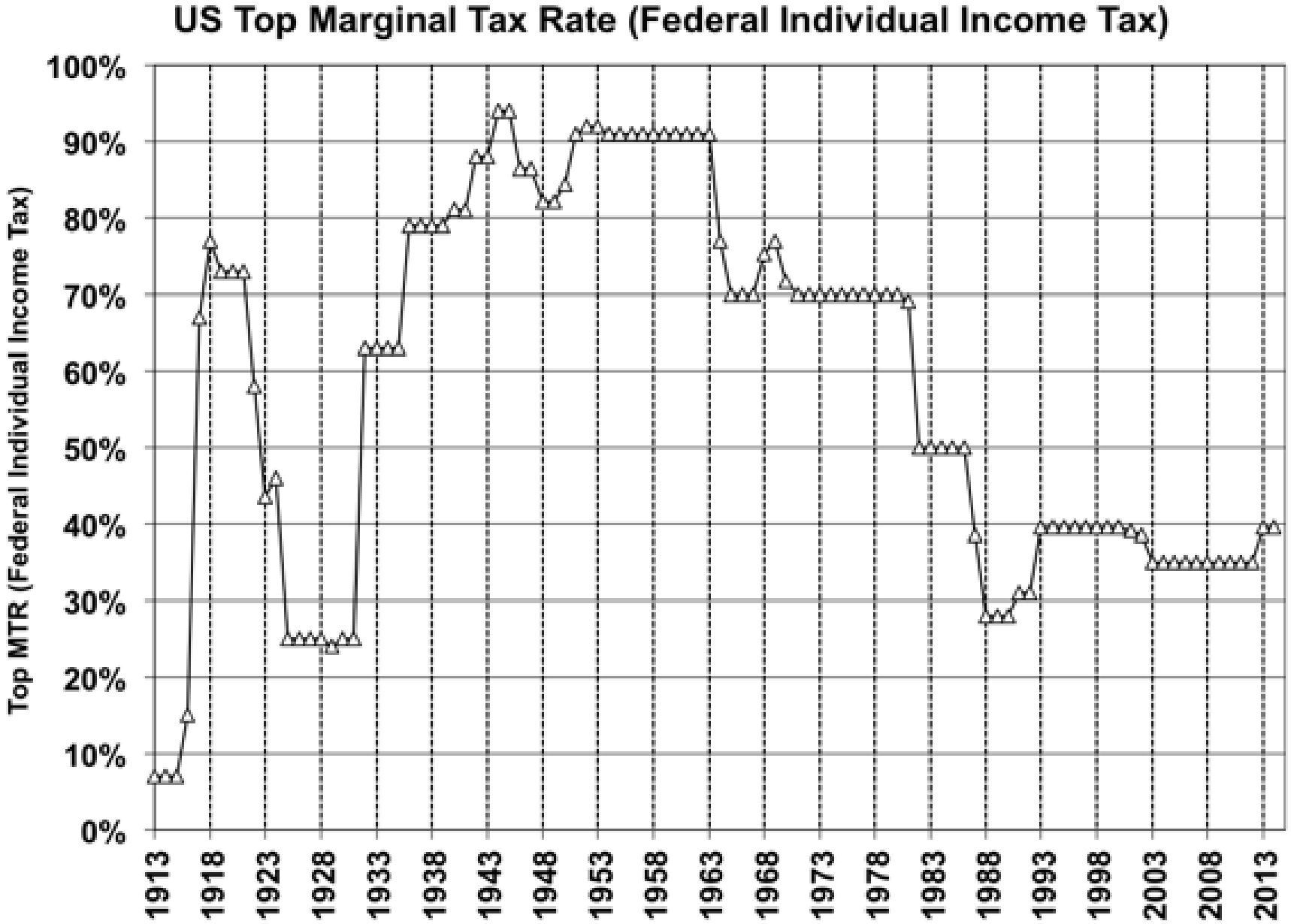
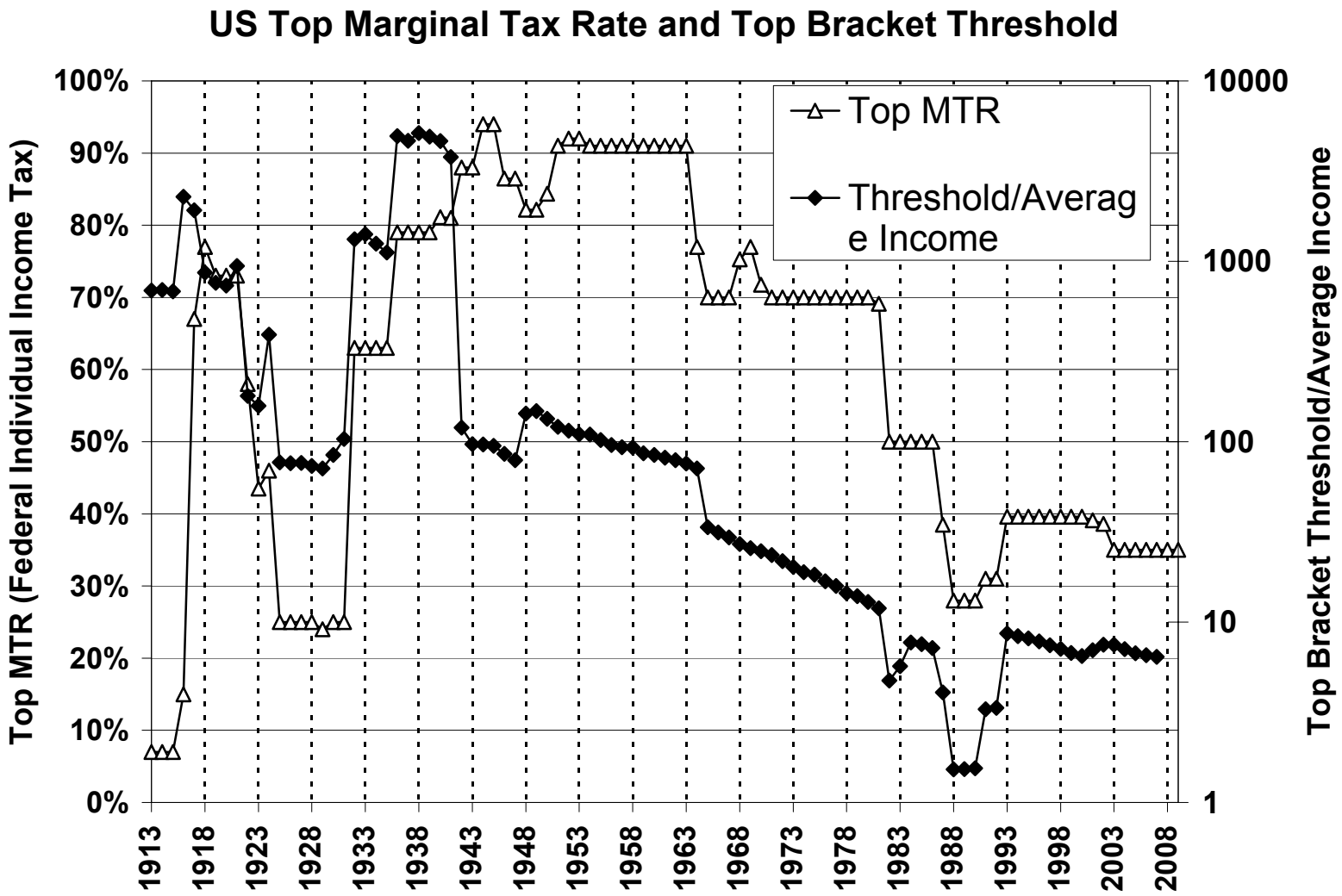
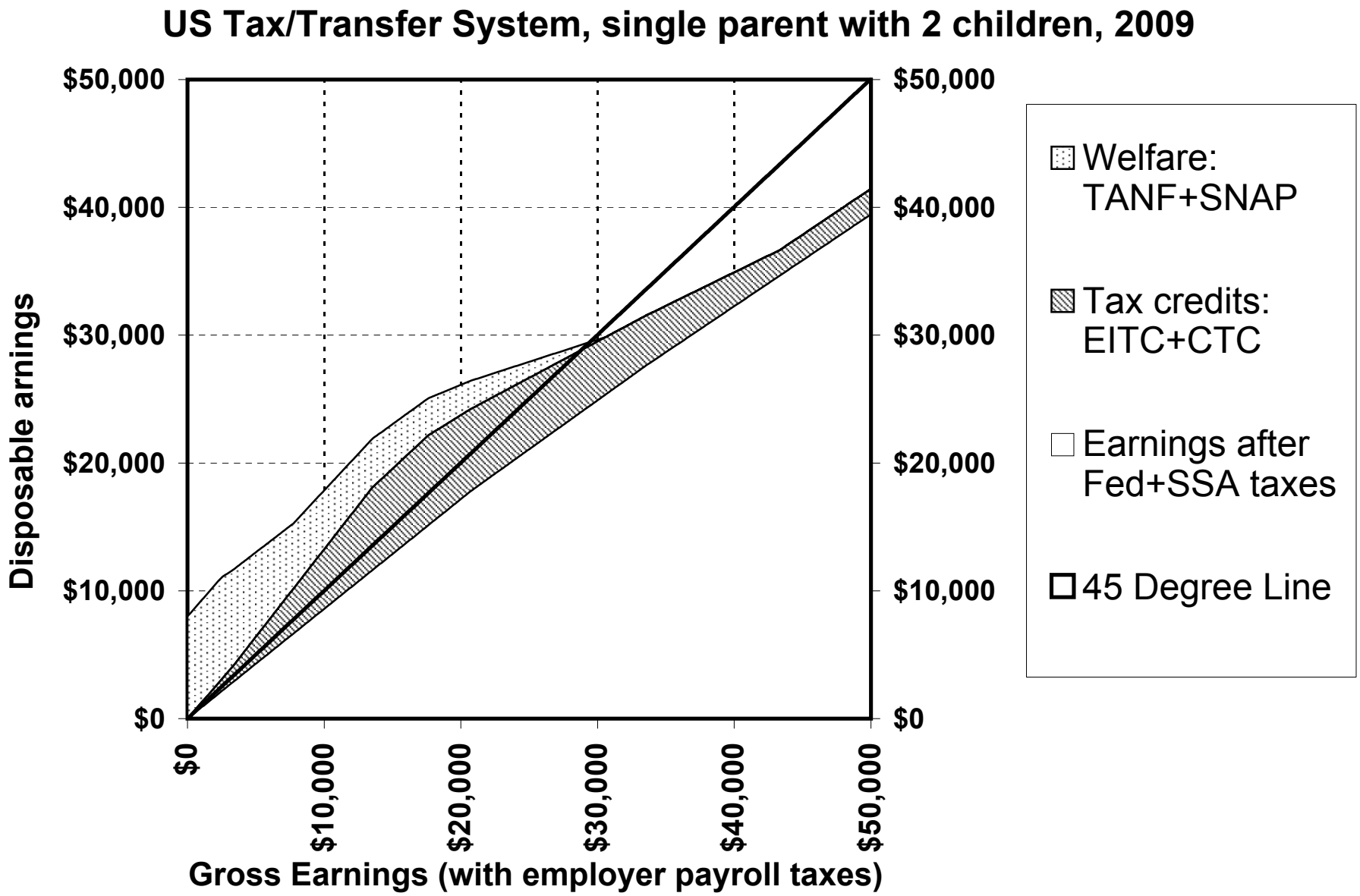


Source: IRS, Statistics of Income Division, Historical Table 23



Source: statistics computed by the author



Source: Federal Govt

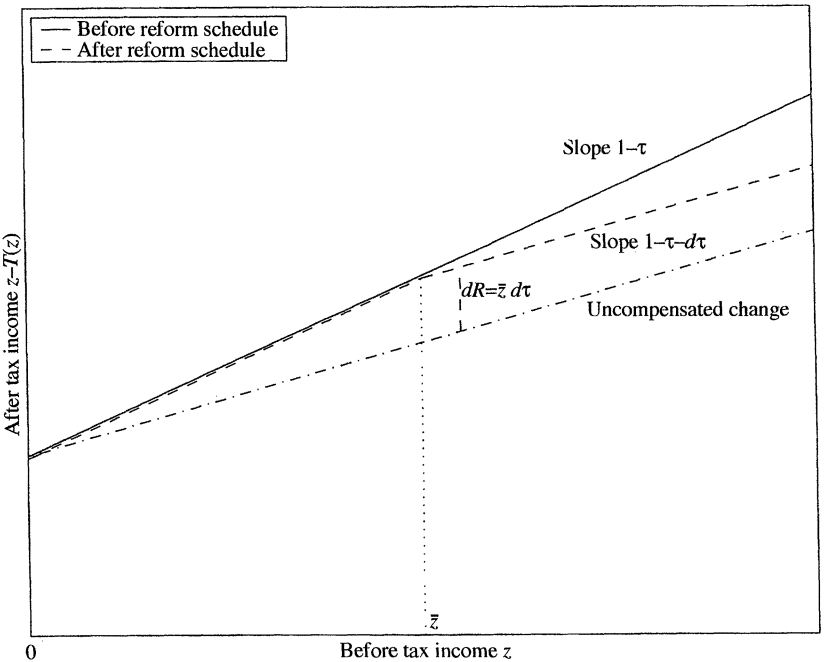
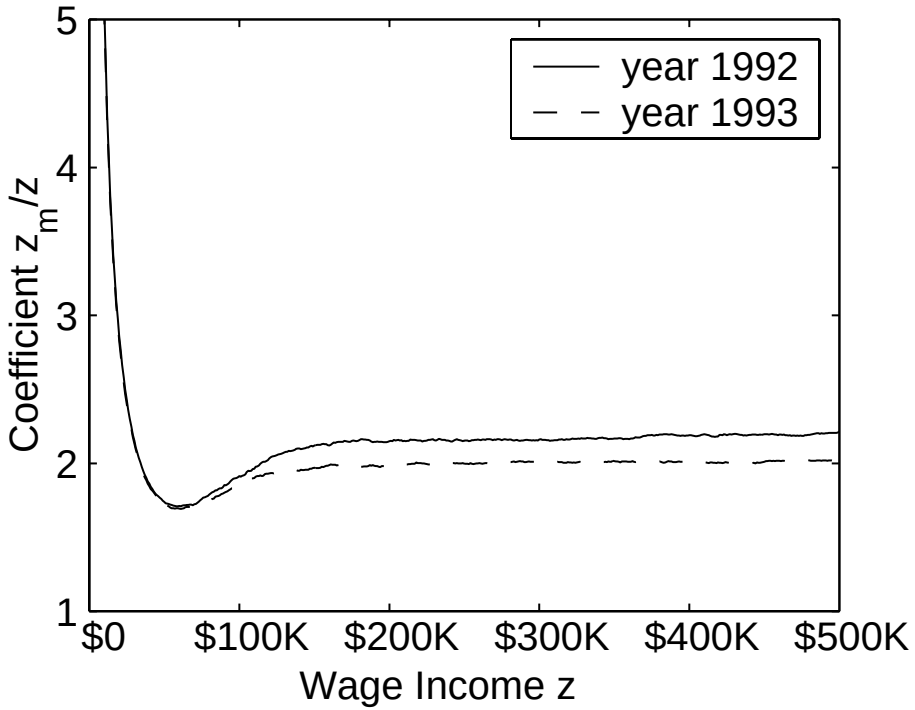


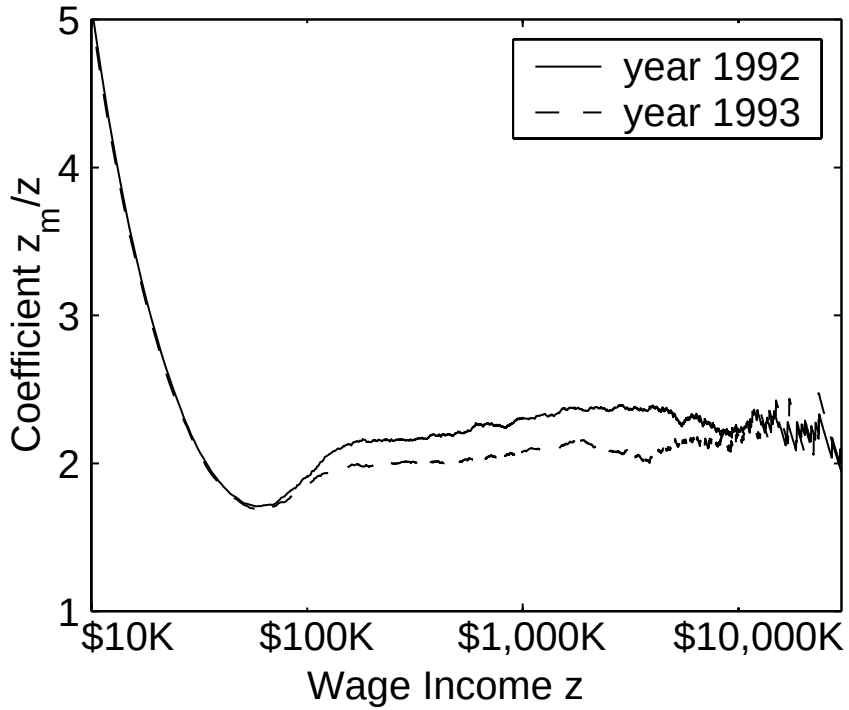
FIGURE 1

High income tax rate perturbation

Source: Saez (2001), p. 209

FIGURE 2 − Ratio mean income above z divided by z, z_m/z, years 1992 and 1993





Source: Saez (2001), p. 211

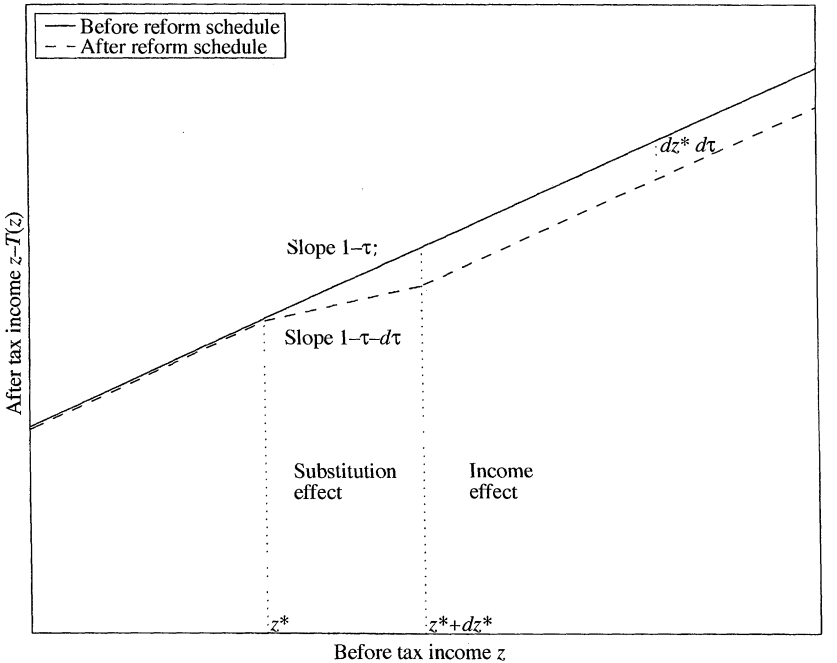
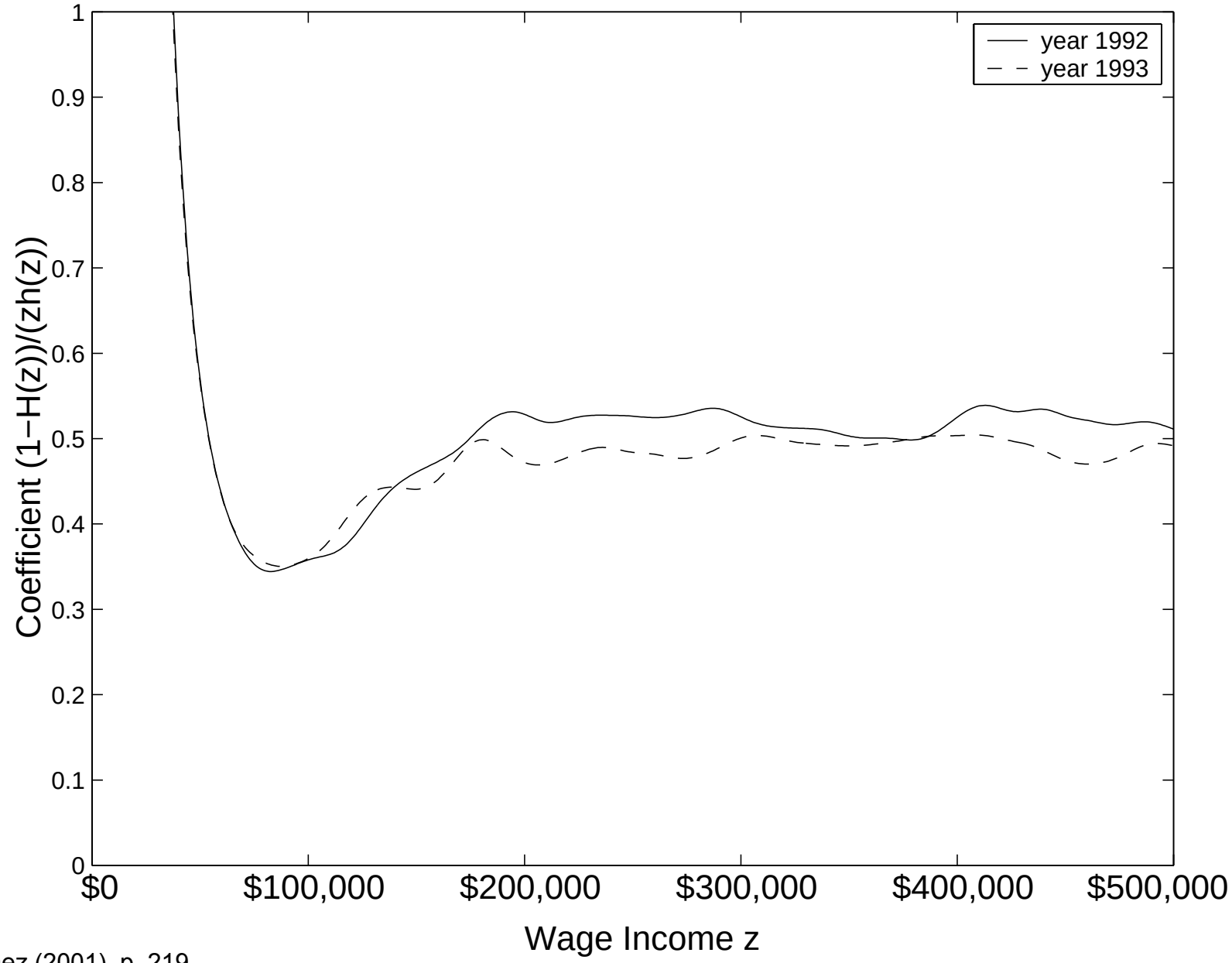


