# **Kevin Simmt** | Research Plan

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## Research Statement

My research focuses on the role of government in modern (market) economies, particularly in its efforts to raise revenues. The research was originally motivated by my puzzling over how economic growth could be made consistent with a strong welfare state. By raising tax-dollars through a tax-mix designed to minimize inefficiencies (known as deadweight losses), a state could afford more public programs at the citizen's "cut-off" level of tax burden. My research has further evolved to grapple with the political fact that optimal tax policy is rarely the primary motive upon which governments act. Throughout my work, I have built generalizable theories, meant to explain taxation decisions in modern states; however, I have found Canada, in particular, to be fruitful in producing case studies for the testing of my hypotheses.

In the following, I lay-out my research pipeline. I have presented my work in an order to demonstrate the evolution of thought, from my public economics work on the optimizing of revenue streams, to my recent political economy work on the institutional circumstances that are required for government motives to be aligned with selecting an optimal tax-mix.

## Book Project I: A Theory of Planned Inefficiency

My first book develops upon my doctoral thesis project. It's central tenants are simple: political leaders must maintain power, insofar as they are to achieve their political agenda; second, in a world of scarcity, a political leader maximizes their utility by implementing the most efficient tax-mix possible within the bounds of not violating the first principle[1].

The first chapter begins with the public economics dimension of a puzzle I initially explored in my MA thesis: the seeming paradox that the government might make a part of the economy more inefficient so as to make the economy as a whole more efficient. I develop a theory of planned inefficiency in order to explain how governments might do well to tax inelastic sectors of the economy (i.e., those transactions that are relatively unaffected by higher tax rates), thereby heightening their inefficiency, so as to relieve tax burden upon sectors that react more elastically (i.e., those transactions that would shrink drastically upon higher taxation). I coined the strategy's name "planned inefficiency."

Herein, I consider how the Alberta and Ontario governments took opposite paths towards alcohol retailing after reaching a critical juncture in 1994. While Alberta privatized, the Ontario government sought to modernize their operations while retaining their state-ownership. The Ontario government, despite entrenched firm-level inefficiencies in their retail operations, was nonetheless able to increase the economy's efficiency as a whole. This occurred through monopolistic rent extraction which, despite its "narrow" inefficiencies, served to offset the even greater inefficiencies of raising public revenues through any alternative mode of taxation. Ironically, one could make the economy as a whole more efficient by intentionally making one of its parts more inefficient. In concluding the paper, I caution against assumptions that aggregating microeconomic findings will automatically lead to a parallel macroeconomic outcome: that is, I note, "a fallacy of composition."

My first chapter, thus, builds the "public economics workhorse" upon which the rest of the book proceeds. The ensuing chapters consider the politics driving governments towards optimal vs. sub-optimal tax-mix decisions. In other words, having demonstrated in Chapter 1 a case of "planned inefficiency" (i.e., increasing the economy's efficiency by sacrificing the efficiency of one of its parts), I ask: "under what conditions will governments actually pursue this form of optimal taxation?" Each chapter is framed in terms of "selectorate theory," which enables me to consider how institutional differences across regime types[2] motivate vastly different tax-mix outcomes across countries, even when economic fundamentals point to their optimal tax-mixes being the same.

The second chapter considers what happens when the selectorate is narrowed due to the state being captured – lacking what Peter Evans calls "embedded autonomy." When politicians, whether autocratic or democratic, can access the necessary resources to retain power through the few instead of the many, or where corruption runs rampant, we can translate this to a narrowed selectorate (because politicians rely on relatively few gatekeepers to hold onto power). Whereas government leadership should seek to tax inelastic sectors (firms and industries) within the economy, captured governments are obstructed from doing so, since those most inelastic industries/firms are exactly those to respond with the greatest bribery/lobbying efforts. Using the World Bank Enterprise Surveys, a multi-level model tests my hypotheses that (i) those firms/industries that are relatively inelastic to taxation demonstrate disproportionate lobbying and bribery efforts; and (ii) inelastic

[1] Efficient tax-mix allows leaders to optimize between maximizing revenues at a fixed level of burden upon the economy and growing the future economy, which they may later opt to tax.

[2] Whereby I am theoretically motivated by differences across regime in the breadth of the population whose support is required for a political leader to maintain office.

firms/industries will face lower tax rates in those states most liable to capture or corruption. Of consequence, upon being captured, governments fail to tax exactly those industries that would react the least negatively to being taxed – thereby failing to attain a state of "planned inefficiency."

