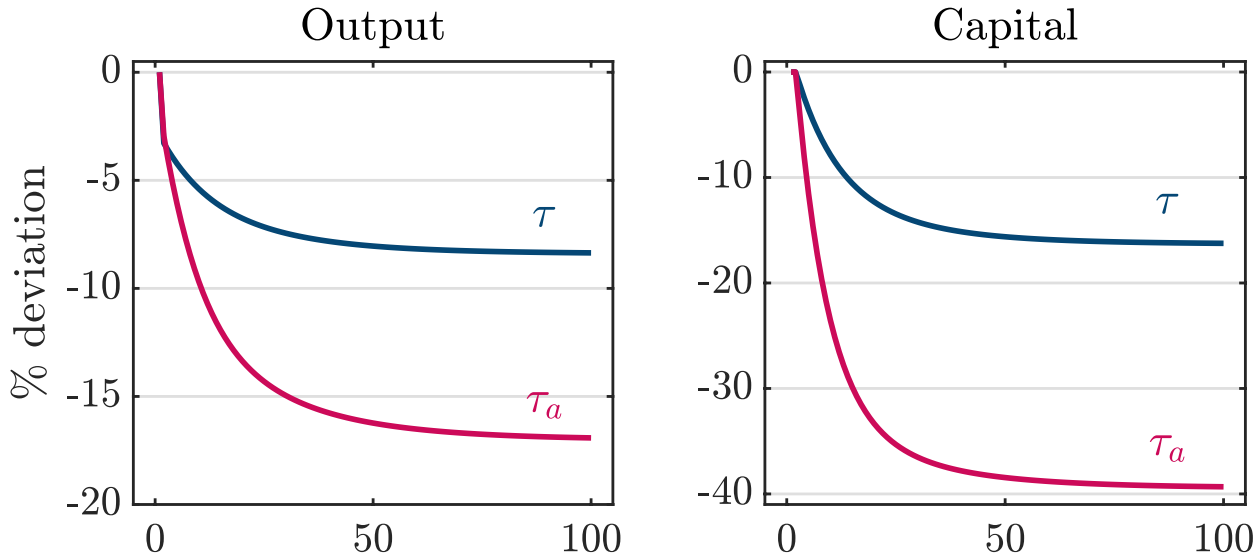
- Are results robust to different social welfare function? Utilitarian welfare W^U v/s average welfare W^A
- Yes for optimal policy (at least qualitatively)
  - Expansion of transfer
  - Increase in level of income tax
  - Moderate role for wealth taxes and additional tax progressivity
- But: now welfare gains from optimal tax reform small.

Outcomes	$W^U; \tau \cdot i$	$W^A; \tau \cdot i$
τ (in %)	56%	43%
ΔW^U (in %)	7.8%	0.6%

- Do households value insurance too little? log-utility!
- Is there too little scope for insurance? Normal and superstar state very persistent. Too little opportunity through $T(i)$?

Comments II: Tax Policy Transitions

- I like: transitions! Steady state analysis overstates macro costs of tax reforms (Bakis-Kaymak-Poschke 2015, Dyrda-Pedroni 2018)



- Concerns: restriction of tax instruments
  - In welfare terms, how close are we to the constrained efficient allocation (Heathcote and Tsujiyama, 2020)? (Is the title optimal?)
  - Time-dependent taxes? τ_{a0} v/s τ_{at}.
  - Restriction on $T(i)$ i): No discrimination of (τ_k, τ_l).
  - Restriction on $T(i)$ ii): High taxes at the very top? Kindermann & Krueger (2020) find 79% optimal marginal rate on top 1%. Why?

Comments III: Model of Top Income Inequality[1]

- What does it take (in model) to be a top earner? Luck ($\bar{e}$) and sweat (high h). Not human capital accumulation.
- Key assumption: $F(e'|e)$ and especially $\bar{e}$ invariant to tax code.
- What do top earners actually do? Of top 0.1% earners
  - 60% executives, managers, supervisors, and financial professionals
  - Small but important minority at the very top are sports/entertainment stars and entrepreneurs
  - Almost 50% of earned income of this group from pass-through entities (sole proprietorships, partnerships, S-corps)
- Being a top earner is transitory: between 1999 and 2007, of those reporting income of $1million or more
  - Only 50% did so for one year
  - 2/3 did so for one or two year
  - Only approx. 10% for all years

[1] Paper contains extension to model with entrepreneurs. See also Brüggemann (2019)

Conclusions

- Very rich, thought-provoking paper!
  - Coherent Theory of Earnings and Wealth Inequality
  - Ambitious Tax Transition Analysis
  - Massive social welfare gains from increase in lump-sum transfers. Most from redistribution, some for better insurance.
- My interpretation: potent call for generous universal basic income (see Daruich-Fernandez 2020, Luduvice 2020, Guner-Kaygusuz -Ventura 2019) and advice how to best finance it.

THANK YOU