FIGURE 3

Local marginal tax rate perturbation

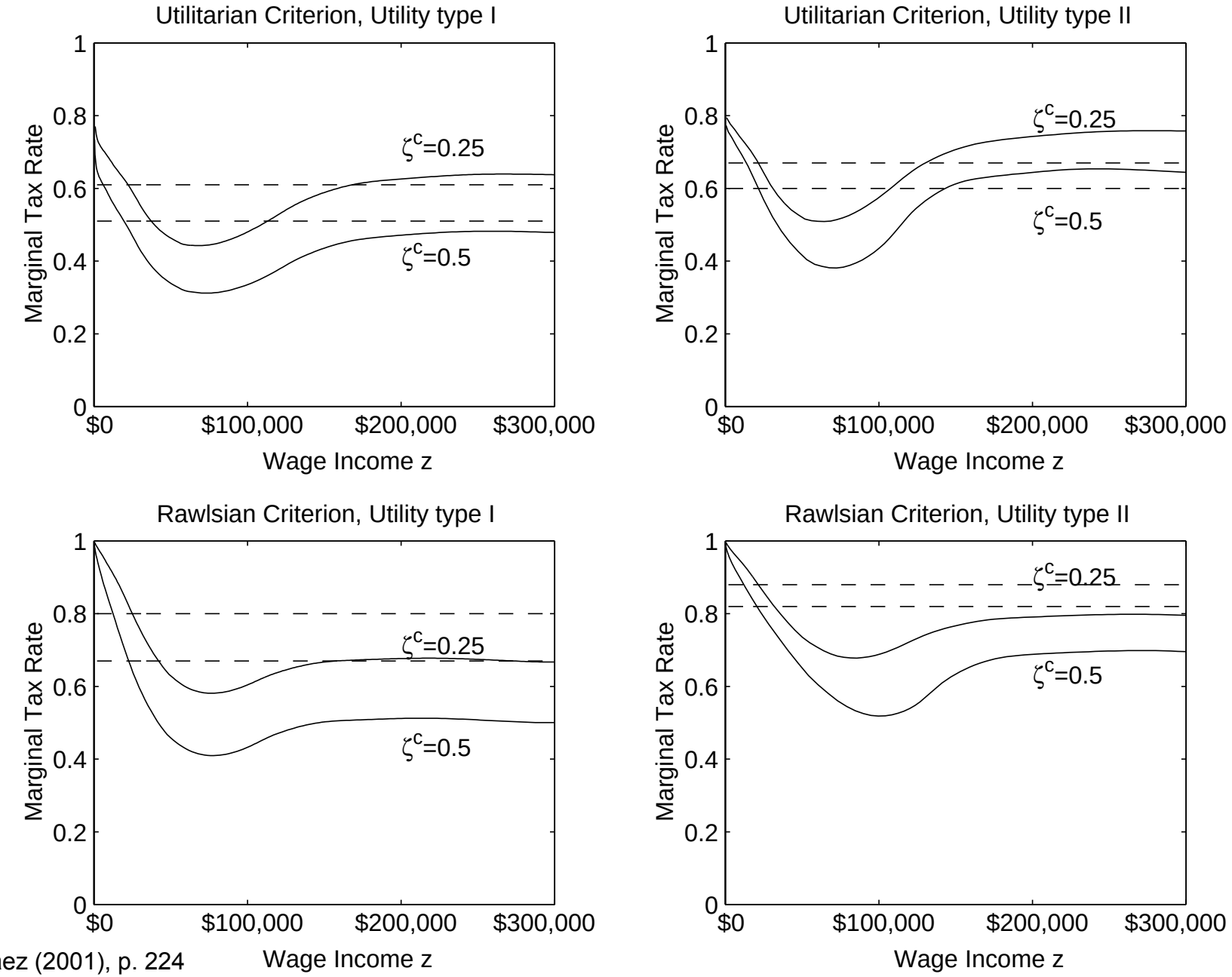
Source: Saez (2001), p. 216

FIGURE 4 − Hazard Ratio (1−H(z))/(zh(z)), years 1992 and 1993



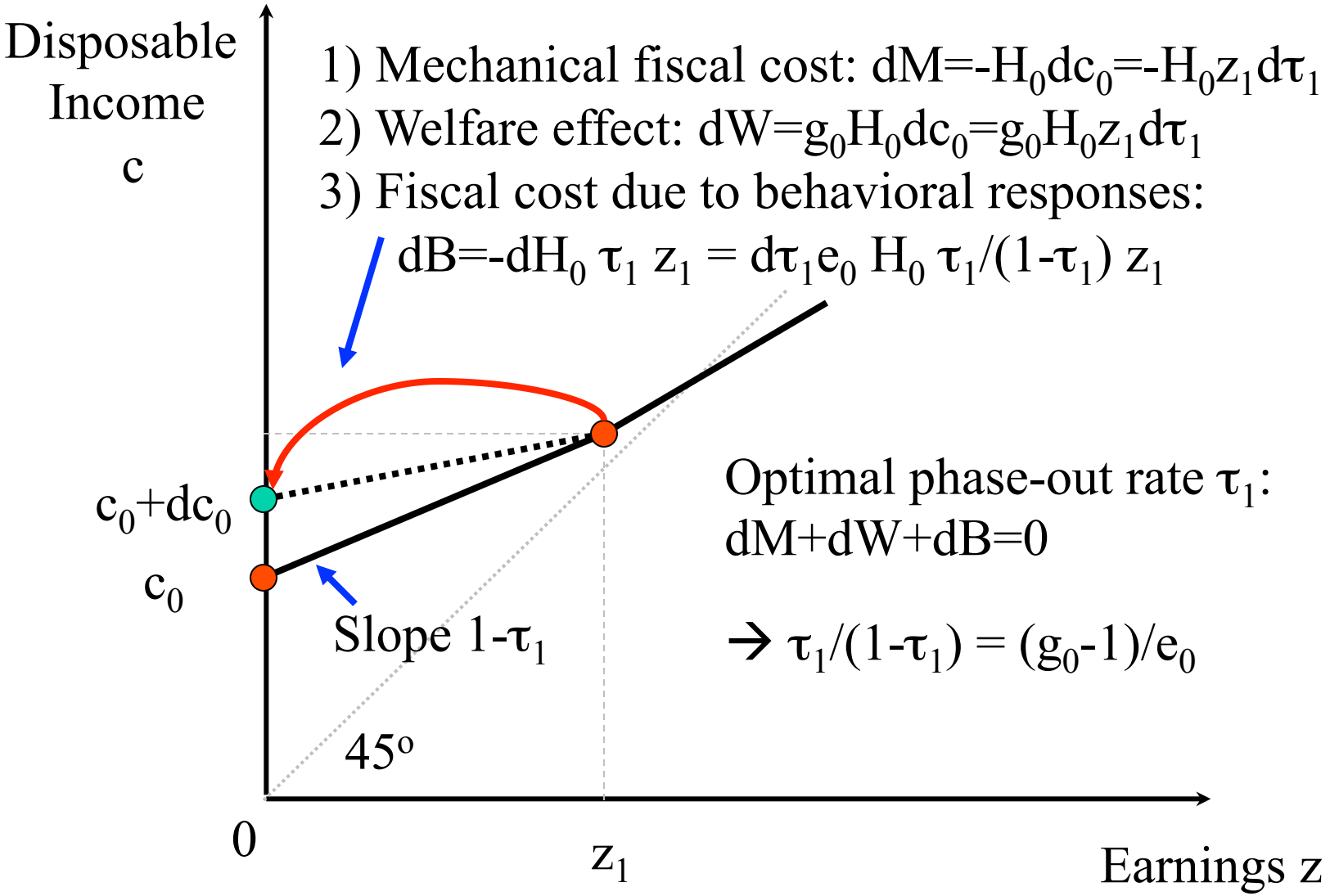
Source: Saez (2001), p. 219

FIGURE 5 − Optimal Tax Simulations

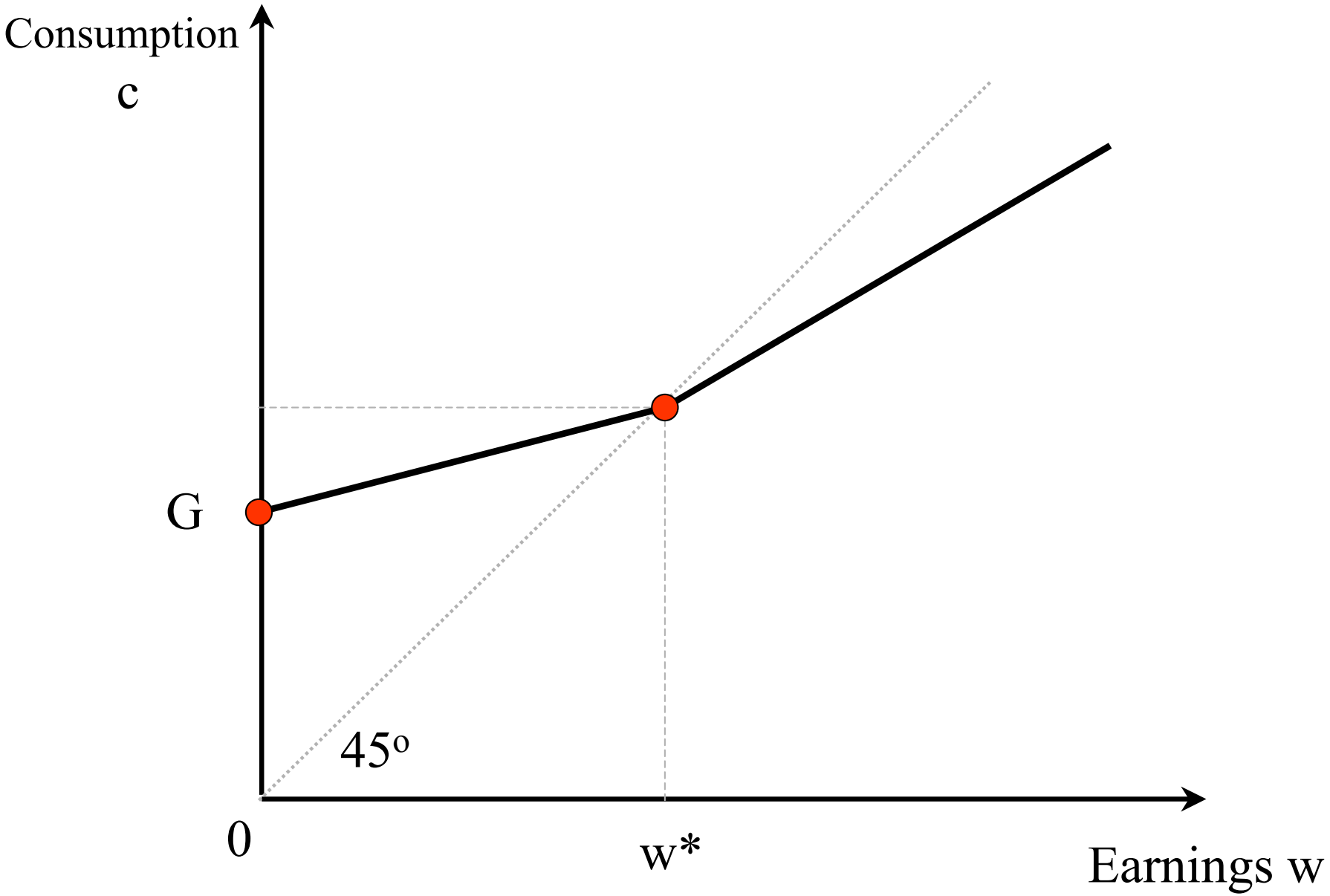


Source: Saez (2001), p. 224

Reform: Increase τ_1 by $d\tau_1$ and c_0 by $dc_0=z_1 d\tau_1$



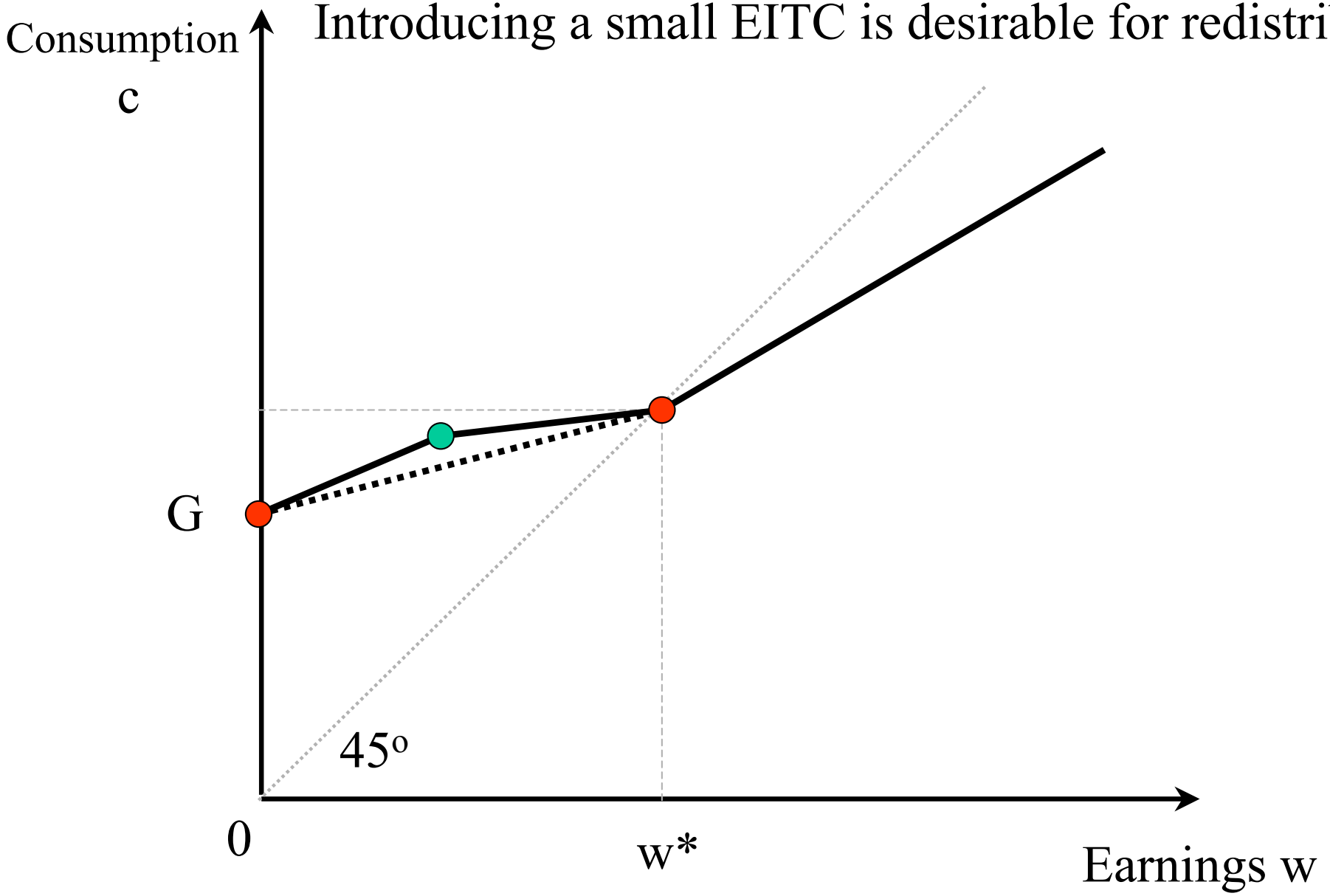
Starting from a Means-Tested Program



Source: revised version of Saez (2002), p. 1050

Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

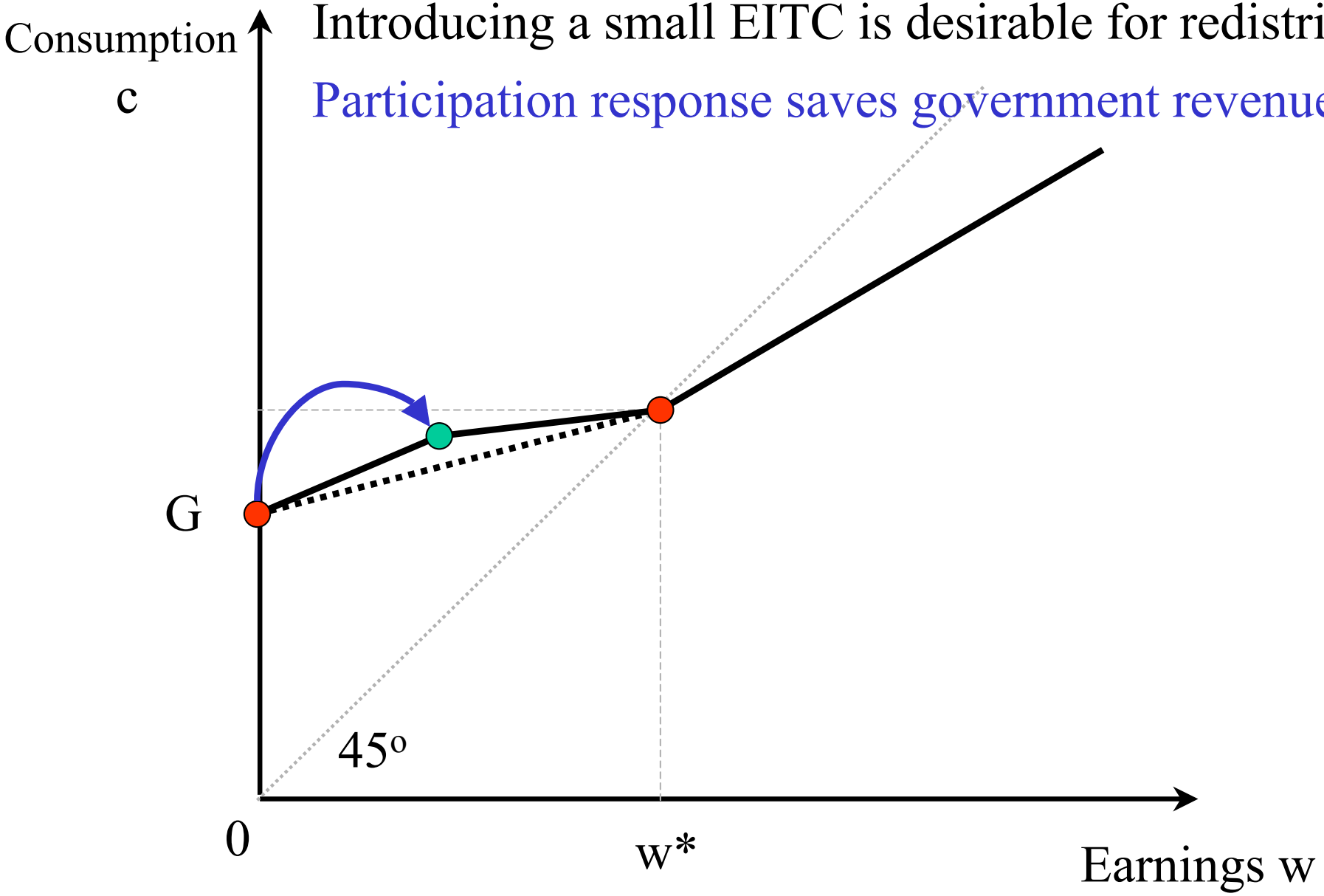


Source: revised version of Saez (2002), p. 1050

Starting from a Means-Tested Program

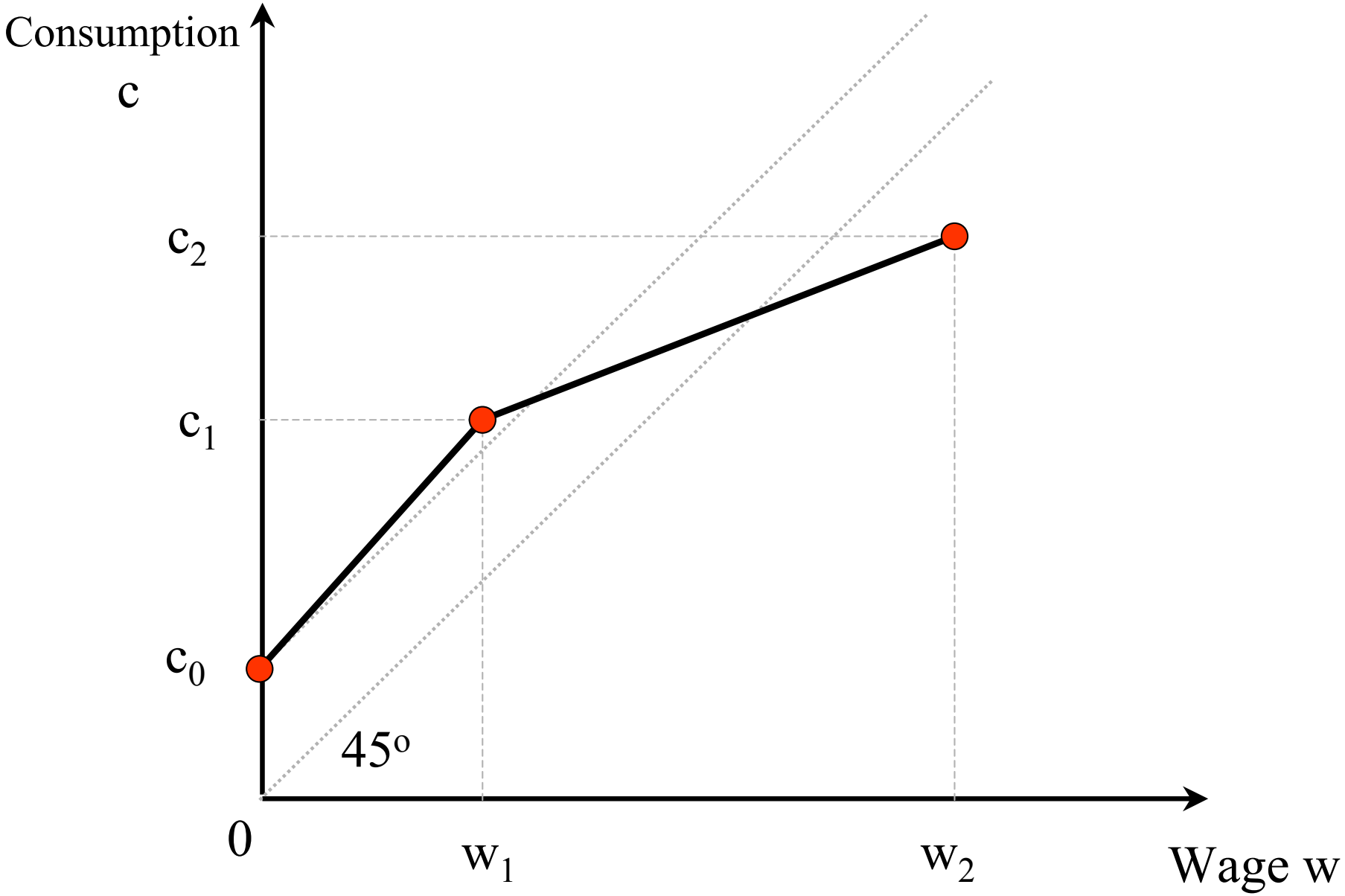
Introducing a small EITC is desirable for redistribution

Participation response saves government revenue



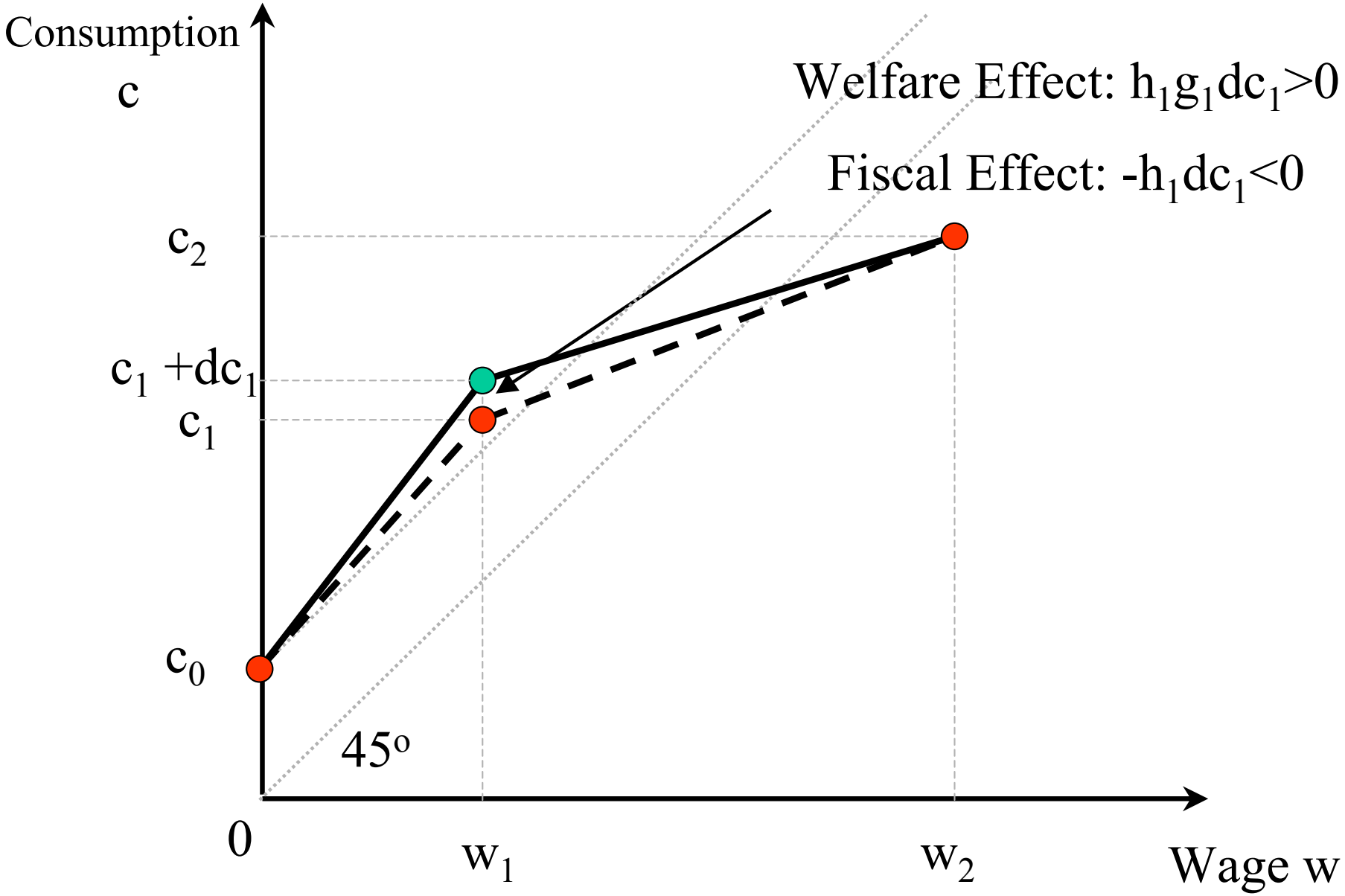
Source: revised version of Saez (2002), p. 1050