The third chapter, named "A Theory of Taxation," continues on the theme that political leaders must maintain the support of those who "select" them into power. Whereas in autocracies this is a rather small proportion of the population, in democracies it is quite large. To amass support in democracies, political leaders forgo "planned inefficiency" by not implementing tax-mixes that heavily draw on taxes that are unavoidable (or inelastic) to large segments of the population, on whom their support depends. As such, democracies see inefficient tax-mixes. Empirically, I test by seeking "tax-flips." Using a database on tax-mix and imputations measuring the size of the informal sector, I evaluate how a growing informal sector affects the usage of income taxes in the context of democracies, with broad selectorates, contra autocracies, with narrow selectorates. Consistent with my theory, I find democracies inefficiently tax income in the context of rising informality, whereas autocracies do the opposite. Tests of mechanisms are performed by testing rates of income taxation, which are set by policy. Additionally, I perform a difference-in-difference analysis, whereby I find that sudden changes in regime from democracy to autocracy leads to "tax-flips," i.e., ruptures in tax policy consistent with my theory's predictions[3]

Finally, a fourth chapter will use a survey instrument to detect the presence of my theory within the behaviours of individuals. I predict that an individual's tax preferences are oriented towards elastic behaviours for themselves (i.e., easily avoidable) yet elastic (i.e., not easily avoidable) for others. To test this, I will conduct an experiment (via M-Turk) to reveal tax preferences at the individual level for those instruments elastic/avoidable relative one's economic behaviours. Individuals are randomly assigned differing abilities to hide their income from "the state." Then individuals are placed randomly into groups – whereby some groups have great heterogeneity in their "elasticity profiles," and others great homogeneity. The experiment expects to confirm the hypothesis that, *cetris paribus* individuals able to hide income will opt to increase "the state's" income tax rates, but also that this will be mediated by heterogeneity: shifting tax burden will only work when "others" in society cannot avoid bearing the burden.

The final chapter considers implications for democracies. Empirically, I demonstrate how Scandinavian countries have "gotten away" with a large welfare state without sacrificing economic growth: their population's homogeneity in terms of "elasticity profiles" leads to efficient taxation, allowing maximized government revenues per "unit of burden" upon the economy. I speak to potential programs by which to make "elasticity profiles" more homogenous across the population, and then I consider adjustments to democratic institutions that might work where altering "elasticity profiles" is too difficult due to structural features of the economy. I consider, for instance, creating a (semi-autonomous) "tax-mix authority" similar to central banks: elected representatives set the revenue and distributional objectives of society, but then leave the specific proportioning across tax-instruments to technocratic professionals. In this manner, a compromise solution may be struck between attaining economic efficiencies and maintaining the power of a democracy's electorate.

[3]As the informal sector grows in democracies, the usage of income taxation increases — which the informal sector entirely avoids, whereas taxes that do affect the informal sector, including property and sales taxes, tend to decrease as a share of government revenues. Checks of mechanism reveal increased income tax rates, confirming a policy avenue through which income taxes as a percent of revenues increases. Moreover, sudden changes of regime, whereby democratization or backslide occur, coincides with "tax-flips" resulting consistently with predictions.

## Book II. Of Planners & Participants: the Ideational & Institutional Prerequisites of Efficient Market Economies

Any market economy, let alone an efficient one, has institutional and ideational prerequisites. My second book is, perhaps oddly, the prequel to my first book. The first book takes foregranted the ideational prerequistes of a market economy. I punt, assuming a favourable ideational environment, so as to consider what institutional conditions markets require to be efficient.

My book seeks to establish a taxonomy of the ideas required to underlay any given market; moreover, it demonstrates how said ideas arise from the institutional prerequisites of the market. While the taxonomy is initially descriptive in the first chapter, I go on in the next four chapters considering testing the theory's four primary theorectical consequence, and in concluding I consider the theory's implications at its most controversial: the ideational and institutional prerequisites of the market economy requires, in essence, a world state to be efficient.

Two types of economic actors are identified: participants (i.e., individuals who engage in decentralized transactions) and planners (i.e., individuals who engage in the centralized allocation of resources). For an efficient market economy to be reified, each "type" must believe in two, contradictory, ideas.

First, I demonstrate how markets are constituted by individual actors who participate in decentralized transactions. These participants must believe that the market is an efficient economic system, lest they act politically to replace the market system as a mode of organizing economic relations. However, in paradoxical fashion, the participant's motivation to invest, work and take entrepreneurial risks (i.e., all of which are necessary to make the market efficient in the first place) is dependent upon each participant believing they can find a 'pocket' of inefficiency amongst the market's parts. In such a 'pocket' the participant is motivated to 'enter' the market because a profit can be made on the difference between the price they can sell a product for and the cost a participant can produce it for. In short, the participant finds pockets in which the market is inefficient, in that it has failed to bid profits down to zero. Individuals who do not believe such inefficiencies exist to be arbitraged will, by self-fulfilling prophecy, lack the motivational drive required by an efficient economy. Hence, the participant faces a contradiction: each engages with an inefficient part of the market (whereby each participant has an inefficient 'pocket' that, in aggregate across broad swaths of participants, constitutes the bulk of the market); however, the participant must see the market system as efficient.