Figure 3a: Optimal Tax/Transfer Derivation



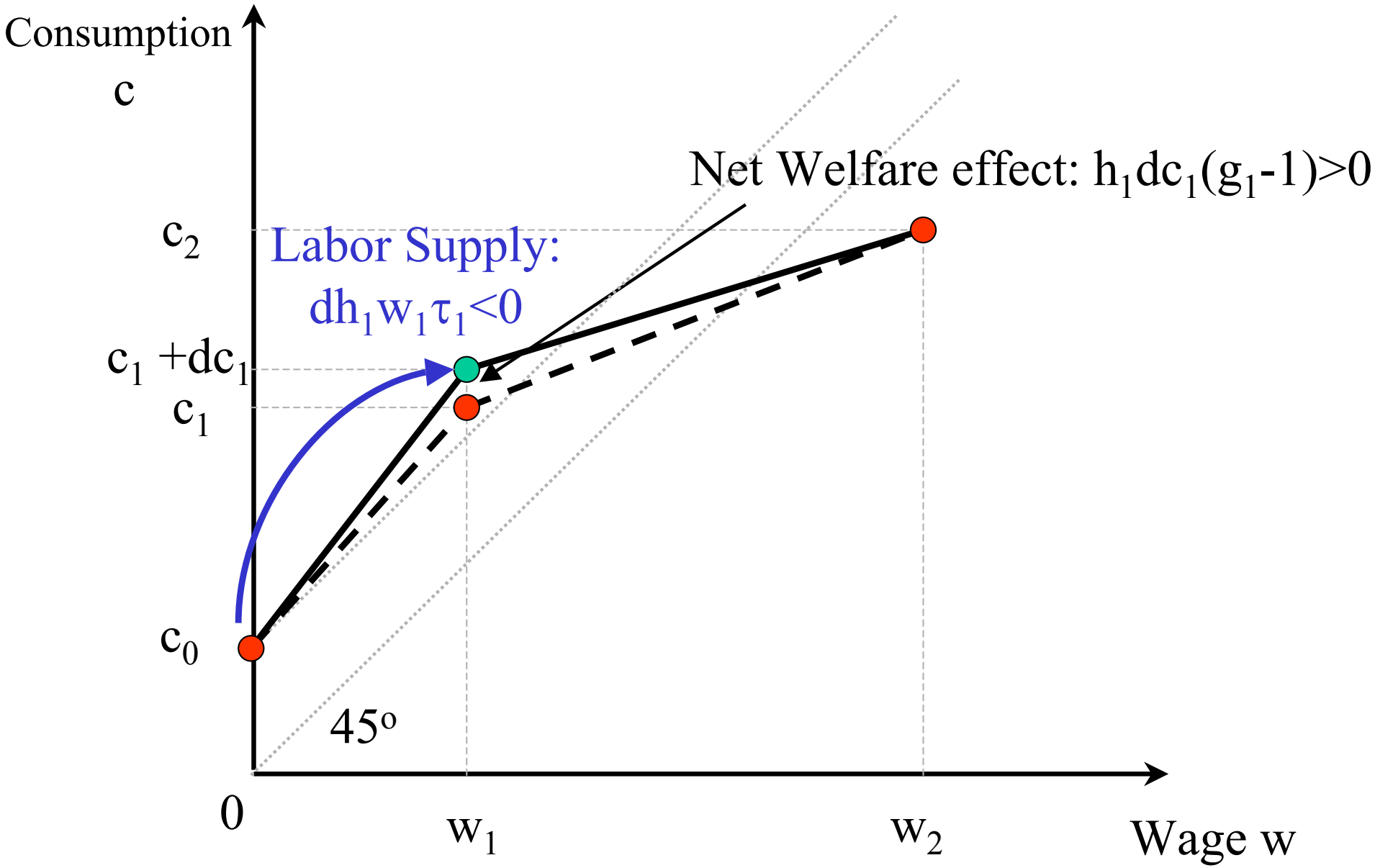
Source: revised version of Saez (2002), p. 1052

Figure 3a: Optimal Tax/Transfer Derivation (assuming $g_1>1$)



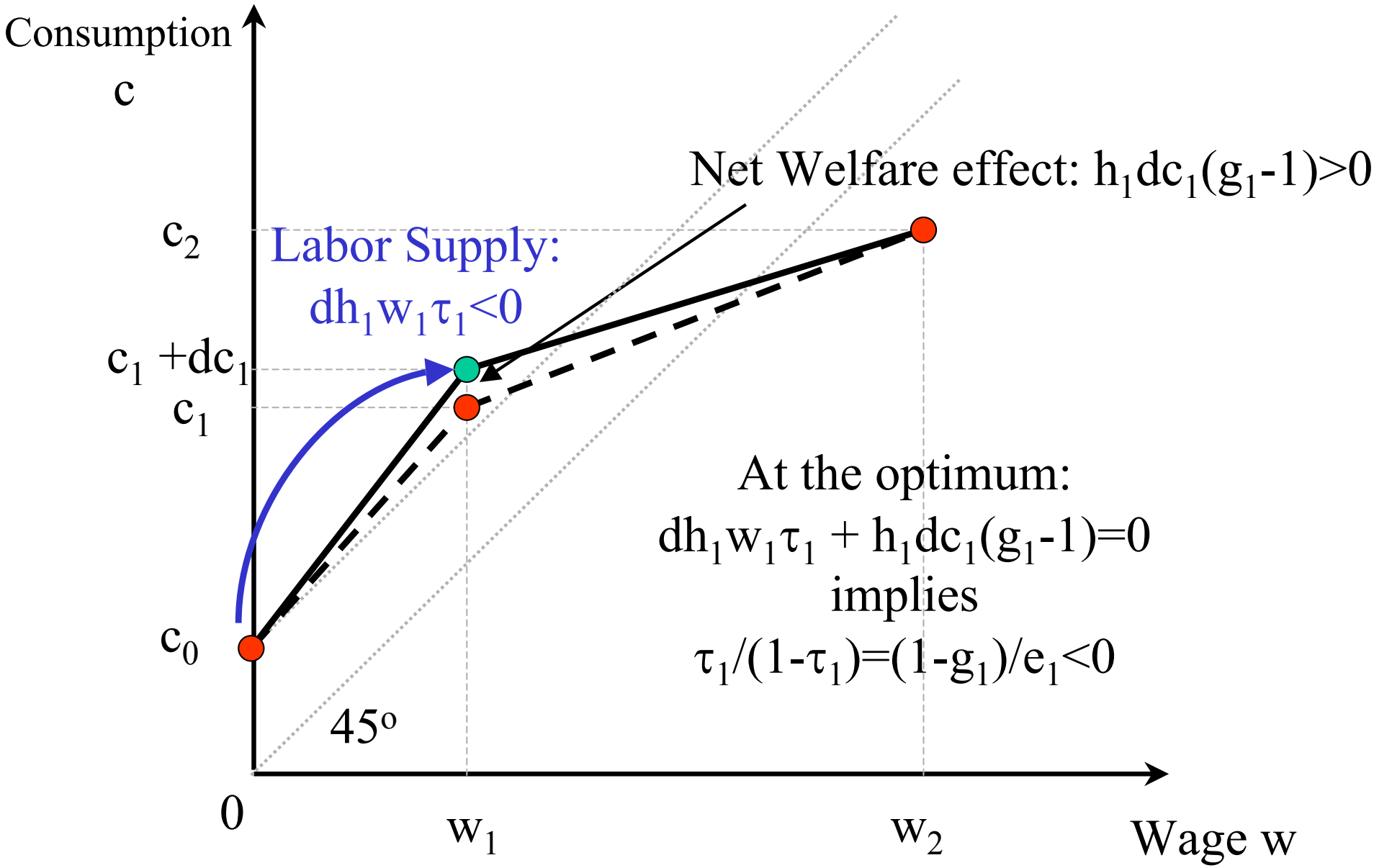
Source: revised version of Saez (2002), p. 1052

Figure 3a: Optimal Tax/Transfer Derivation (assuming $g_1>1$)



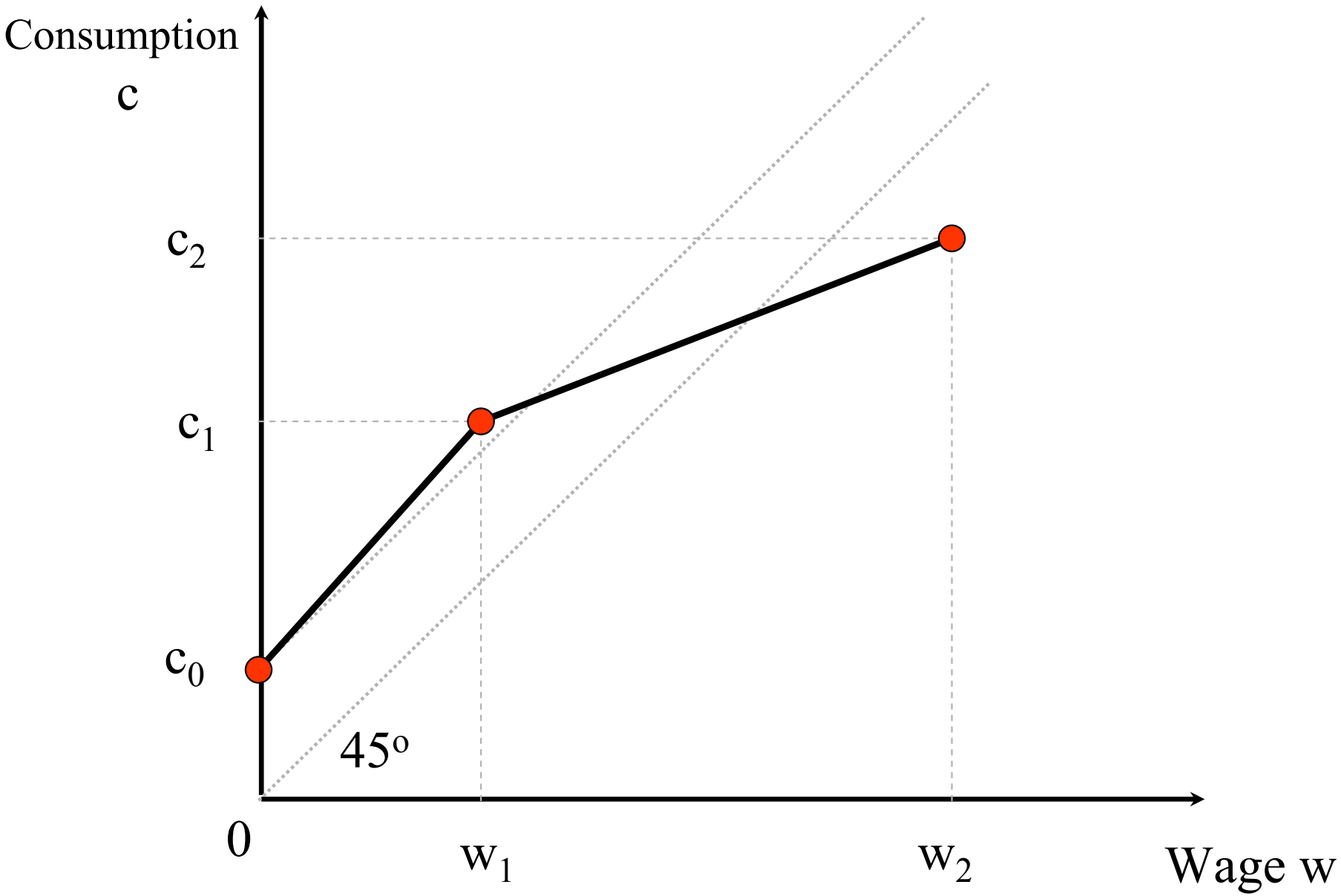
Source: revised version of Saez (2002), p. 1052

Figure 3a: Optimal Tax/Transfer Derivation (assuming $g_1>1$)



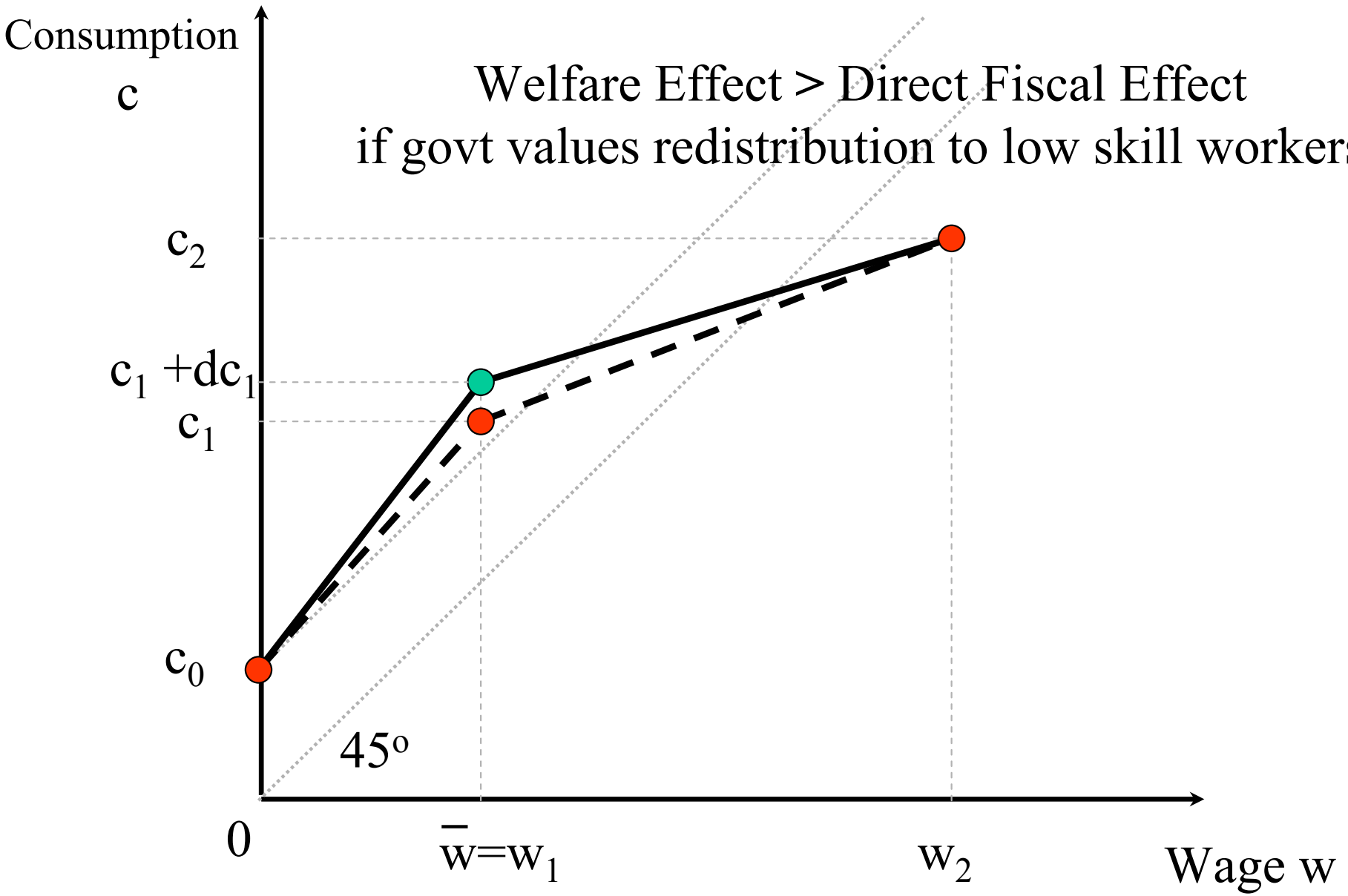
Source: revised version of Saez (2002), p. 1052

2. Optimal Tax/Transfer System (no min wage)



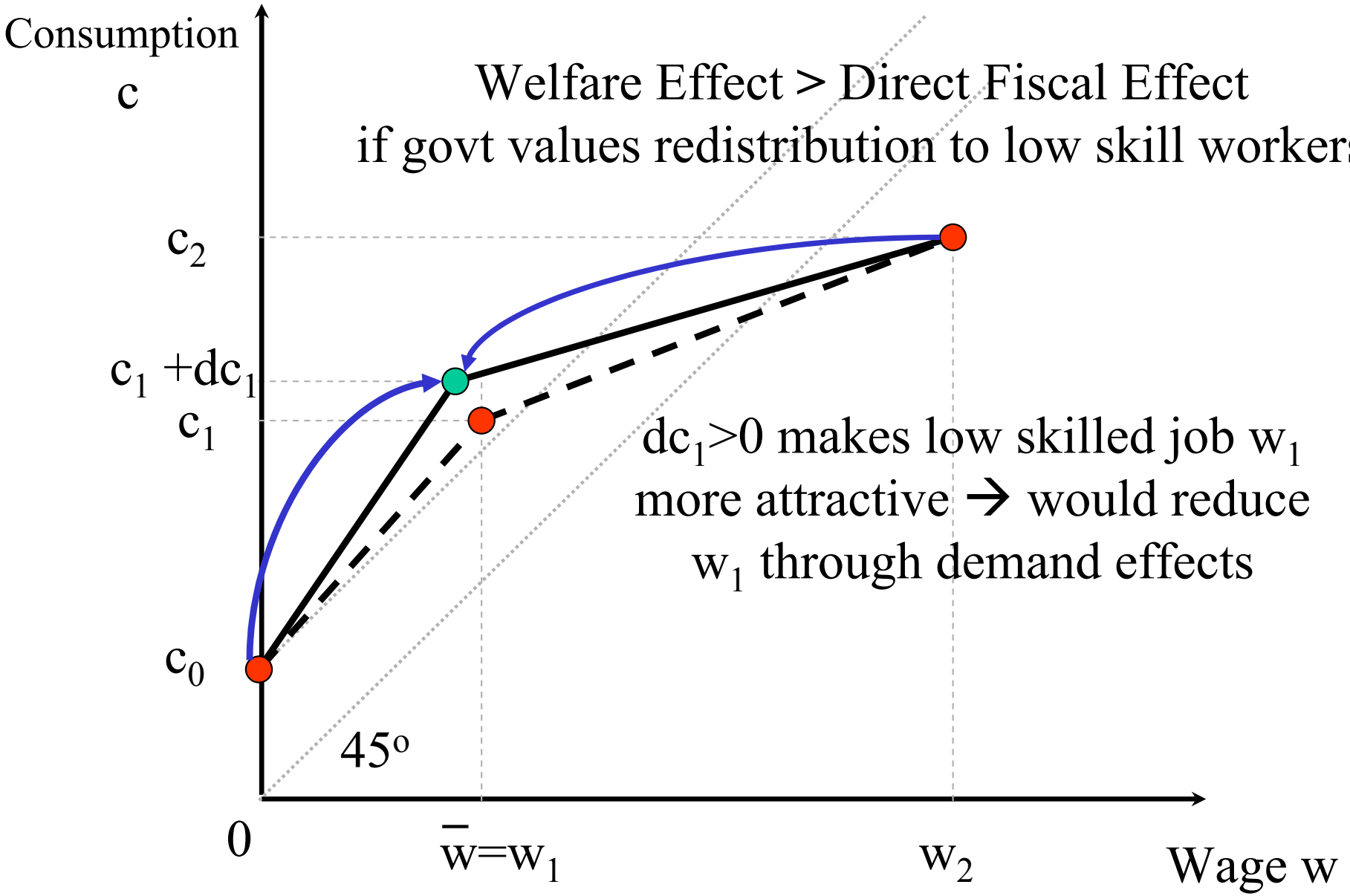
Source: Lee and Saez (2008)

2. Set Min wage $\bar{w}=w_1$ and increase c_1 by dc_1



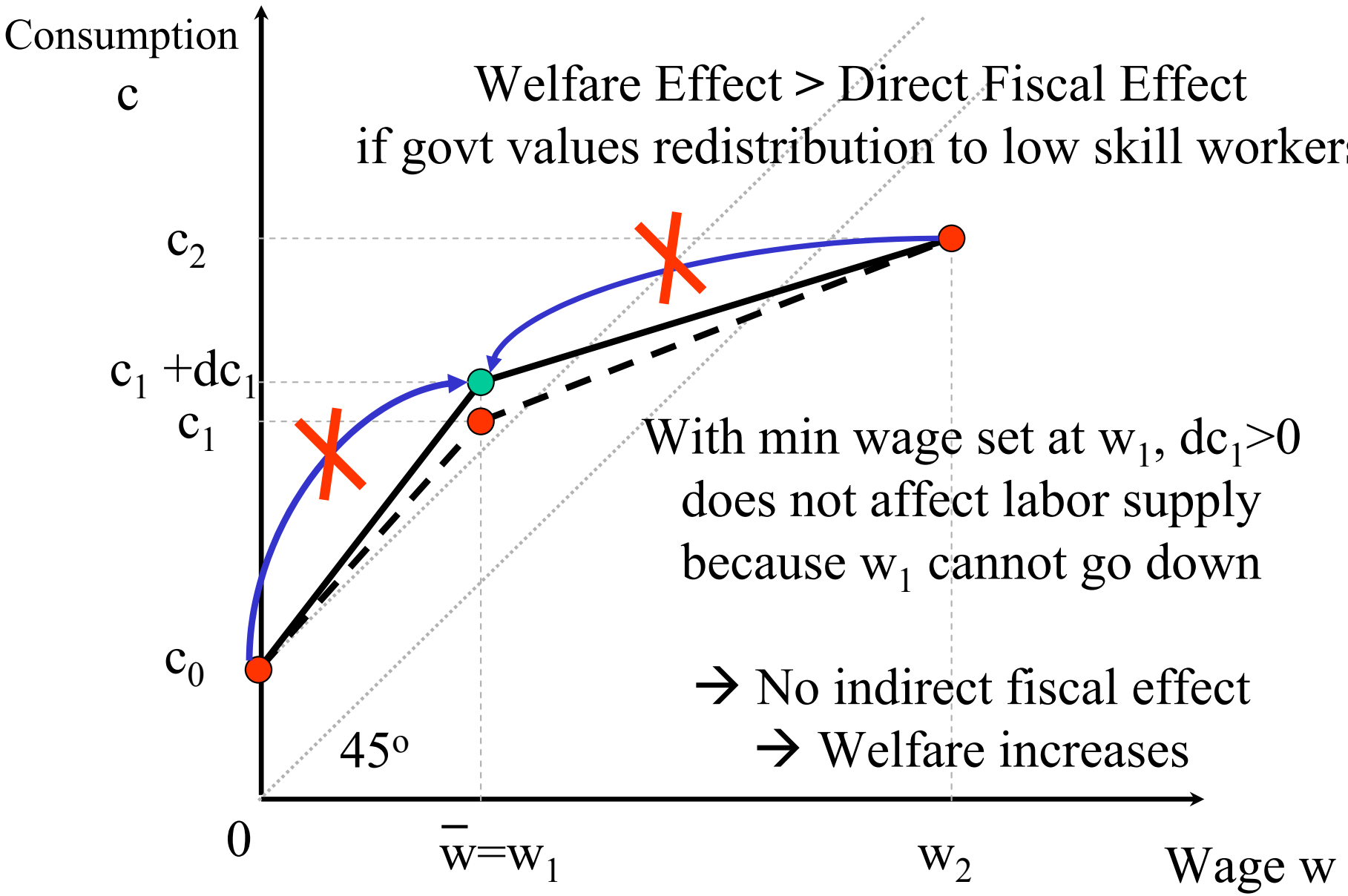
Source: Lee and Saez (2008)

2. Desirability of Min Wage with Optimal Taxes



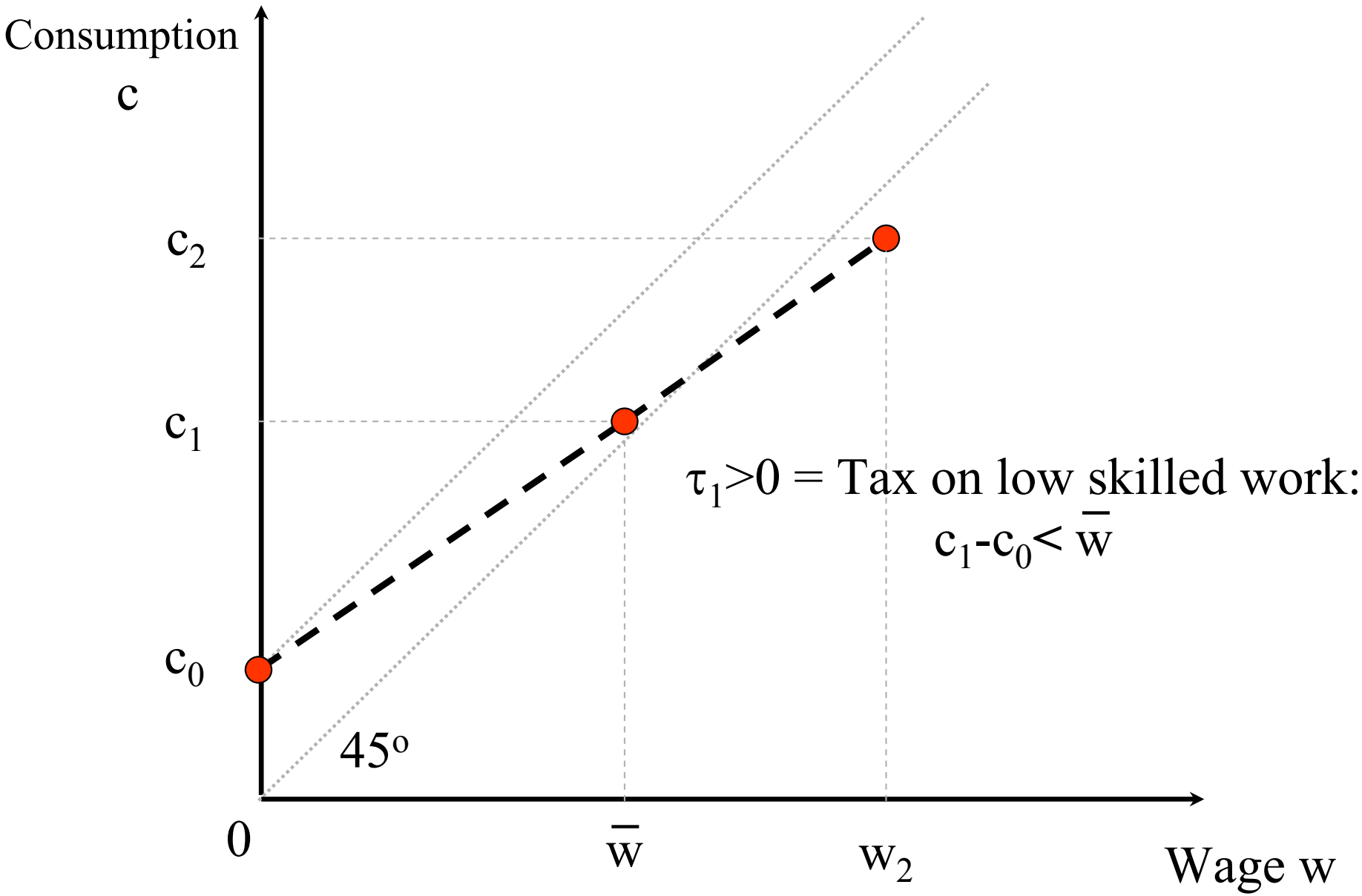
Source: Lee and Saez (2008)

2. Desirability of Min Wage with Optimal Taxes



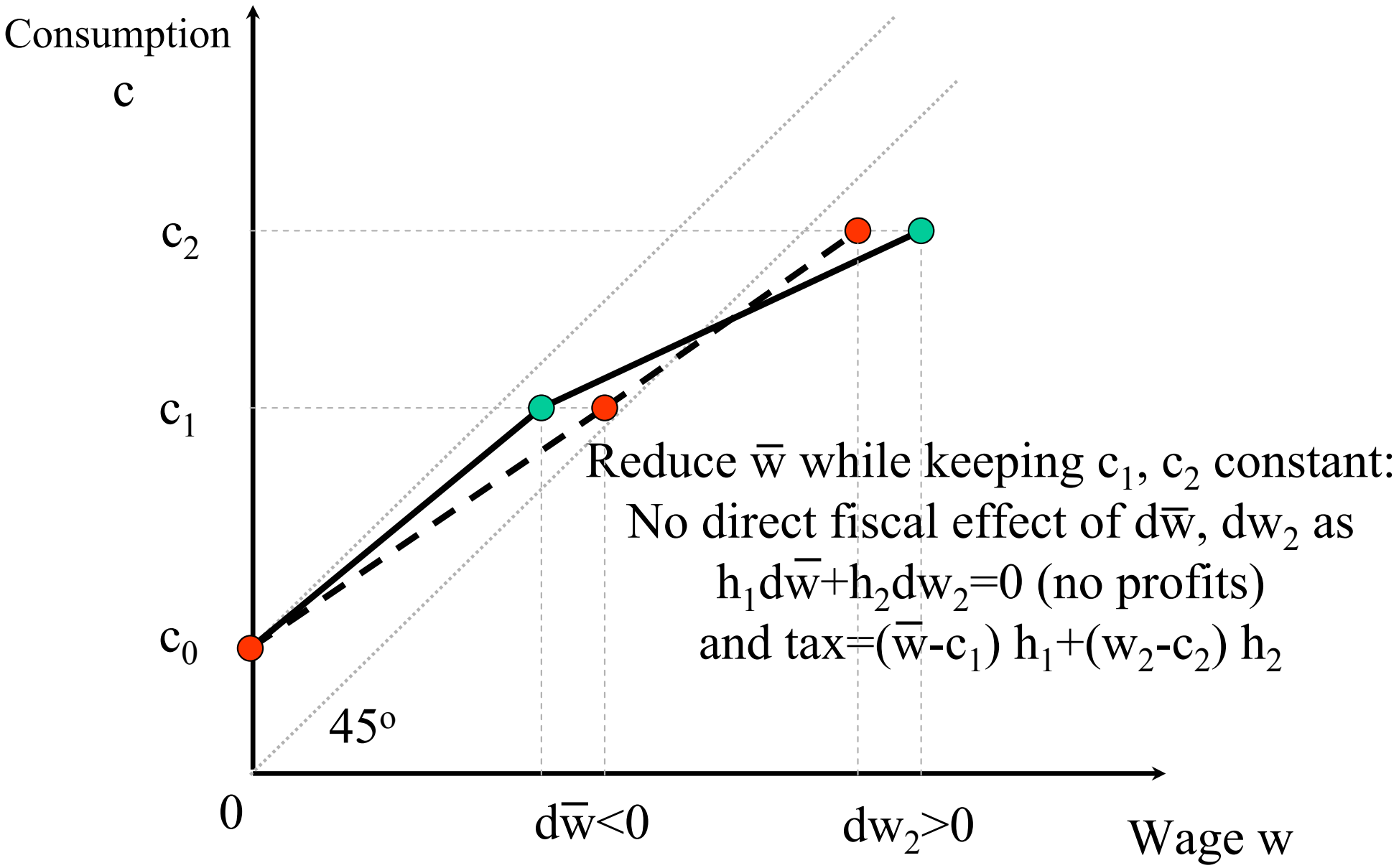
Source: Lee and Saez (2008)

3. Pareto Improving Policy when $\tau_1>0$ and min wage binds



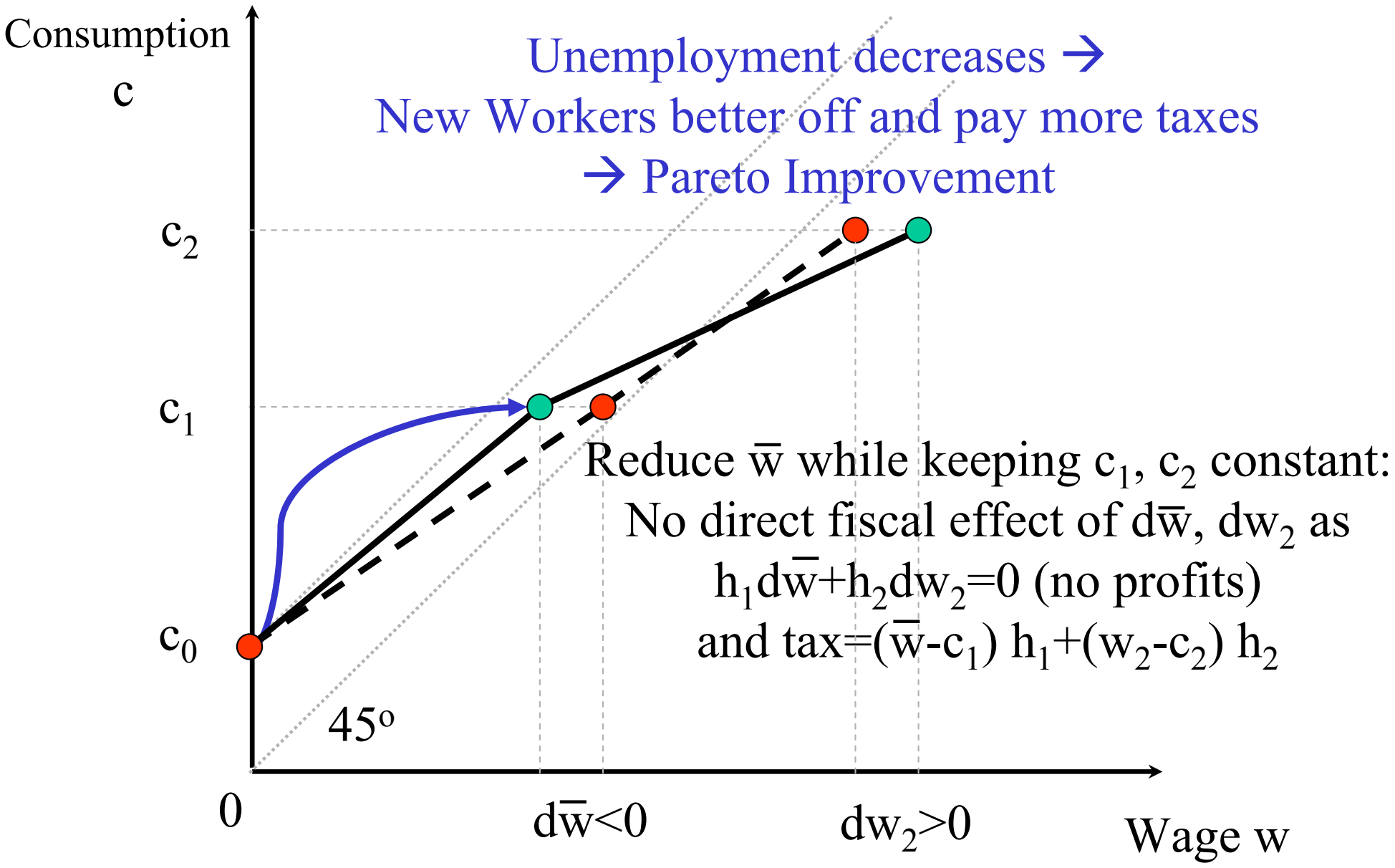
Source: Lee and Saez (2008)

3.Pareto Improving Policy when $\tau_1>0$ and min wage binds



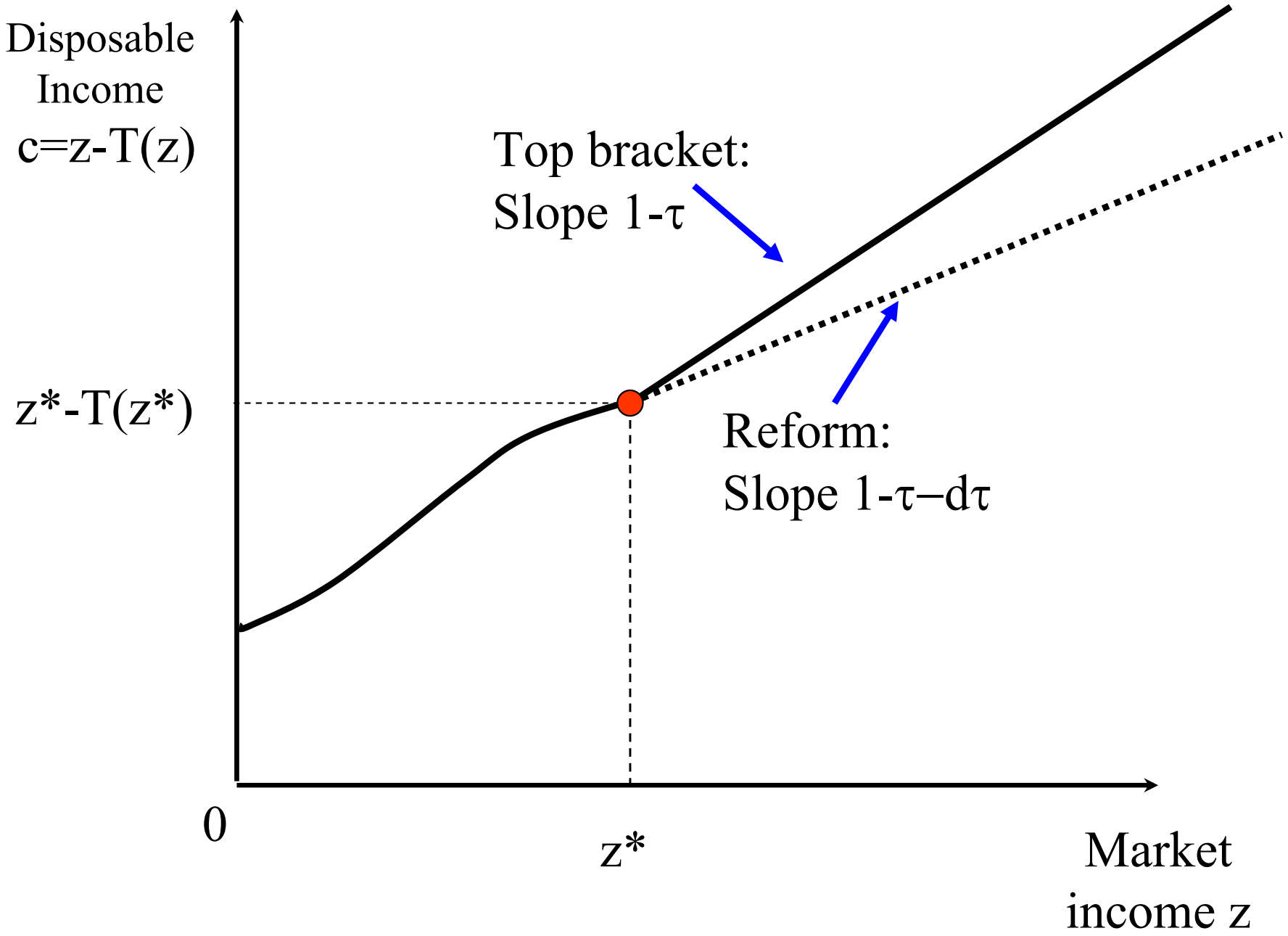
Source: Lee and Saez (2008)

3. Pareto Improving Policy when $\tau_1>0$ and min wage binds



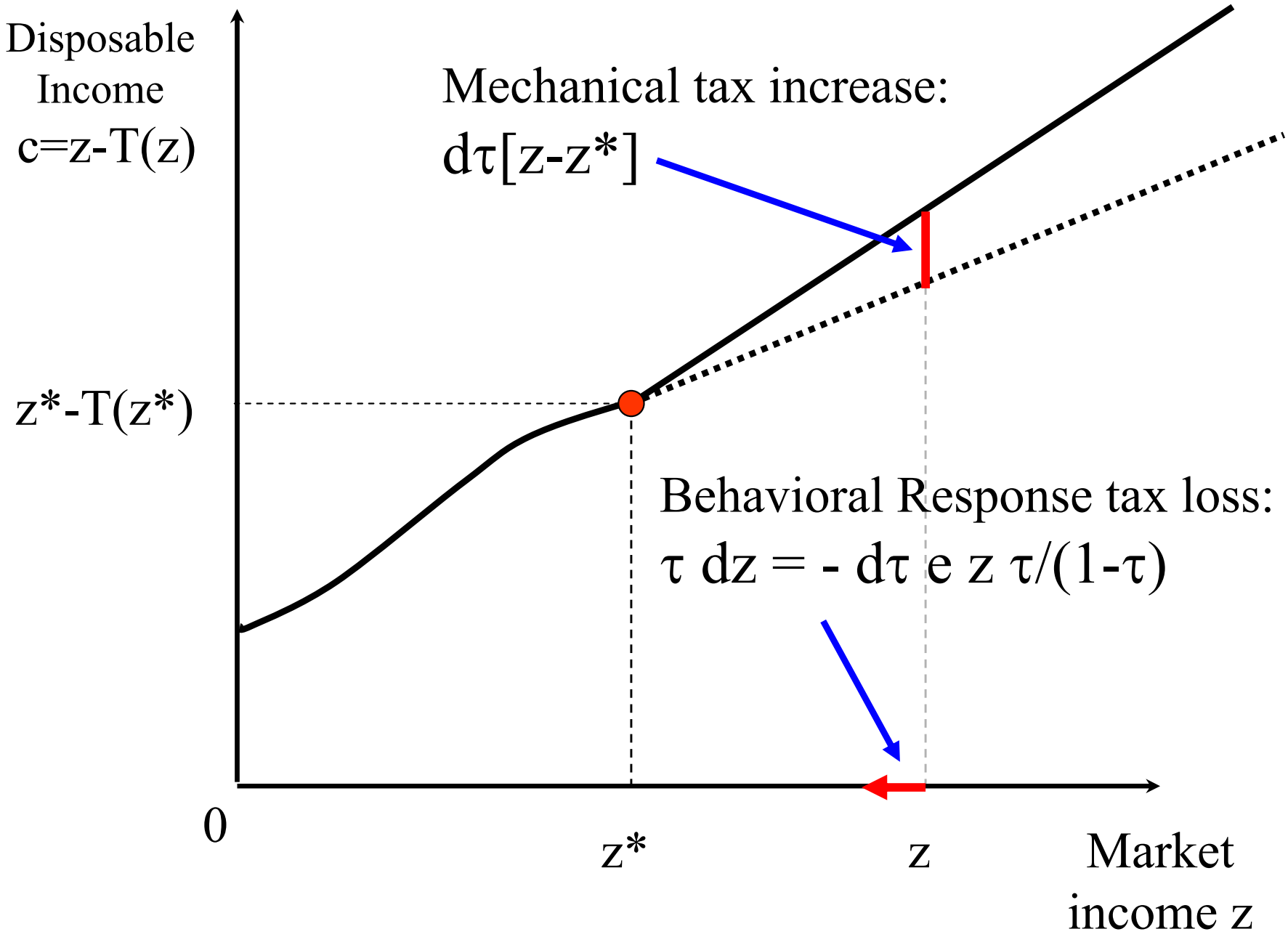
Source: Lee and Saez (2008)

Optimal Top Income Tax Rate (Mirrlees '71 model)

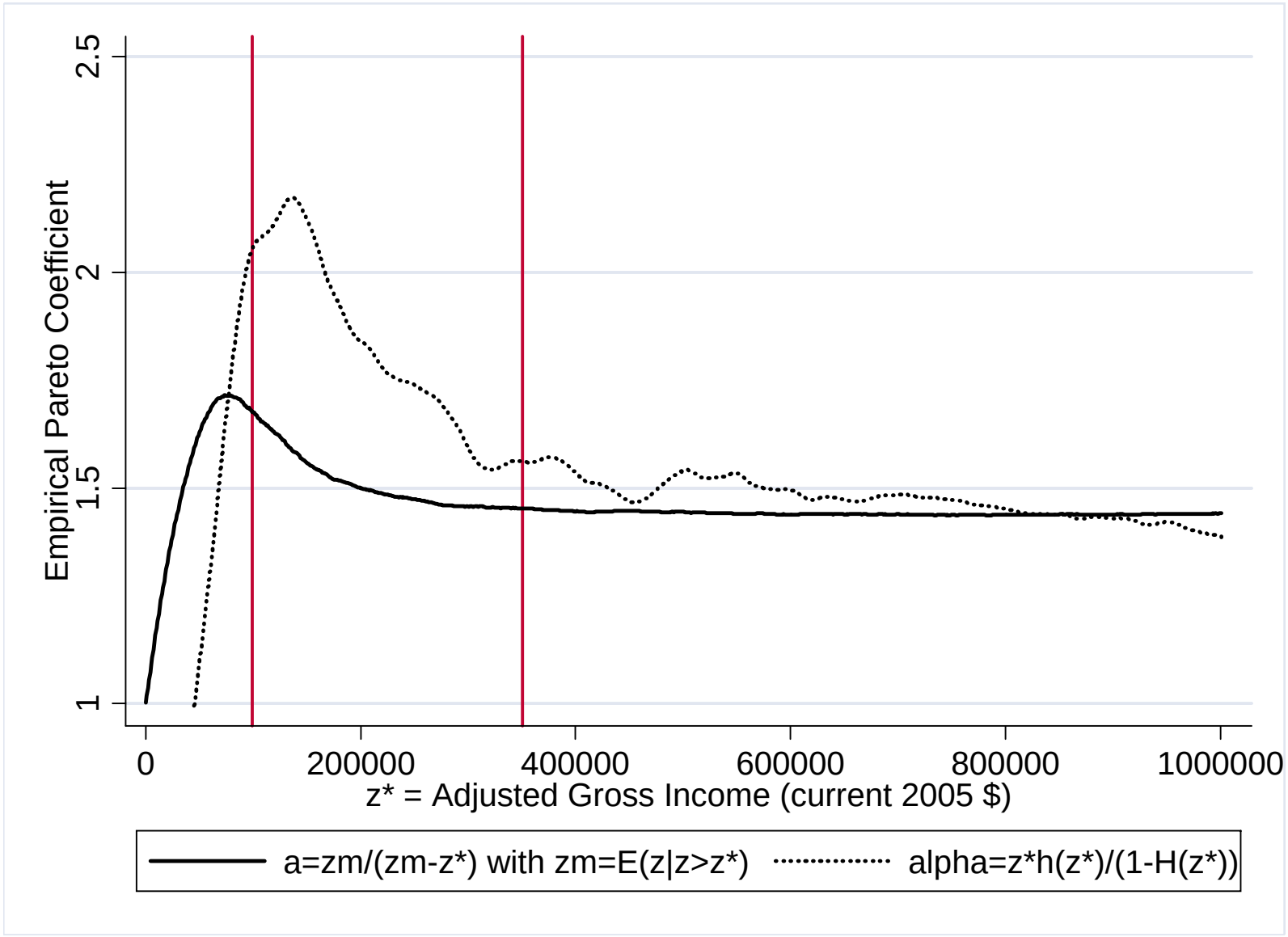


Source: Diamond and Saez JEP'11

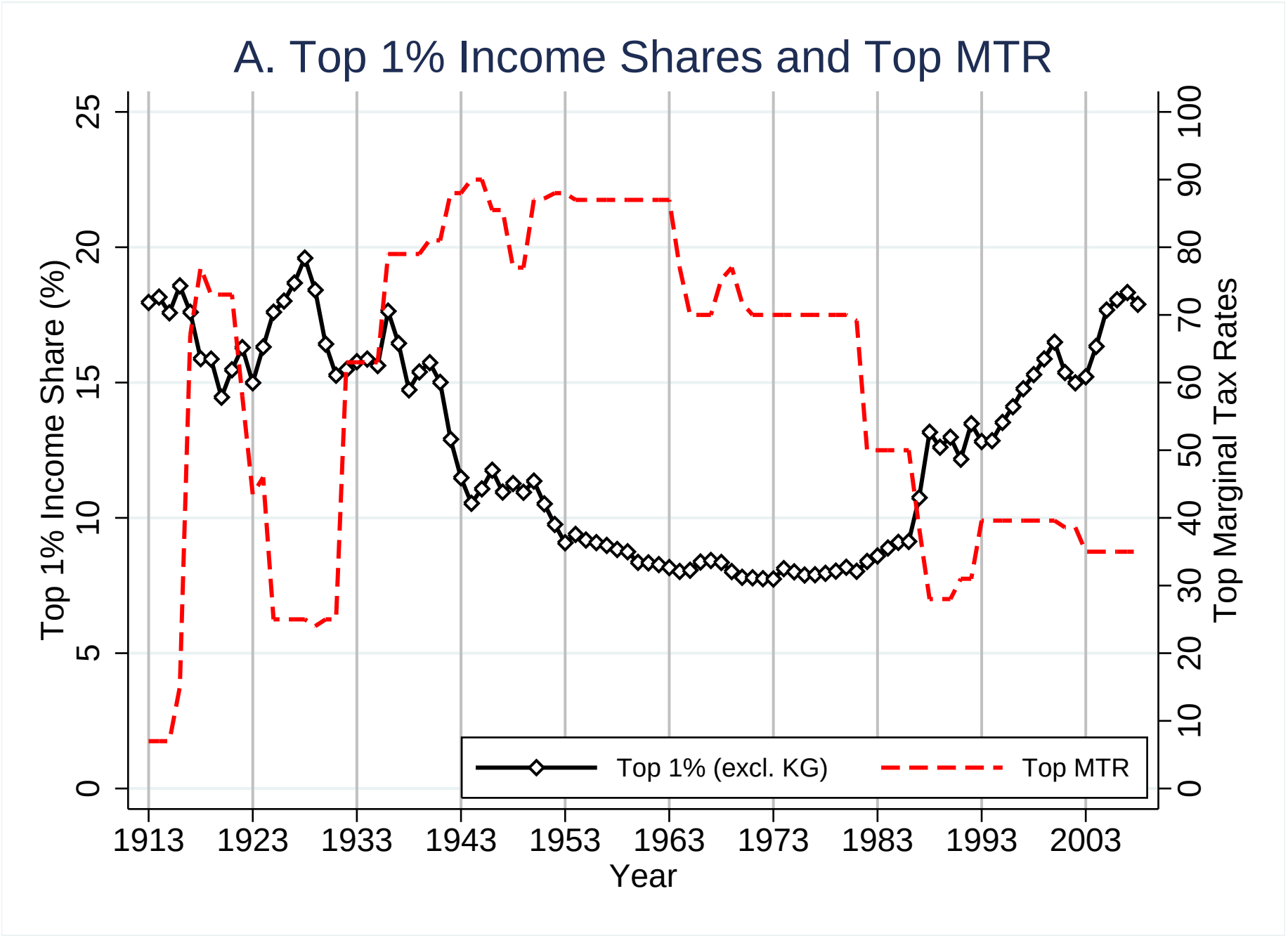
Optimal Top Income Tax Rate (Mirrlees '71 model)