Second, I demonstrate how markets cannot exist independently of a centralized authority (its role may be relatively small, but never zero). As such, there exists a second type of economic actor: planners, who make centralized decisions to allocate resources in the economy. Like the participant, the planner's beliefs must be composed of two contradictory ideas about markets; however, their contradiction runs opposite the participant. If the planner believes that the market's parts are inefficient, then they will have a impetuous (justified by belief in 'market failure') to replace decentralized transaction with centralized intervention (e.g., governments may nationalize 'staple' industries or regulate monopolies). When planners believe in the efficiency of fewer and fewer of the markets parts then, in piecemeal fashion, the market will continually look less like one. Hence, to maintain an economy whose components operate upon market principles, planners must see the market's parts as the 'default' efficient option. However, an efficient market economy requires its planners to believe the market system is inefficient (as a total structure). I show the market to have costly institutions undergirding it. If these institutions are to be paid for at all, let alone efficiently, planners must believe that markets will fail to efficiently allocate the costs onto its constituent parts. Hence, they need engage in "planned inefficiency." Without such a belief, there exists no motive to enact policy whereby resources are strategically drawn from those elements of the economy "least elastic" to paying for the institutional prerequisites of the market. Of consequence, the planner – like the participant – must hold contradictory beliefs whereby the market system is inefficient despite the efficiency of its parts.

The book, after an introductory theory chapter, takes up each piece of the following 2x2 to "fill it" with an expanded description, historical process tracing, and analysis of a survey administered to citizens (participants) and civil servants (planners). In each chapter, I will test whether my specified arrangement of the beliefs of individuals (aggregated to the country-level) correlates with the relative success of a country's market economy (both in terms of its efficiency and market-orientation); in this manner, I can test whether my hypothesis are carried-out.

| Belief Structure Required for Efficient Market Economy | | |
|---|---|---|
| | Planner | Participant |
| System | Inefficient [Ch. 2] | Efficient [Ch. 4] |
| Part | Efficient [Ch. 3] | Inefficient [Ch. 5] |

## Working Paper I. Ratless Alberta: a Natural Experiment on the Construction of Popular Trust in Government

In 1960, the Government of Alberta established a rat-patrol zone, encompassing all land within 17 miles of the Saskatchewan border, unto its northern cut-off (set at Cold Lake). Using polling-station data from provincial and federal elections, I use a Regression Discontinuity Design (RDD) to consider how citizen interaction with civil servants effects perceptions of government competence.

I am currently awaiting time in Alberta to build datasets from archival data. For instance, using historical Elections Alberta documents containing data at the polling-station level, I can explore how direct exposure to the Alberta rat-elimination program in the 1960s (i.e., those voters living within 17 miles of the Saskatchewan border) altered voter's attitudes towards government competence and, potentially, spending (a regression discontinuity design).

## Working Paper II. A Theory of Radical Kindness: a Measurable Conceptualization of the Effects of Everyday Decency in Society

Theories that exist beyond measurement often struggle to gain prominence in the social sciences. After all, without variables to measure, how can a theory be tested? I note that theories of radical kindness have received such treatment, in addition to prejudice of its blind optimism.

Crucially, radical kindness is just kindness unless it brings about the change required for a just society to arise. I define a proxy variable of radical kindness that measures the dollar effect of decency in redressing "institutional gaps." An institutional gap occurs when establishing a set of rules to fix one problem requires opening vulnerability to yet another. Were people's decency to "cover" the gap, we can measure the dollar effect.

Through my redefinition, I reposition theories of radical kindness such that (i) they are not blindly optimistic, but merely point to where institutions will not be able to get us out of problems; and (ii) becomes less a dichotomous measure (e.g., a society of sinners or saints), but more one of graduation (e.g., the dollar value of a society becoming marginally more "kind"). The paper illustrates its theory with an example of an "institutional gap" and its costs.

International patent law is used to incentivize innovation, but at the cost of enabling monopolist pricing, which endows the economy with yet other inefficiencies. In a scenario of radical kindness, whereby monopolists price at a competitive market level (where marginal returns are zero), based on a sense of decency, provides a measurable dollar value of the effects of radical kindness, via the dollar value of reduced inefficiencies occurring in the economy as a result.