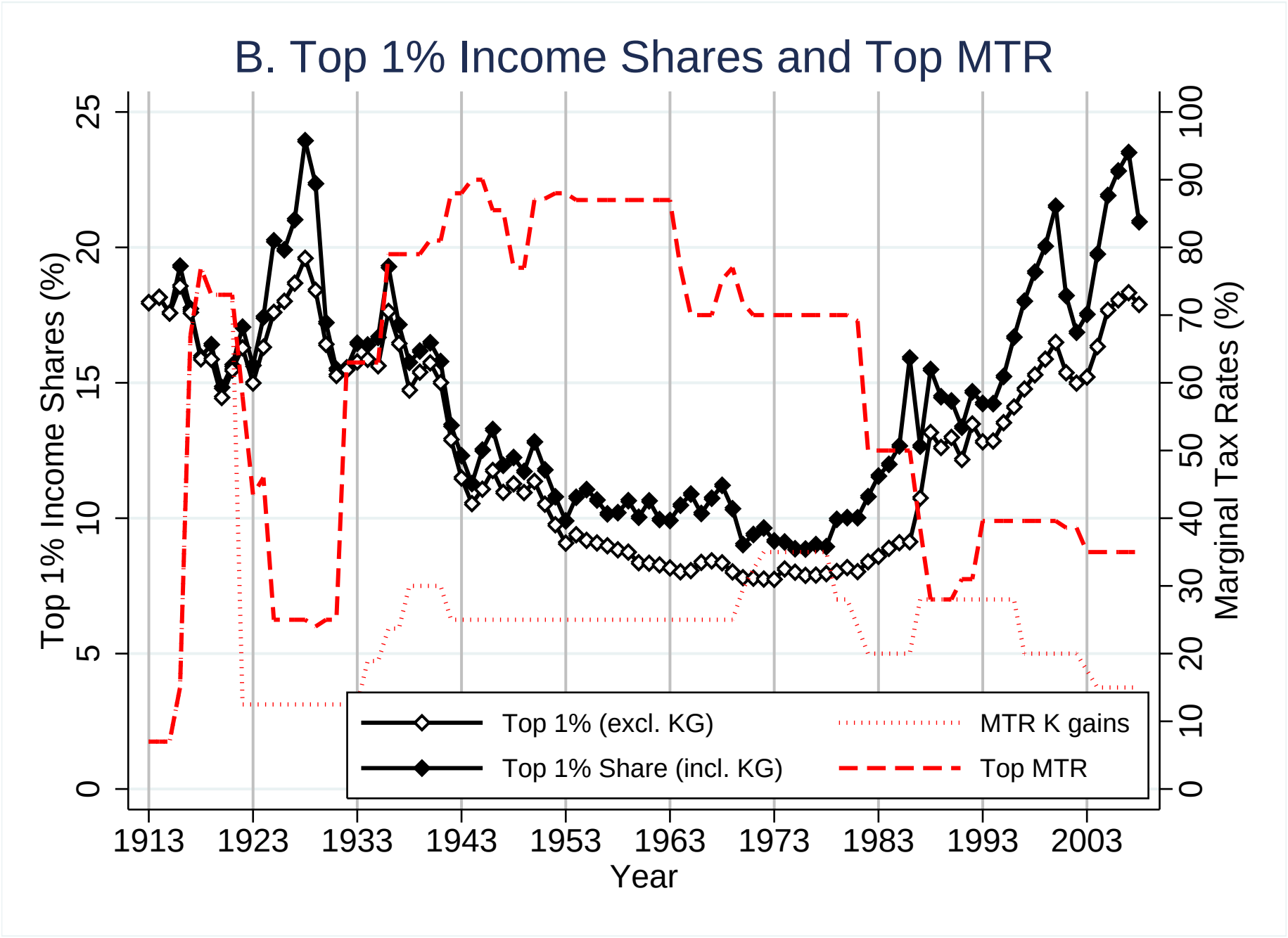
Source: Diamond and Saez JEP'11



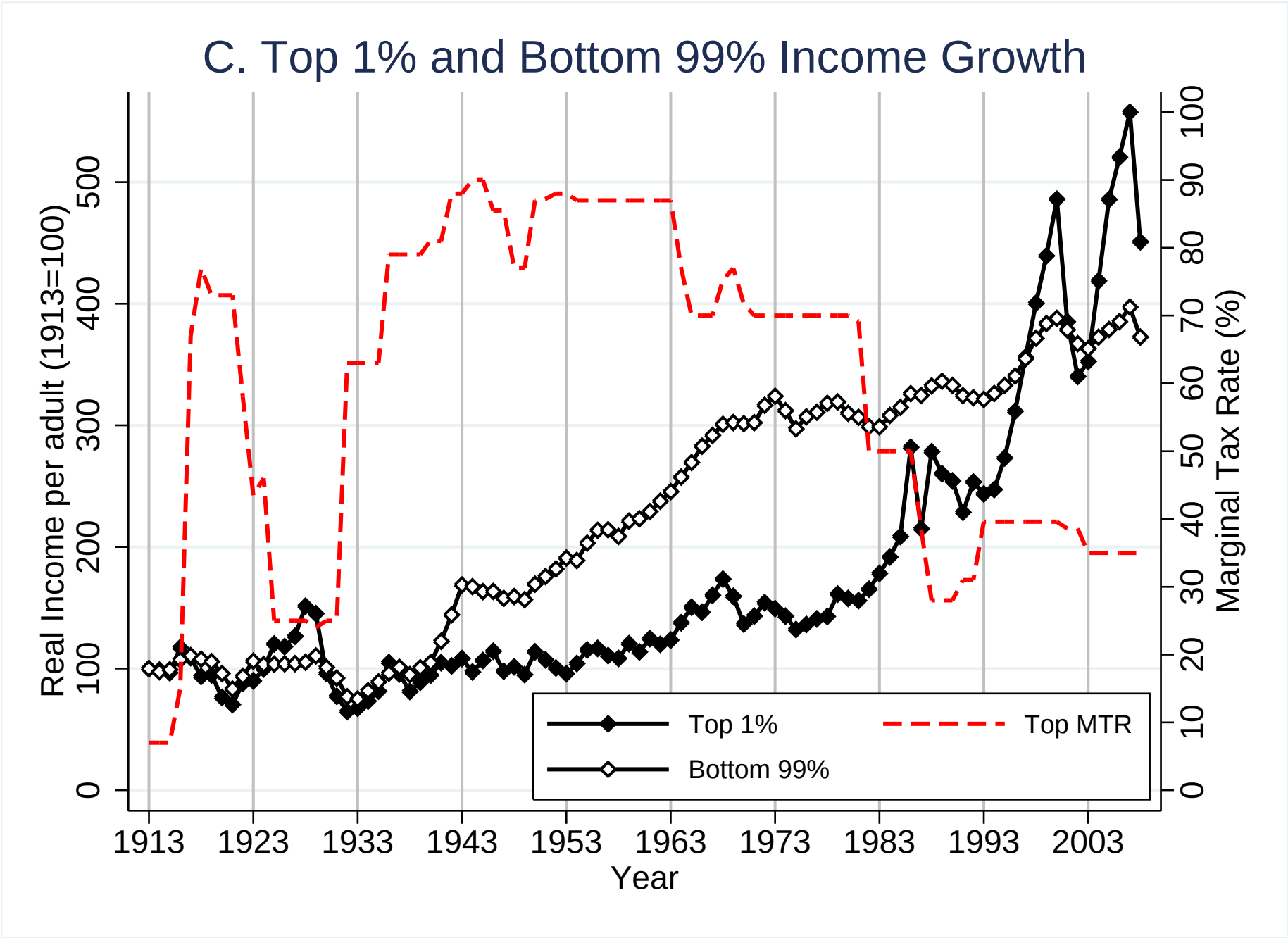
Source: Diamond and Saez JEP'11



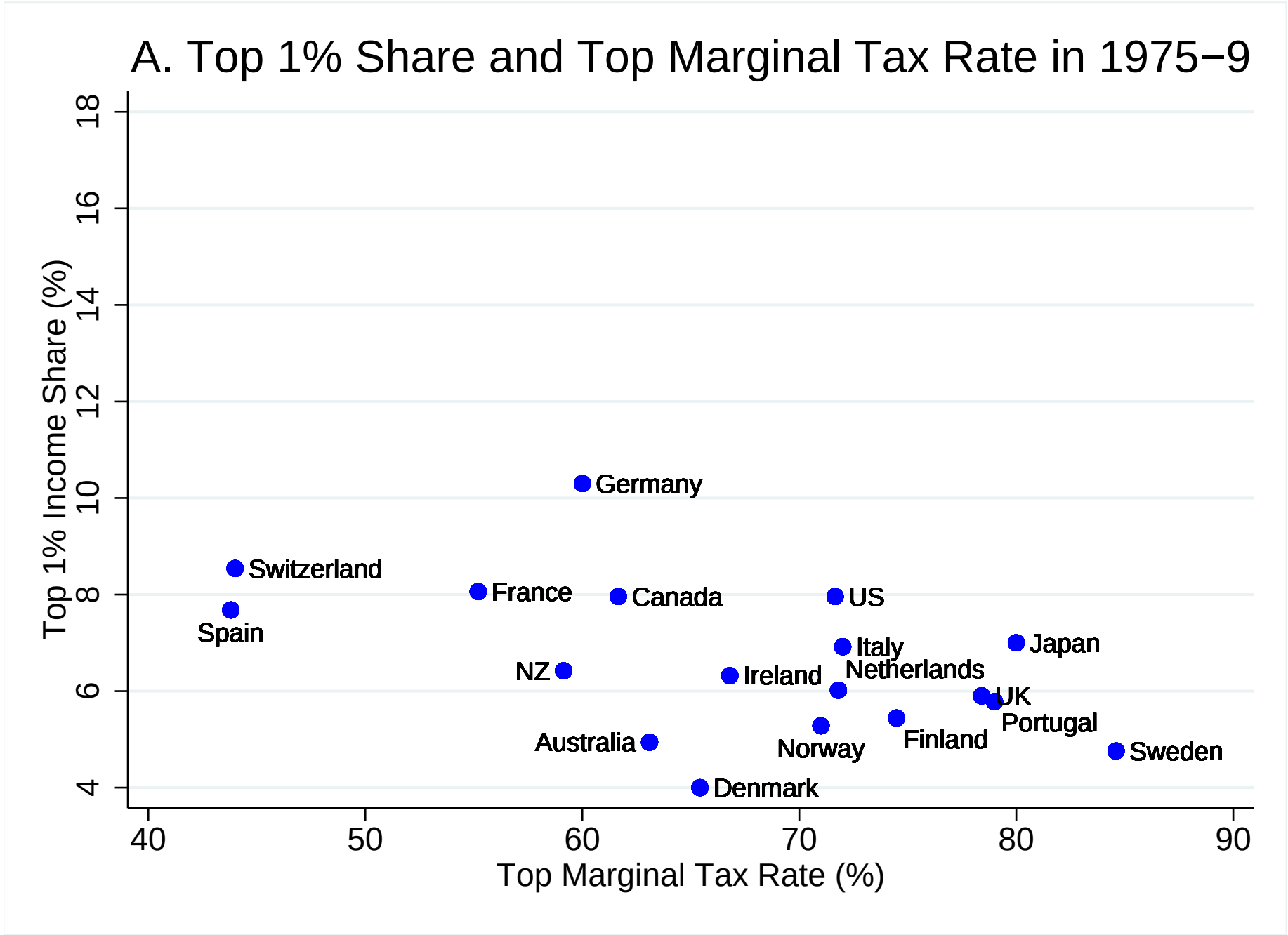
Source: Piketty, Saez, and Stantcheva NBER'11



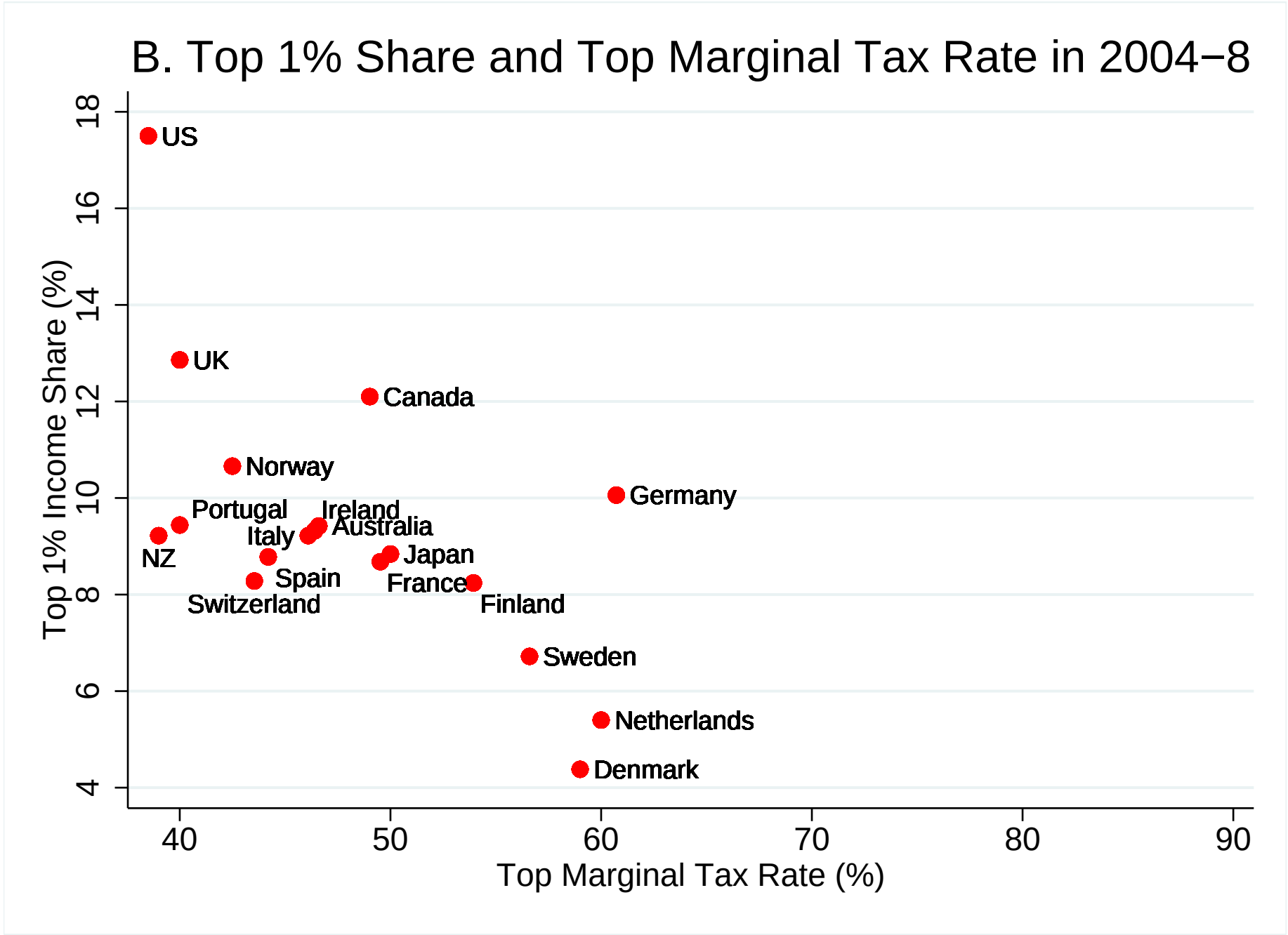
Source: Piketty, Saez, and Stantcheva NBER'11



Source: Piketty, Saez, and Stantcheva NBER'11



Source: Piketty, Saez, and Stantcheva NBER'11



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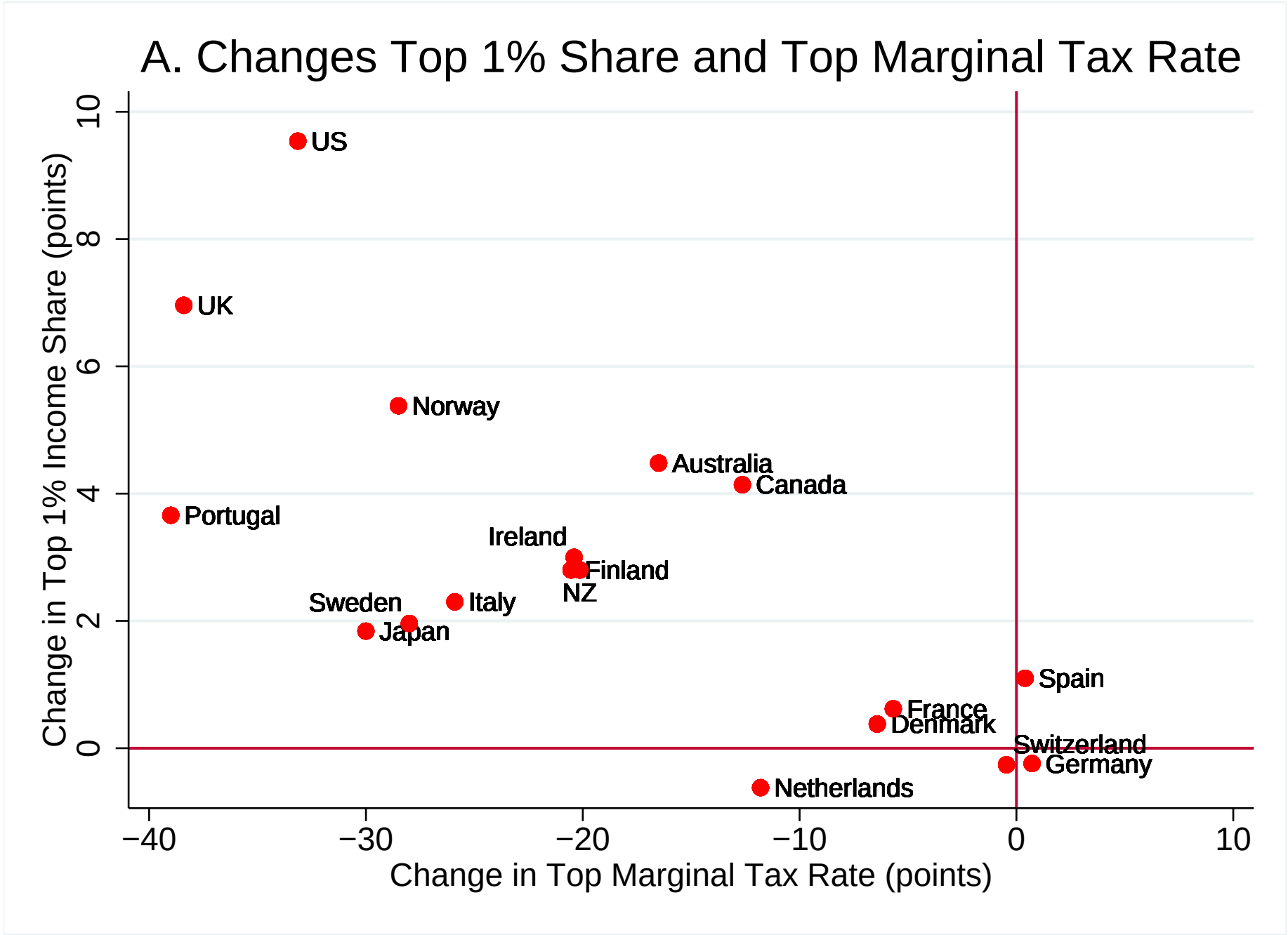
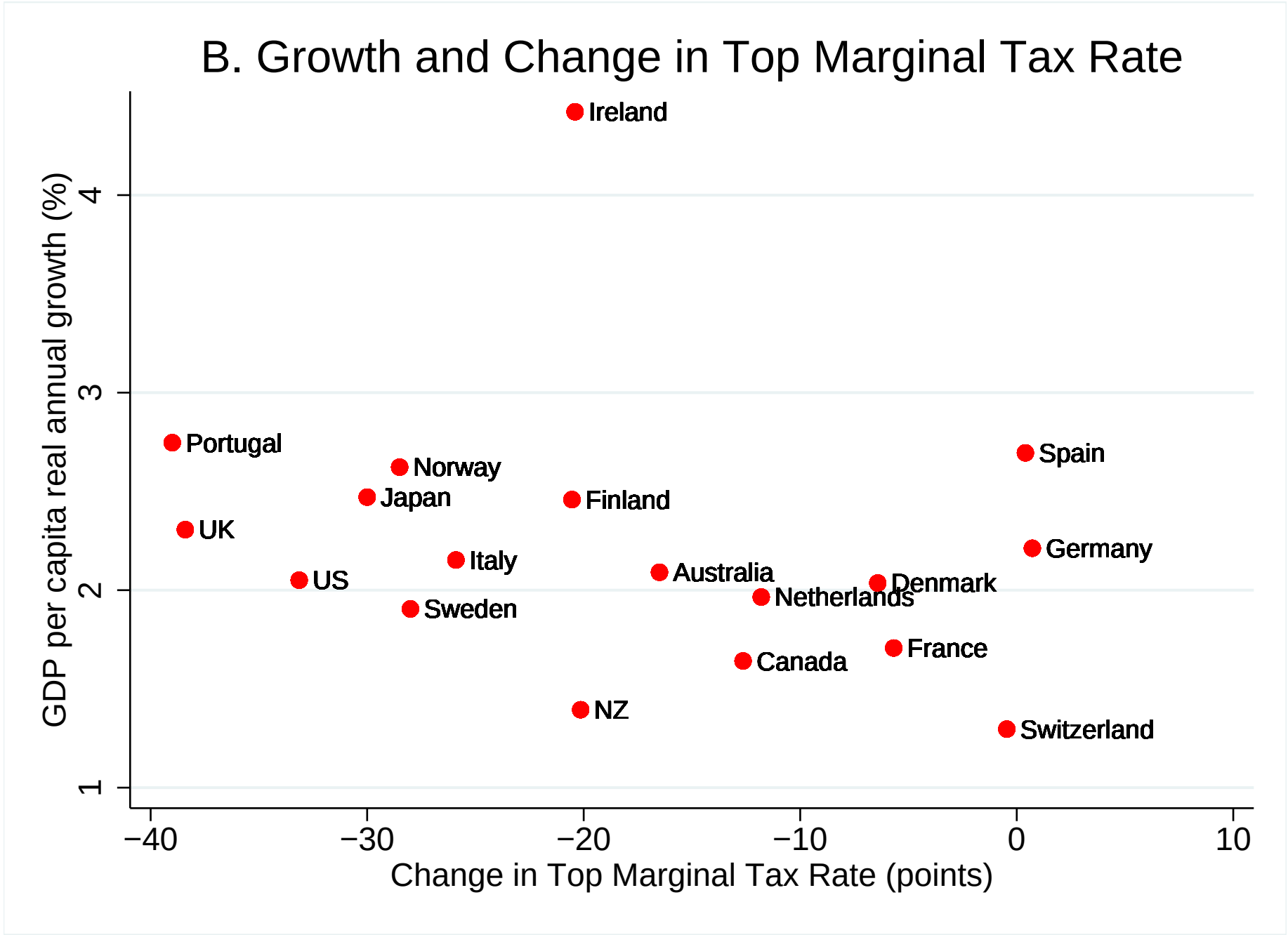
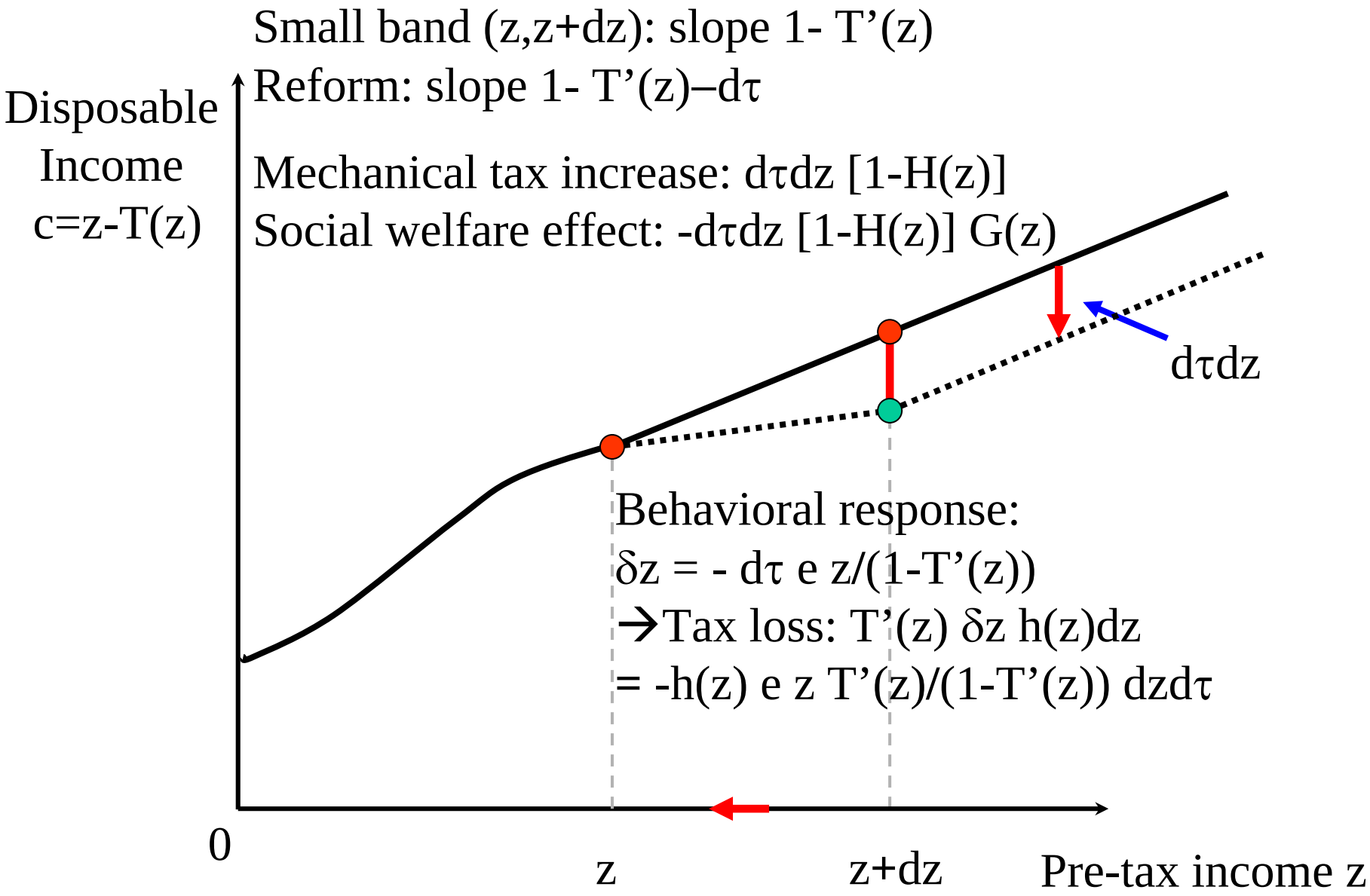


Source: Piketty, Saez, and Stantcheva NBER'11



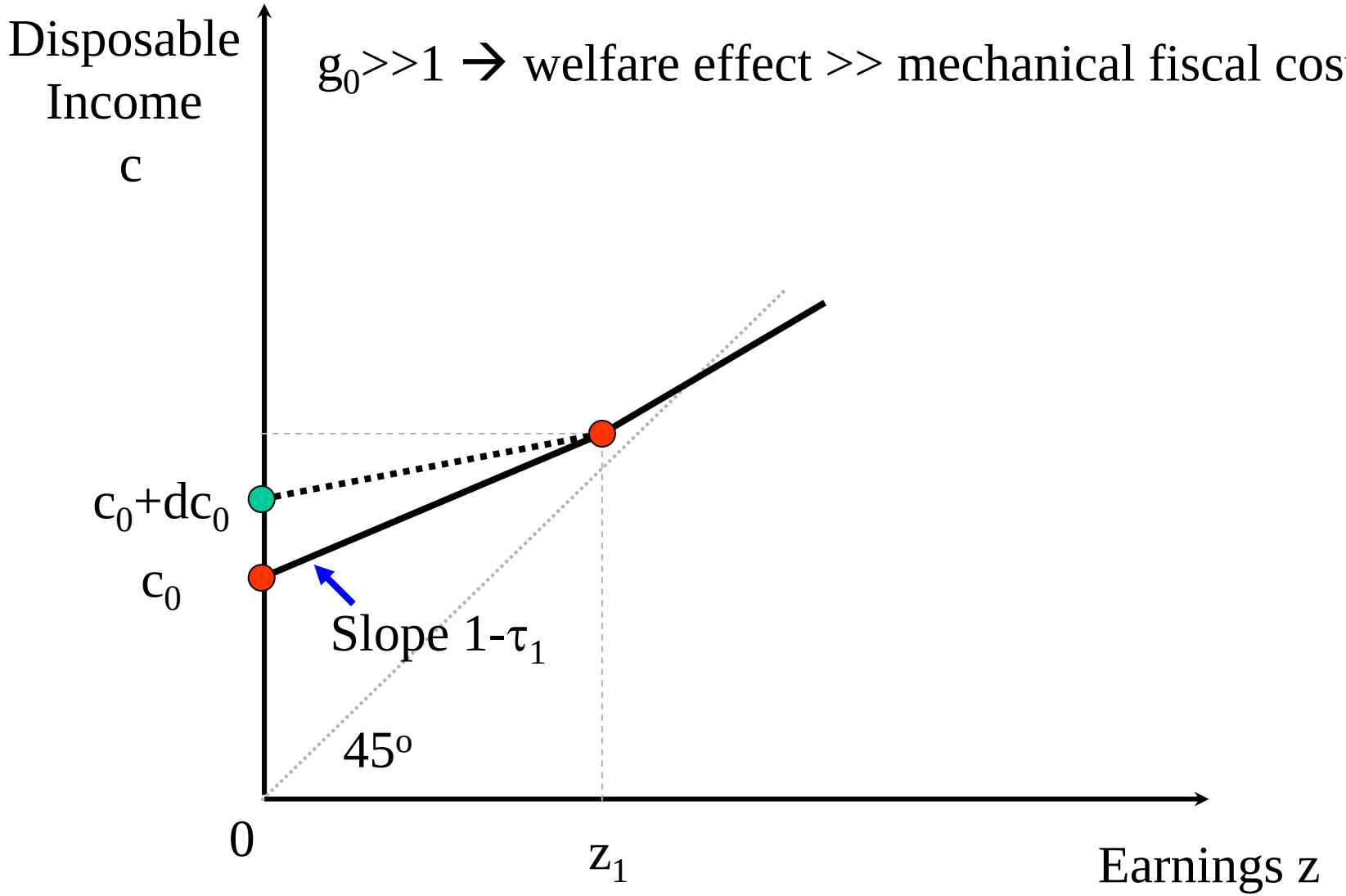
Source: Piketty, Saez, and Stantcheva NBER'11



Source: Diamond and Saez JEP'11

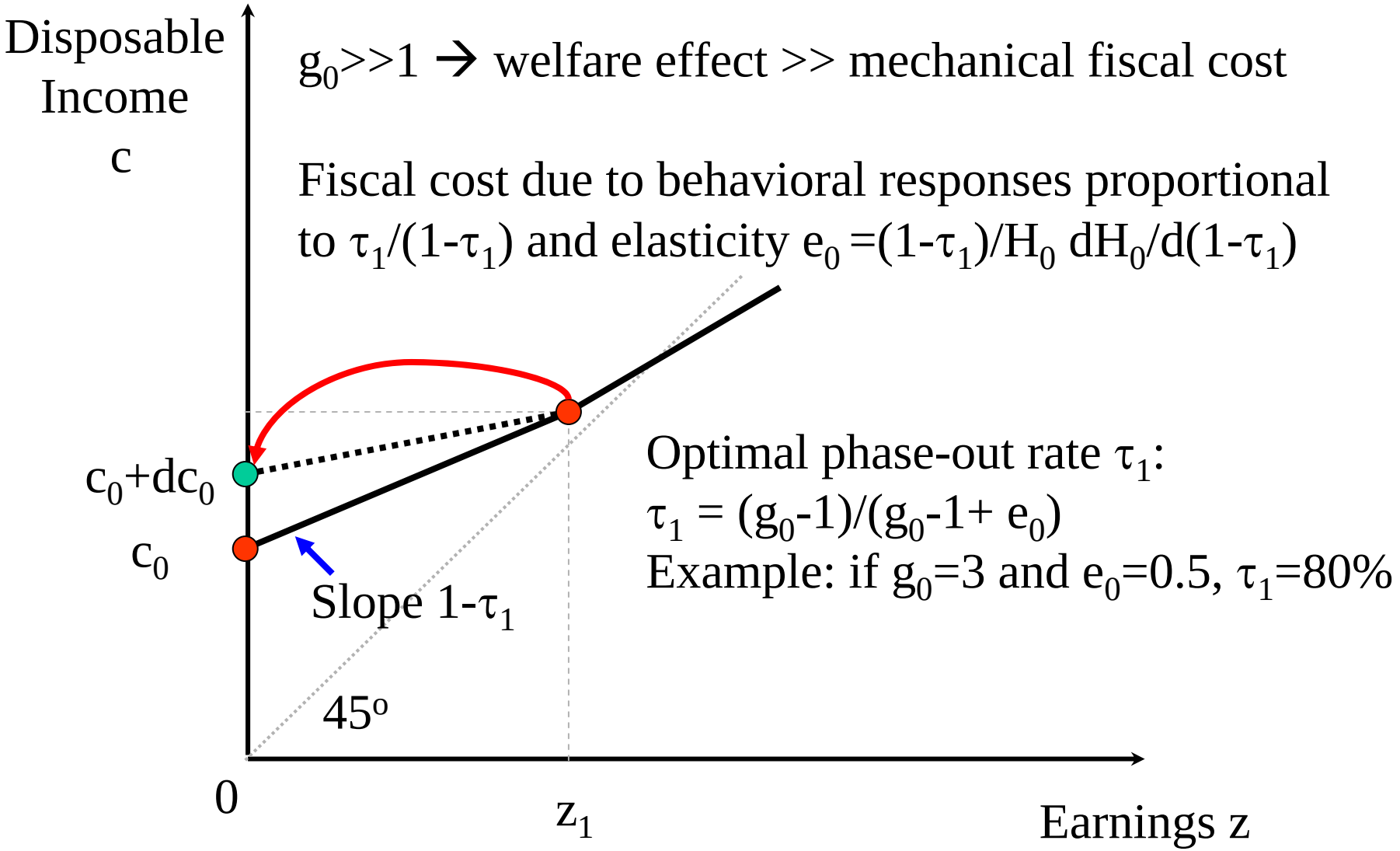
Reform: Increase τ_1 by $d\tau_1$ and c_0 by $dc_0=z_1 d\tau_1$

$g_0>>1$ → welfare effect >> mechanical fiscal cost



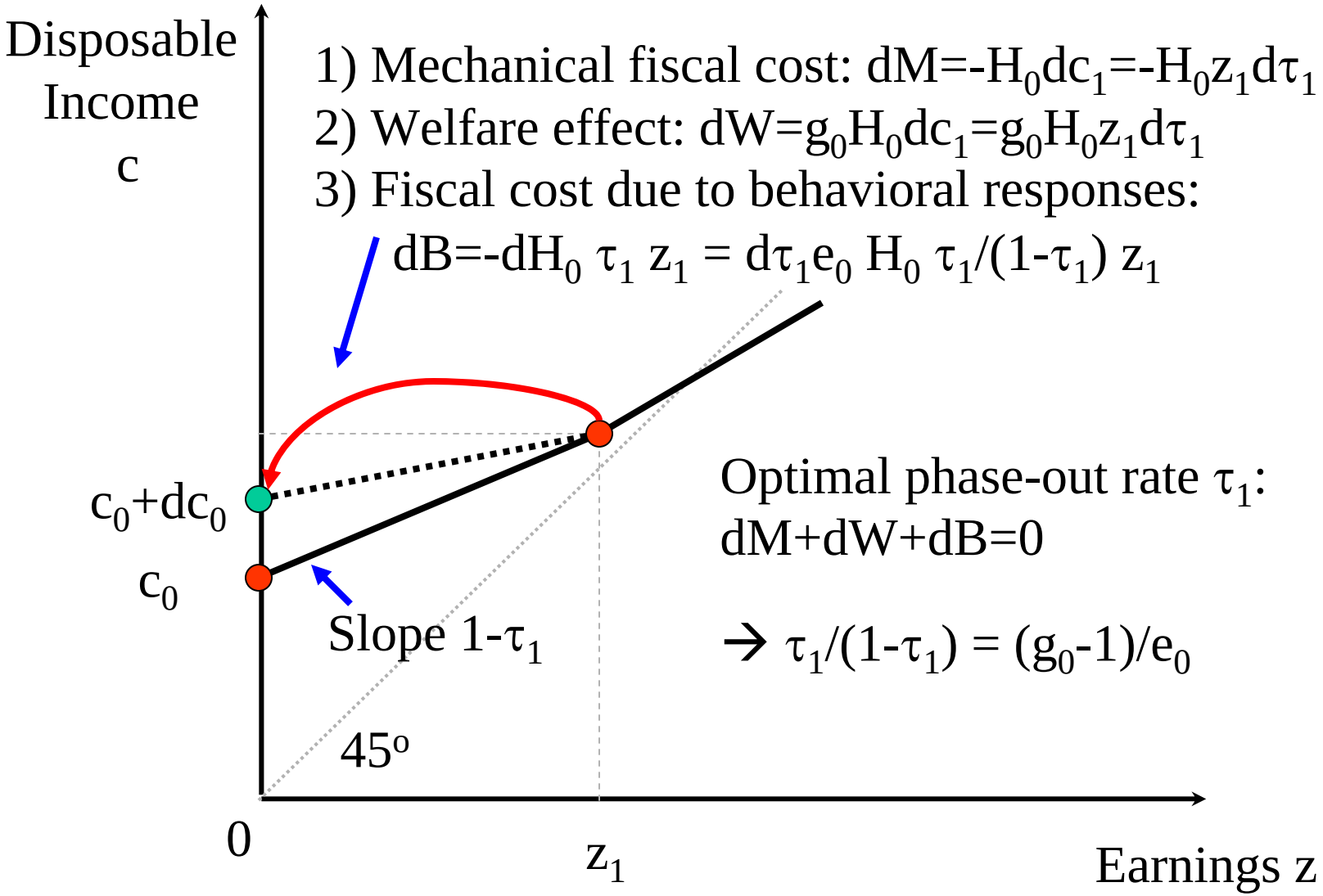
Source: Diamond and Saez JEP'11

Reform: Increase τ_1 by $d\tau_1$ and c_0 by $dc_0=z_1 d\tau_1$



Source: Diamond and Saez JEP'11

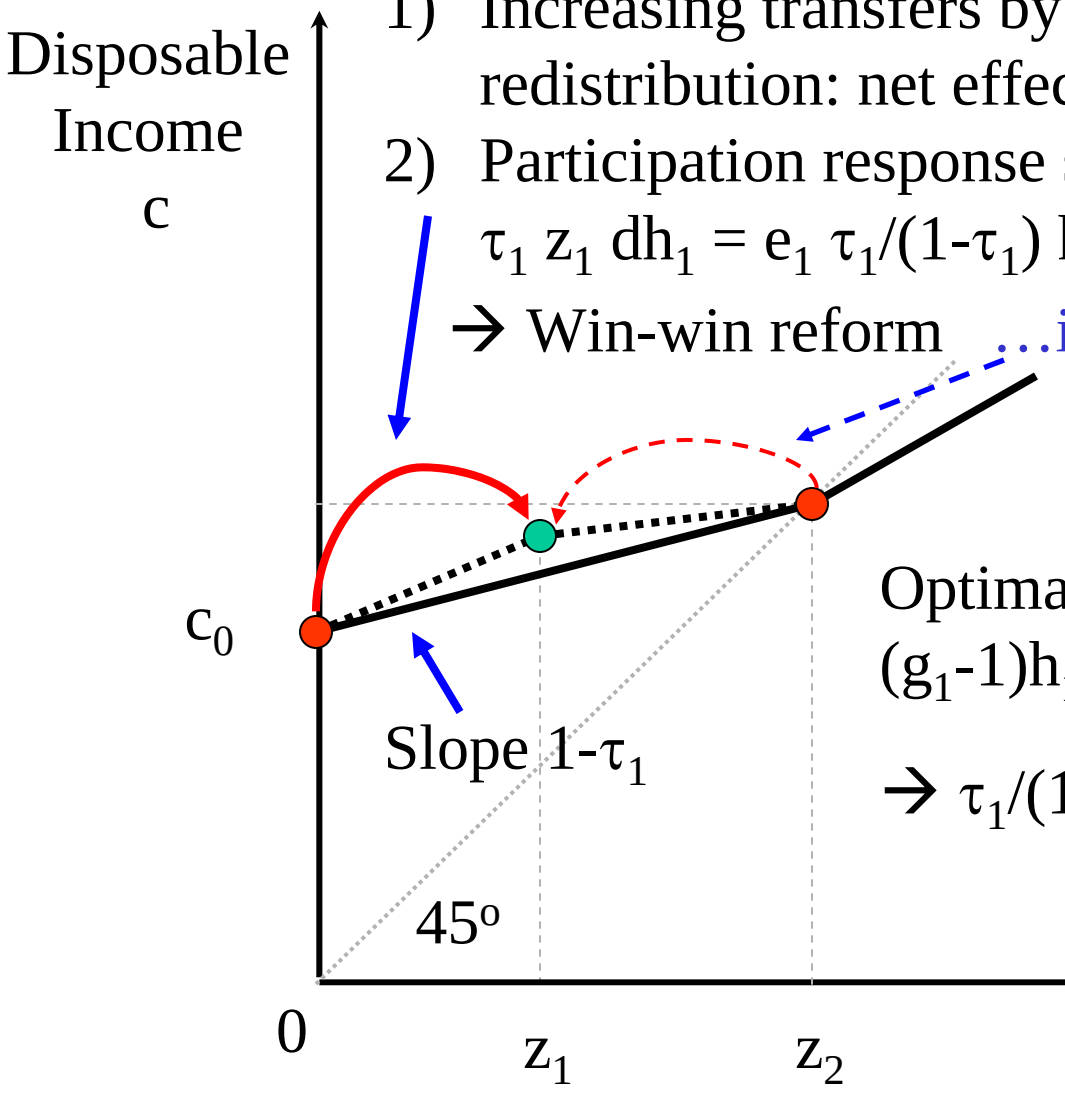
Reform: Increase τ_1 by $d\tau_1$ and c_0 by $dc_0=z_1 d\tau_1$



Starting from a positive phasing-out rate $\tau_1>0$:

1) Increasing transfers by dc_1 at z_1 is desirable for redistribution: net effect $(g_1-1)h_1\, dc_1> 0$ if $g_1>1$
2) Participation response saves government revenue $\tau_1\, z_1\, dh_1 = e_1\, \tau_1/(1-\tau_1)\, h_1\, dc_1>0$

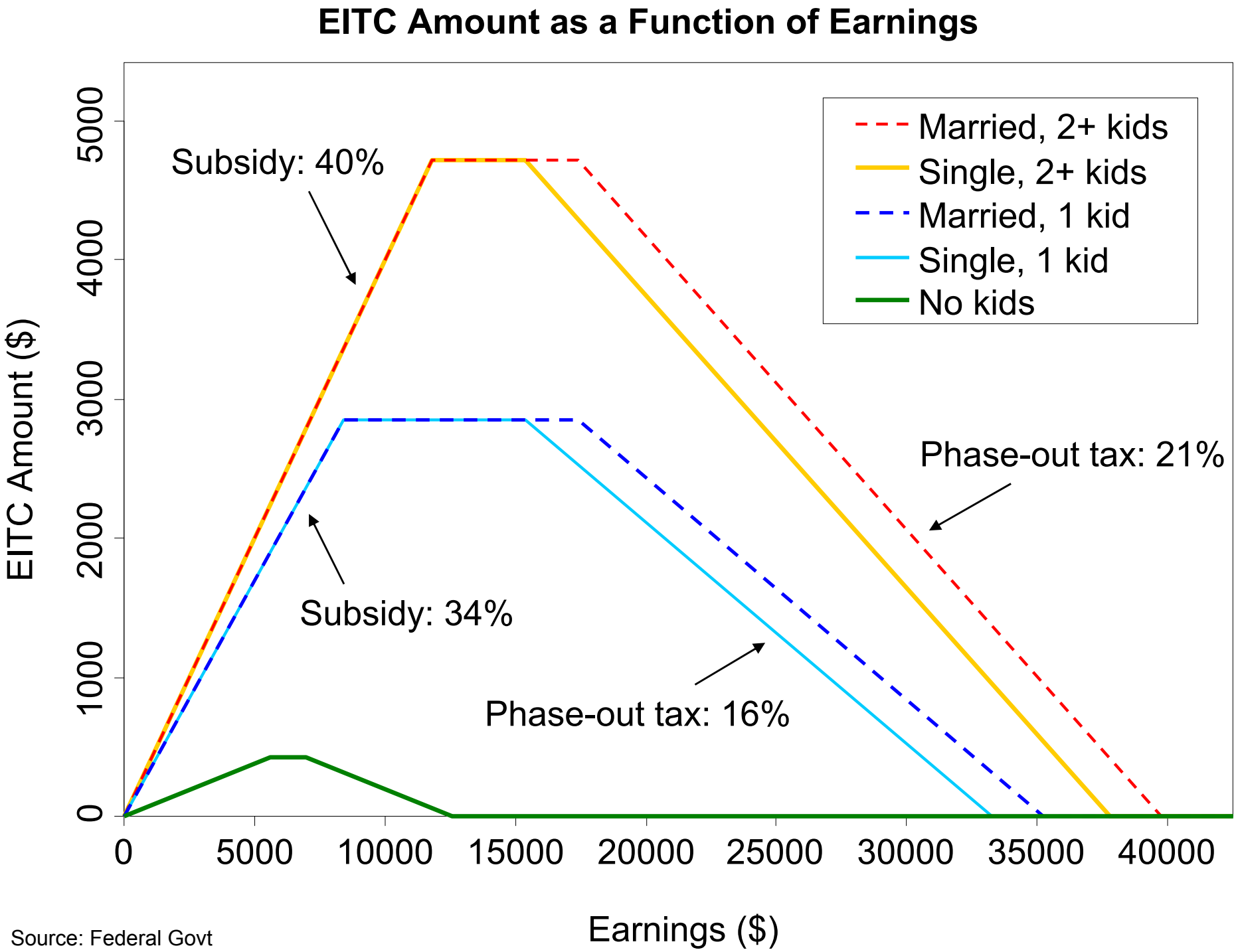
→ Win-win reform …if intensive response is small



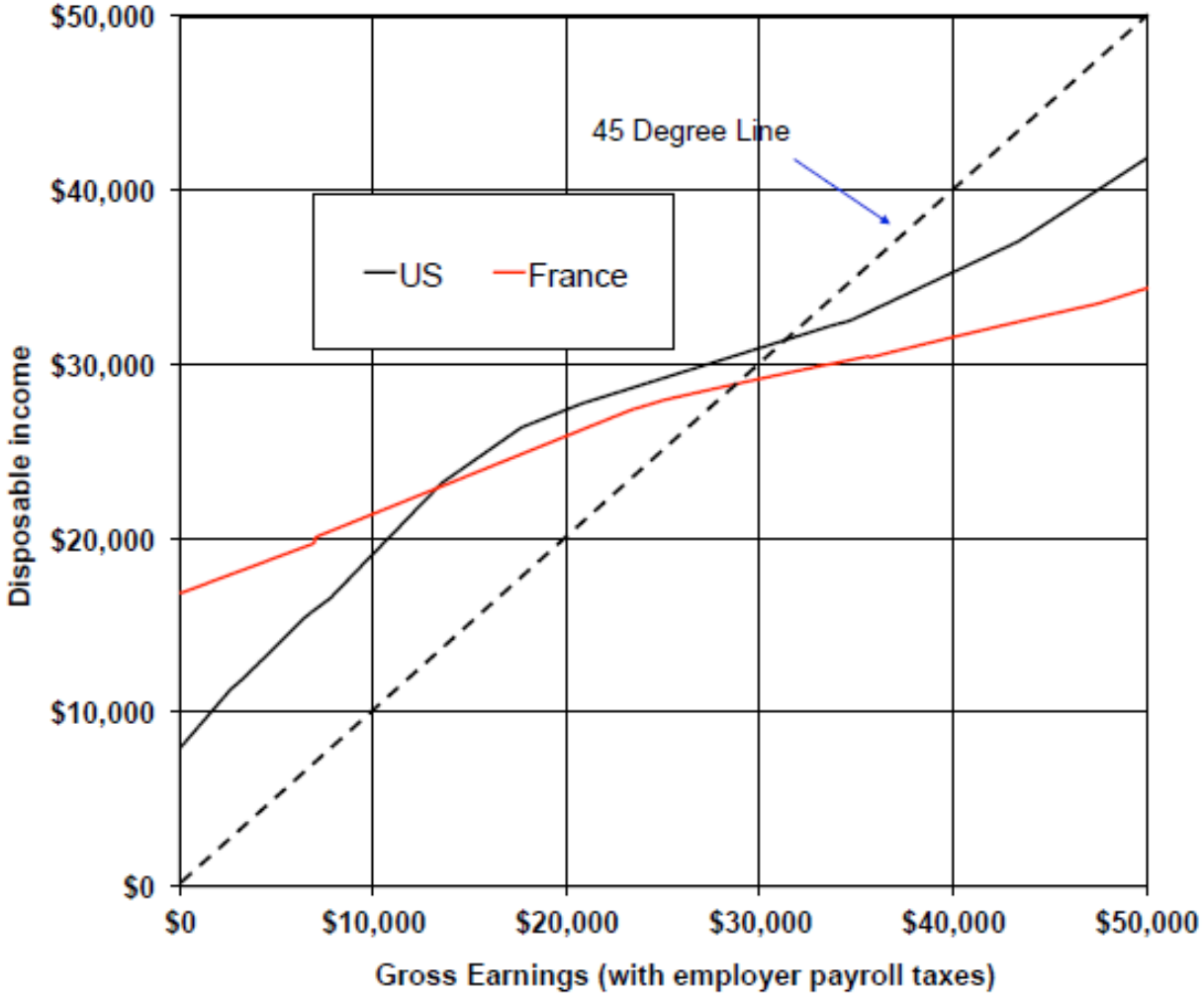
Optimal phase-out rate τ_1:

$(g_1-1)h_1\, dc_1 + e_1\, \tau_1/(1-\tau_1)\, h_1\, dc_1= 0$

→ $\tau_1/(1-\tau_1) = (1-g_1)/e_1 < 0$ if $g_1>1$



Source: Federal Govt



Source: Piketty, Thomas, and Emmanuel Saez (2012)

Table 2: Equality of Opportunity vs. Utilitarian Optimal Tax Rates

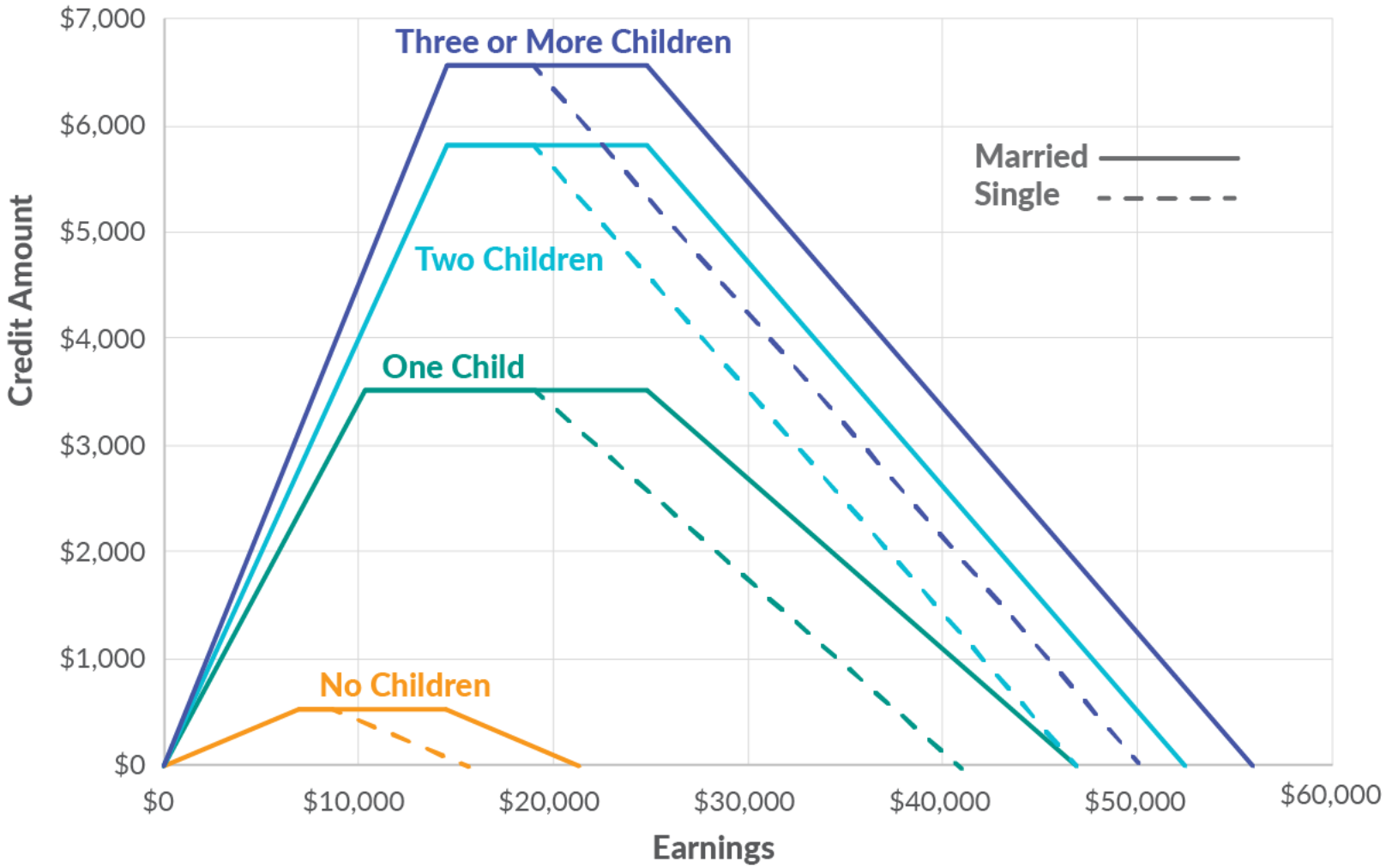
	Equality of Opportunity			Utilitarian (log-utility)	
	Fraction from low background (=parents below median) above each percentile	Implied social welfare weight G(z) above each percentile	Implied optimal marginal tax rate at each percentile	Utilitarian social welfare weight G(z) above each percentile	Utilitarian optimal marginal tax rate at each percentile
	(1)	(2)	(3)	(4)	(5)
Income percentile					
z= 25th percentile	44.3%	0.886	53%	0.793	67%
z= 50th percentile	37.3%	0.746	45%	0.574	58%
z= 75th percentile	30.3%	0.606	40%	0.385	51%
z= 90th percentile	23.6%	0.472	34%	0.255	42%
z= 99th percentile	17.0%	0.340	46%	0.077	54%
z= 99.9th percentile	16.5%	0.330	47%	0.016	56%

Notes: This table compares optimal marginal tax rates at various percentiles of the distribution (listed by row) using an equality of opportunity criterion (in column (3)) and a standard utilitarian criterion (in column (5)). Both columns use the optimal tax formula T'(z)=[1-G(z)]/[1-G(z)+α(z)*e] discussed in the text where G(z) is the average social marginal welfare weight above income level z, α(z)=(zh(z))/(1-H(z)) is the local Pareto parameter (with h(z) the density of income at z, and H(z) the cumulative distribution), and e the elasticity of reported income with respect to 1-T'(z). We assume e=0.5. We calibrate α(z) using the actual distribution of income based on 2008 income tax return data. For the equality of opportunity criterion, G(z) is the representation index of individuals with income above z who come from a disadvantaged background (defined as having a parent with income below the median). This representation index is estimated using the national intergenerational mobility statistics of Chetty et al. (2013) based on all US individuals born in 1980-1 with their income measured at age 30-31. For the utilitarian criterion, we assume a log-utility so that the social welfare weight g(z) at income level z is proportional to 1/(z-T(z)).

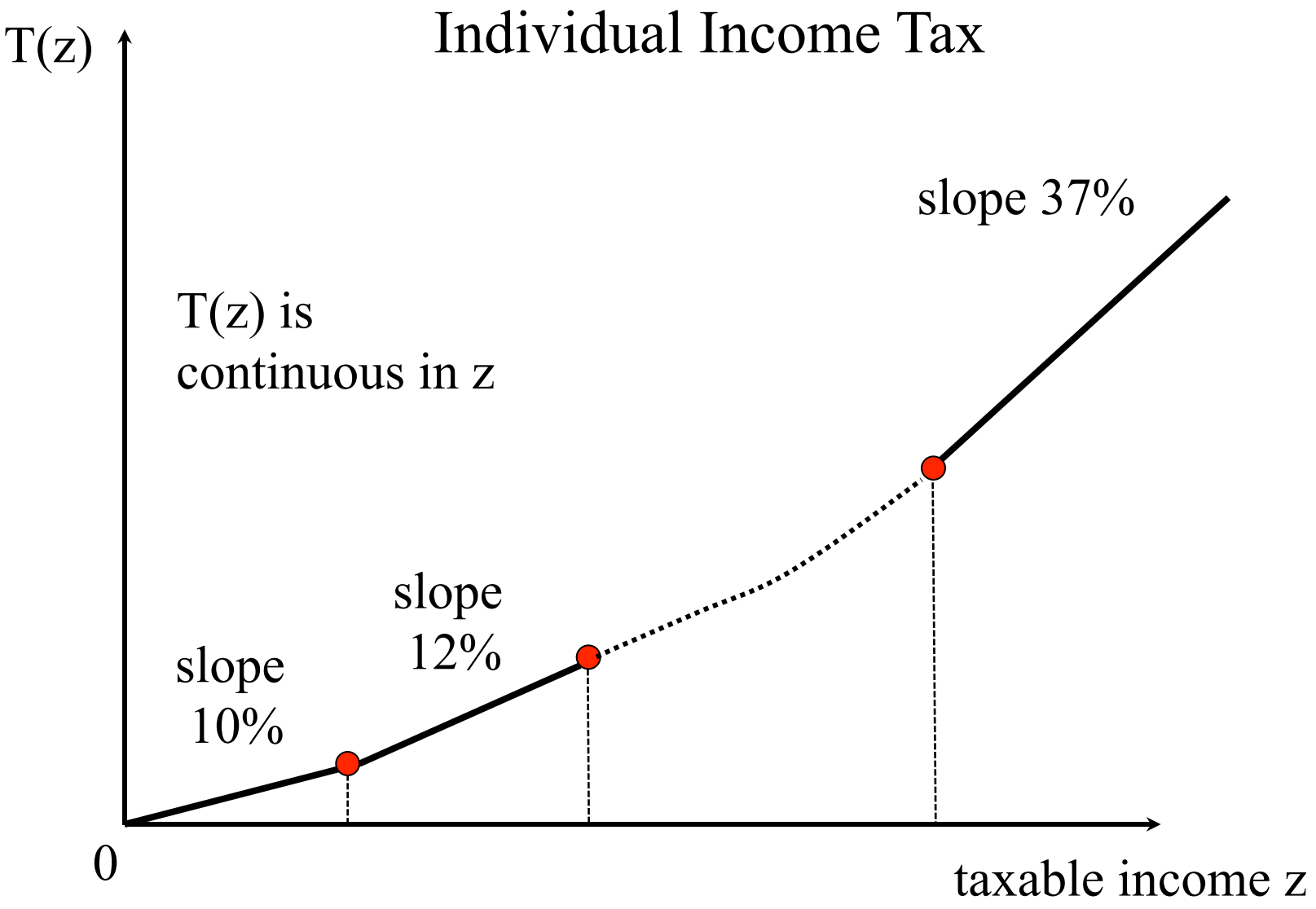
Source: Saez and Stantcheva (2014)

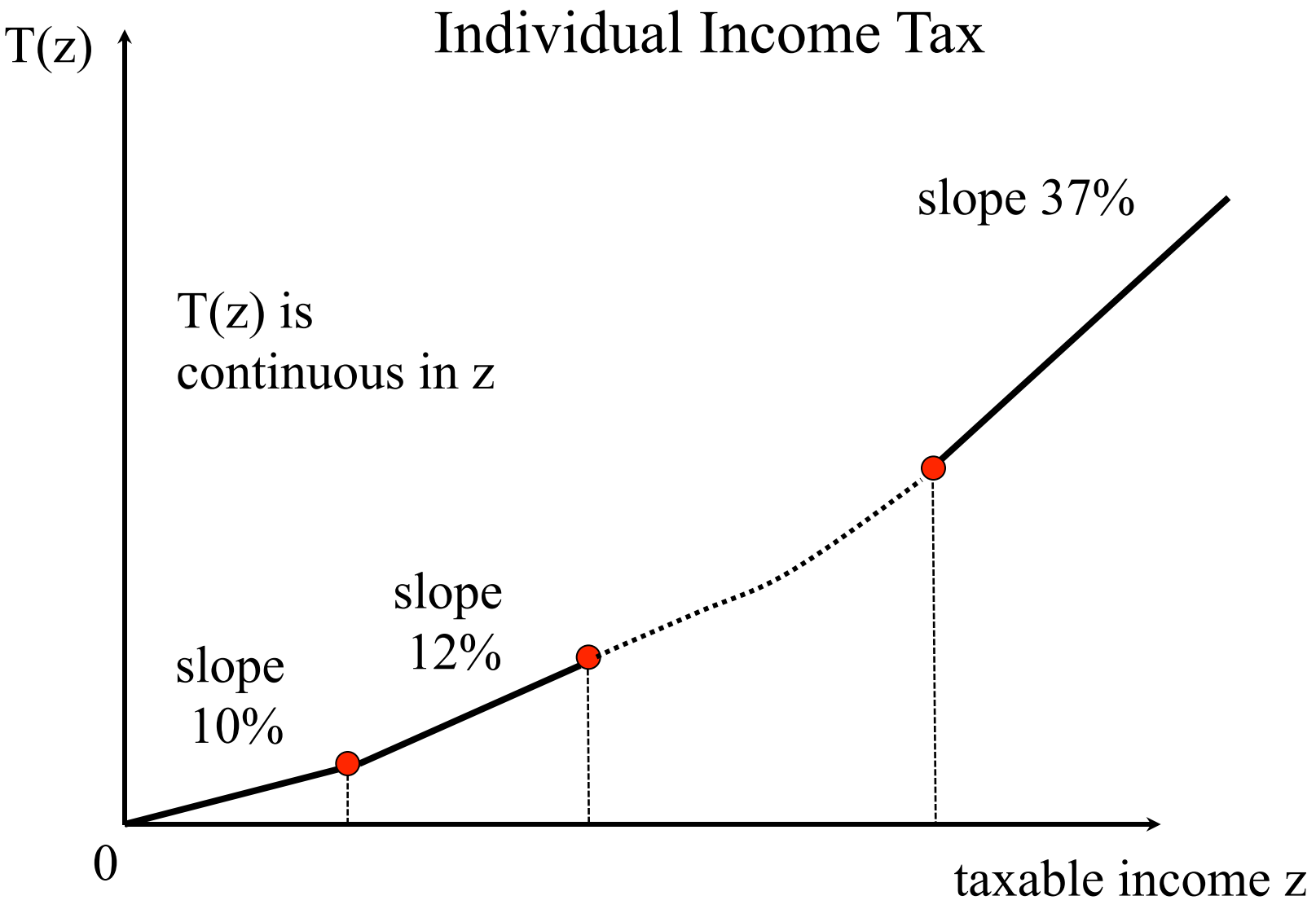
The Phase-In and Phaseout of the EITC

Credit Amount by Marital Status and Number of Children

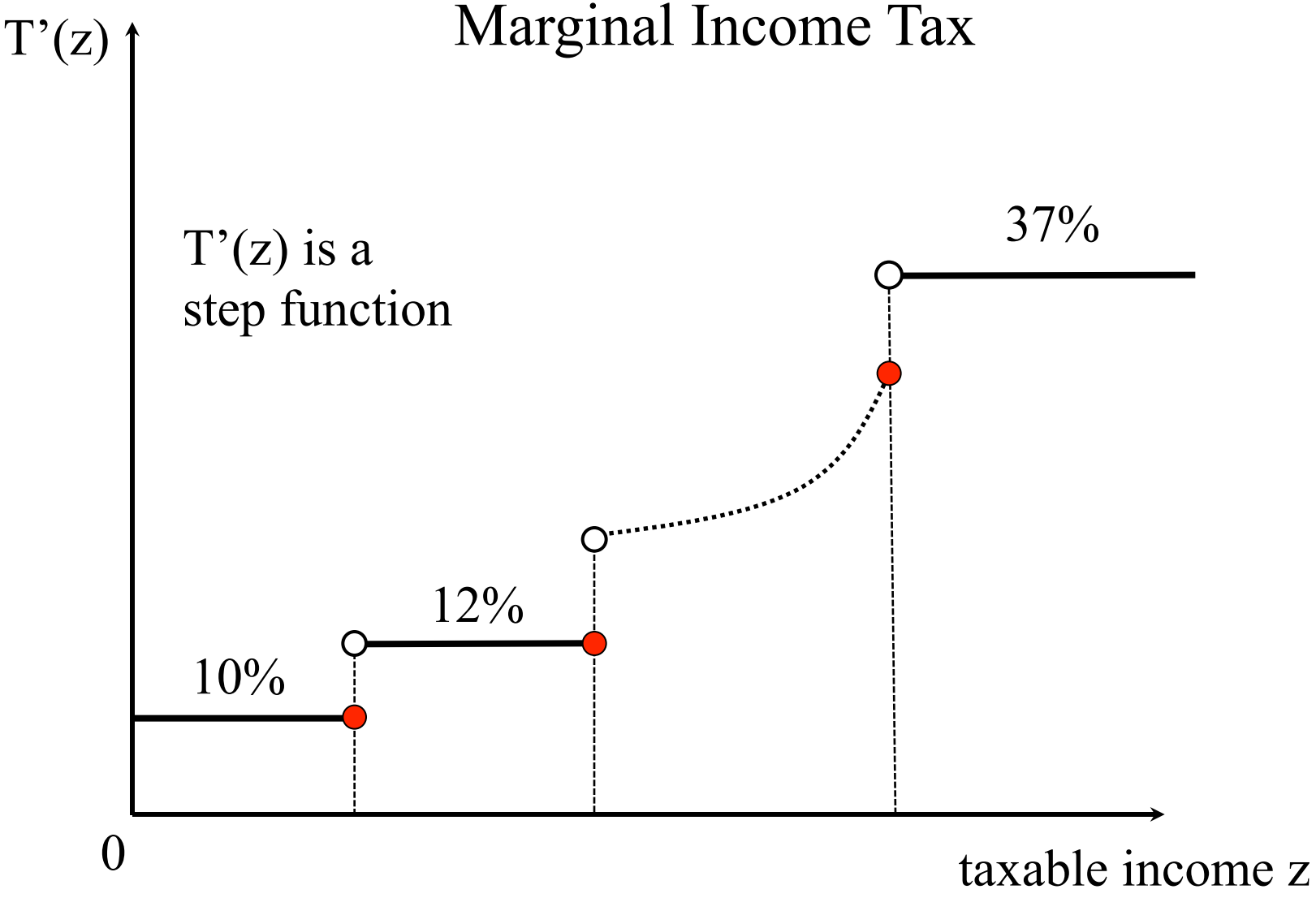


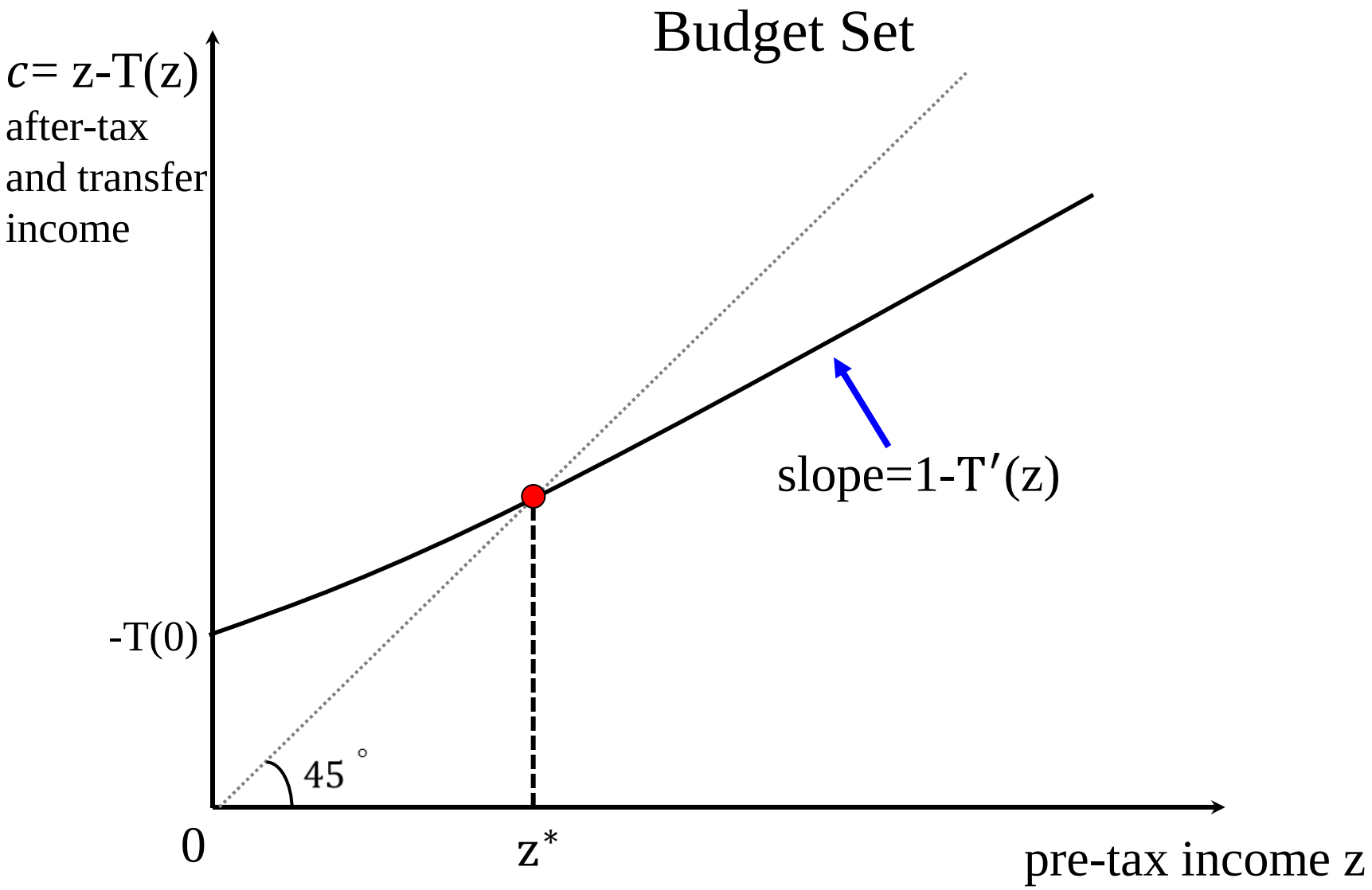
Source: Amir El-Sibaie, "2019 Tax Brackets," Tax Foundation, Nov. 28, 2018.

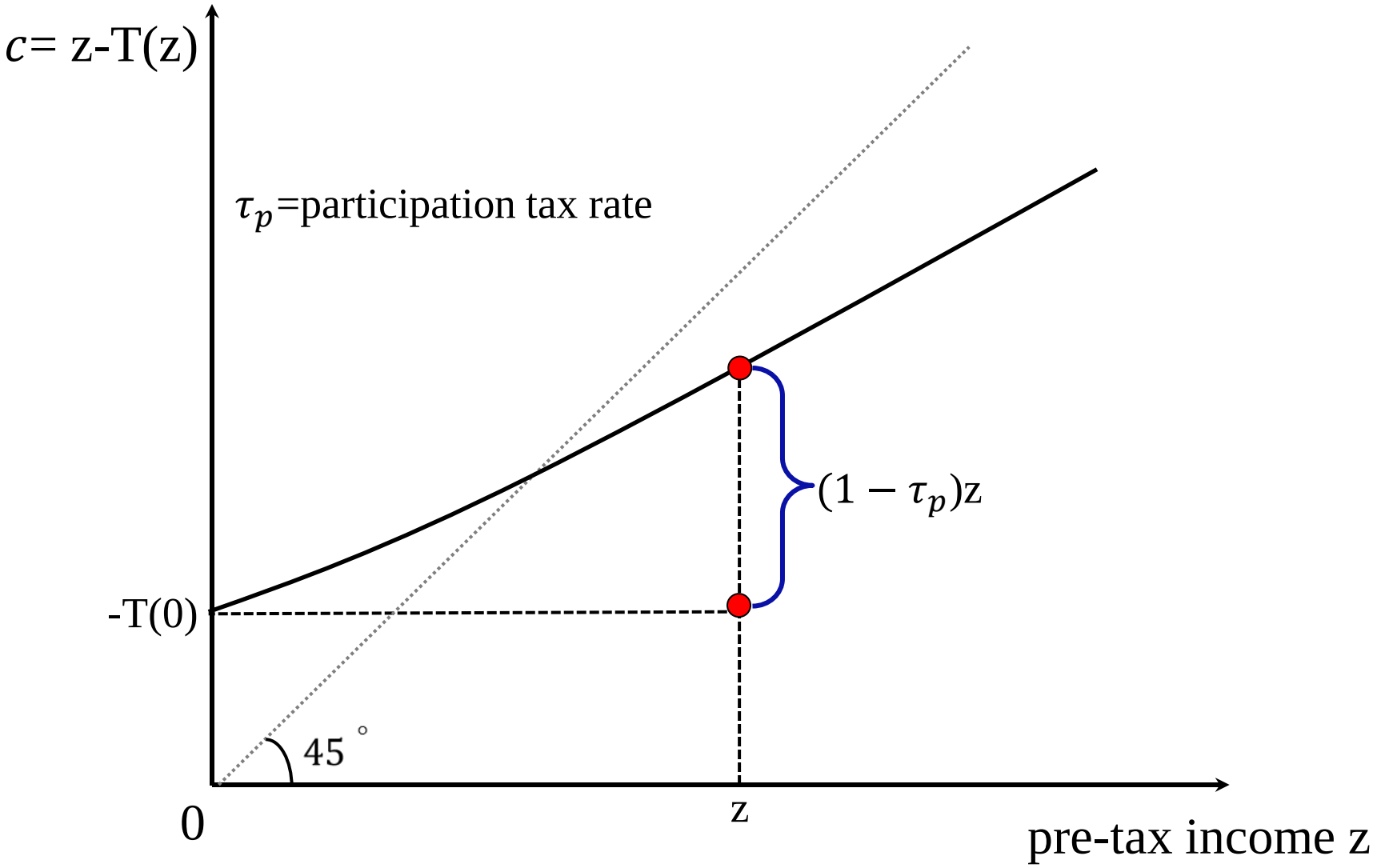

Individual Income Tax
T(z)
slope 37%
T(z) is
continuous in z
slope
12%
slope
10%
0
taxable income z

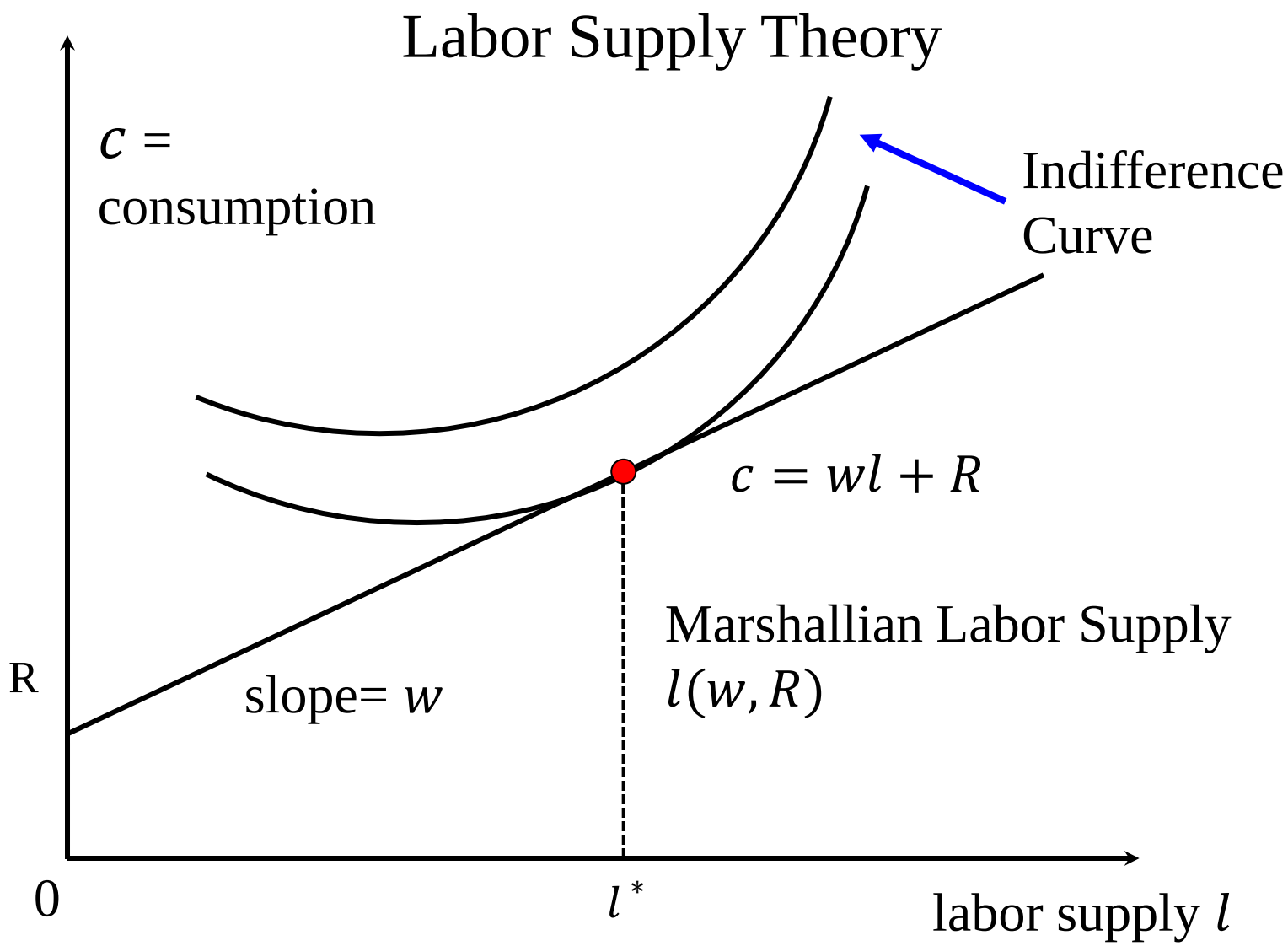

Individual Income Tax
T(z)
slope 37%
T(z) is
continuous in z
slope
12%
slope
10%
0
taxable income z

Marginal Income Tax

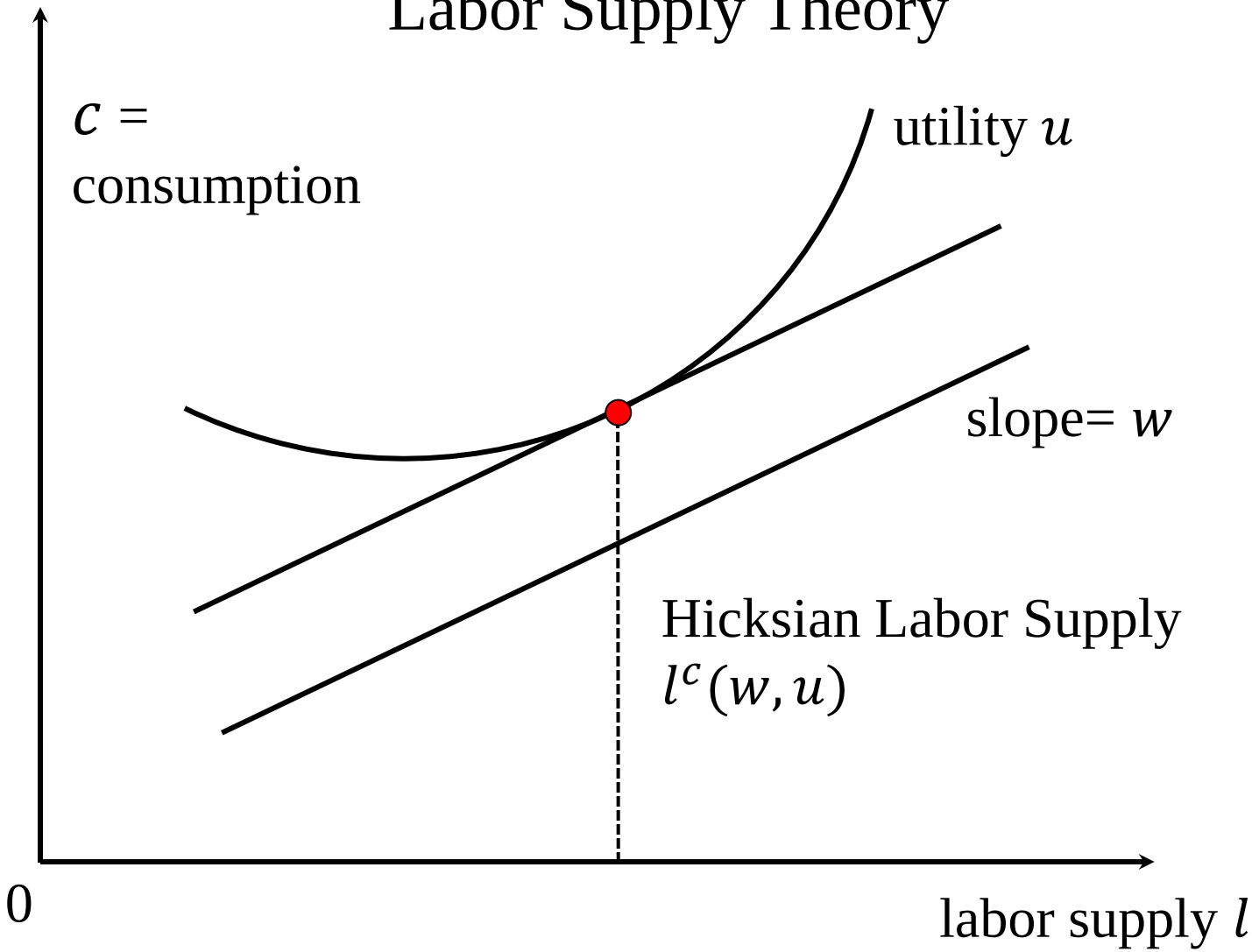


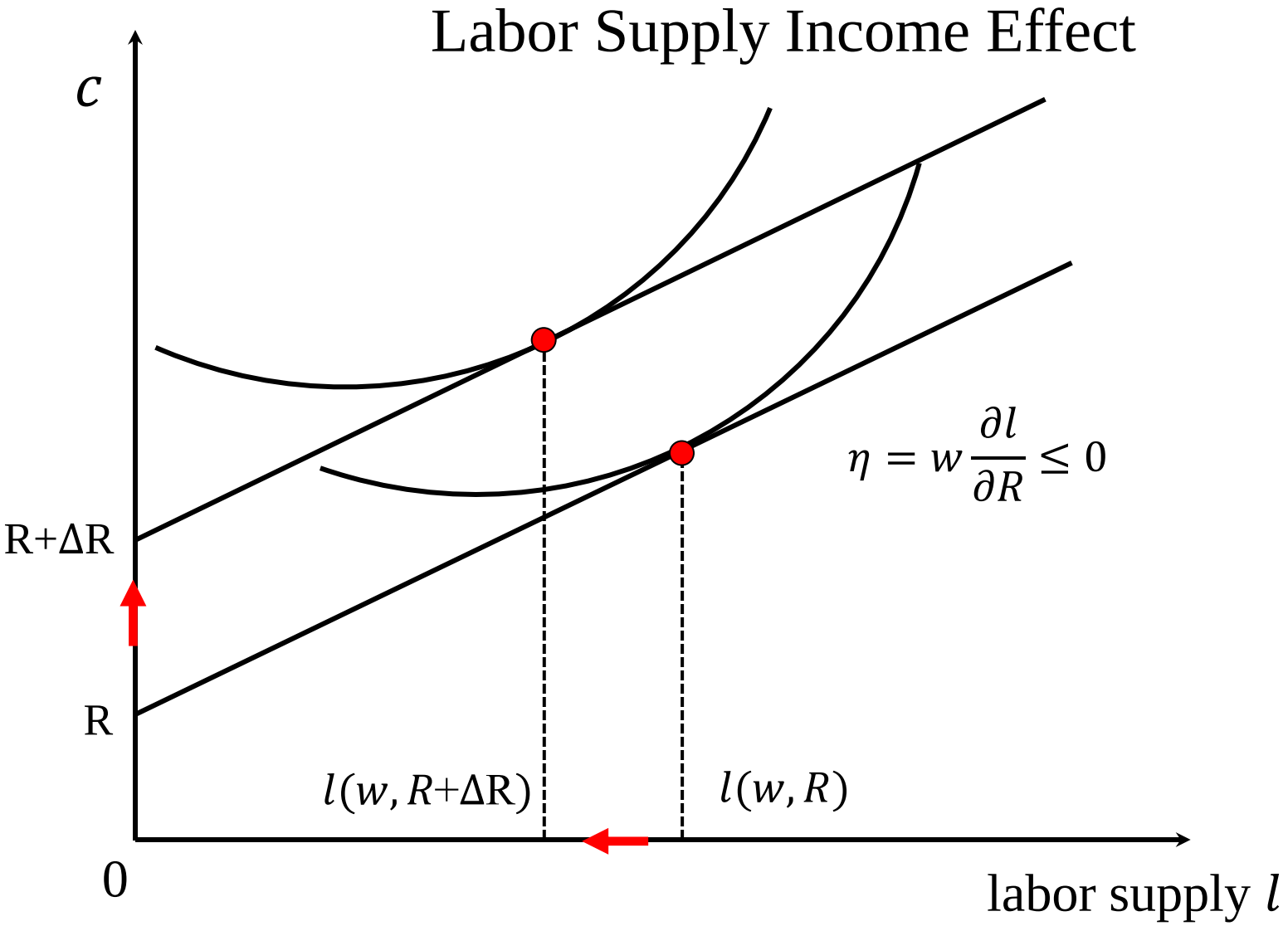

Budget Set
c= z-T(z)
after-tax
and transfer
income
slope=1-T′(z)
-T(0)
45 °
0
z*
pre-tax income z

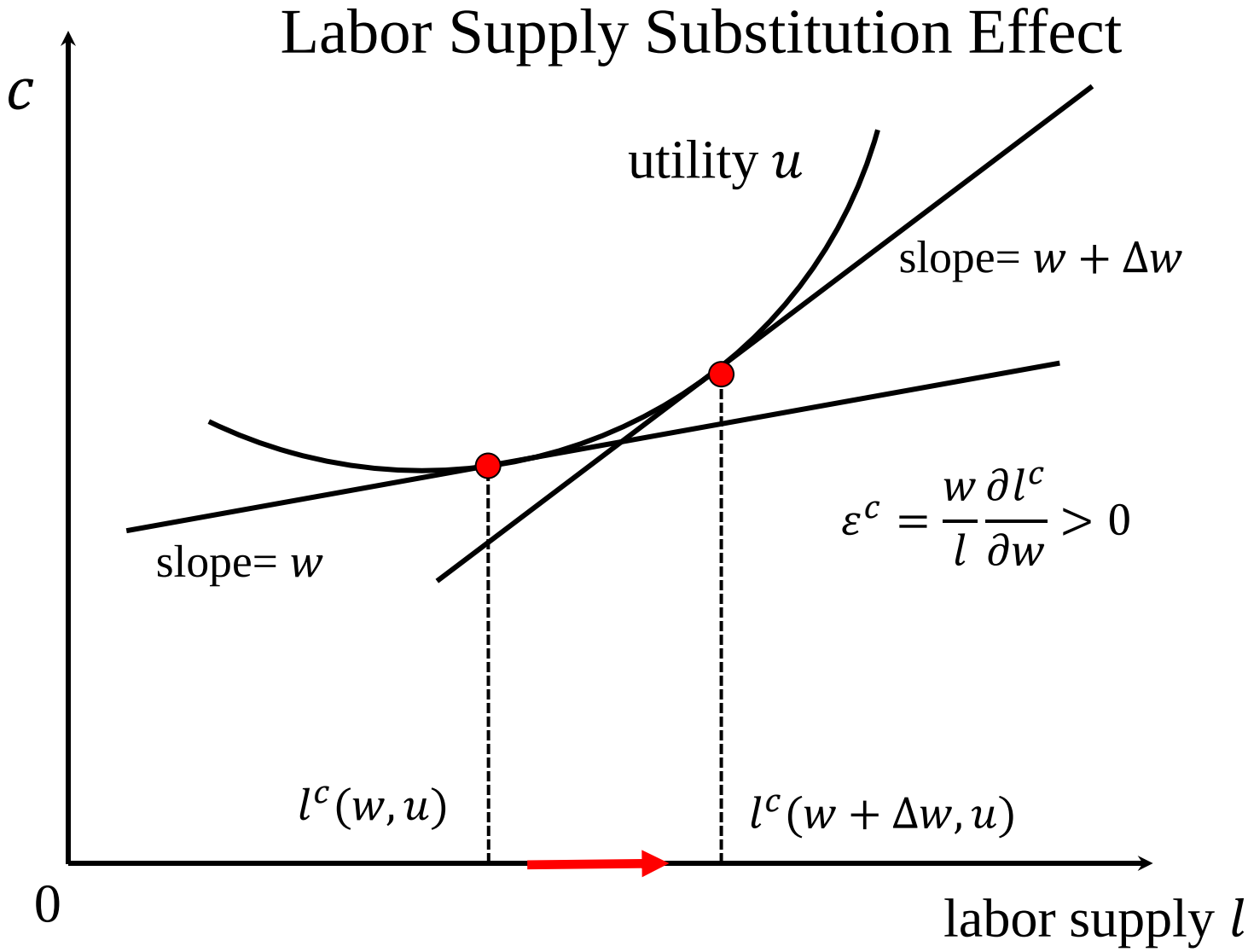

c= z-T(z)
τ_p=participation tax rate
$(1-\tau_p)$z
-T(0)
45°
0
z
pre-tax income z

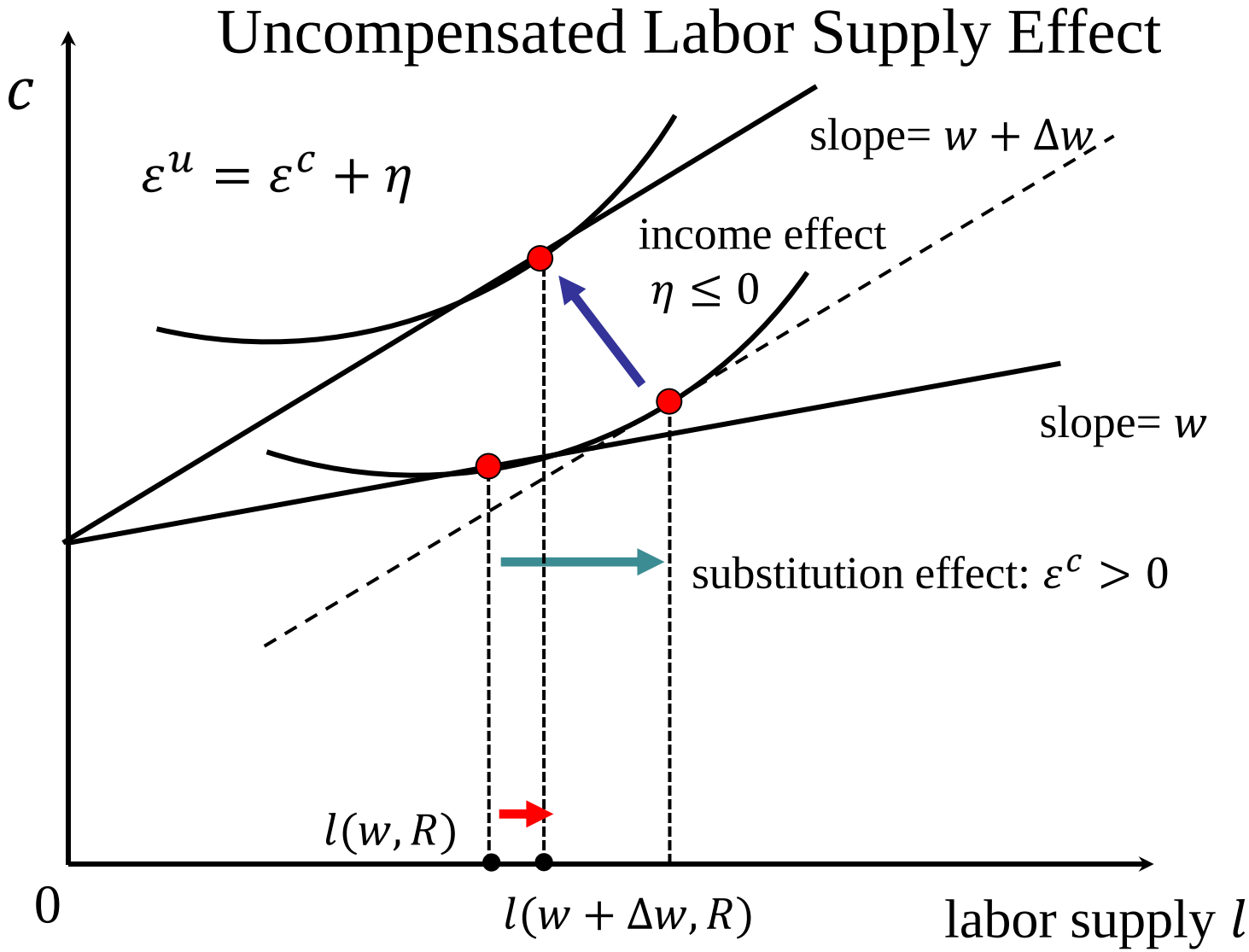

Labor Supply Theory
c =
consumption
Indifference
Curve
$c = wl + R$
Marshallian Labor Supply
$l(w, R)$
R
slope= w
0
l^*
labor supply l

Labor Supply Theory

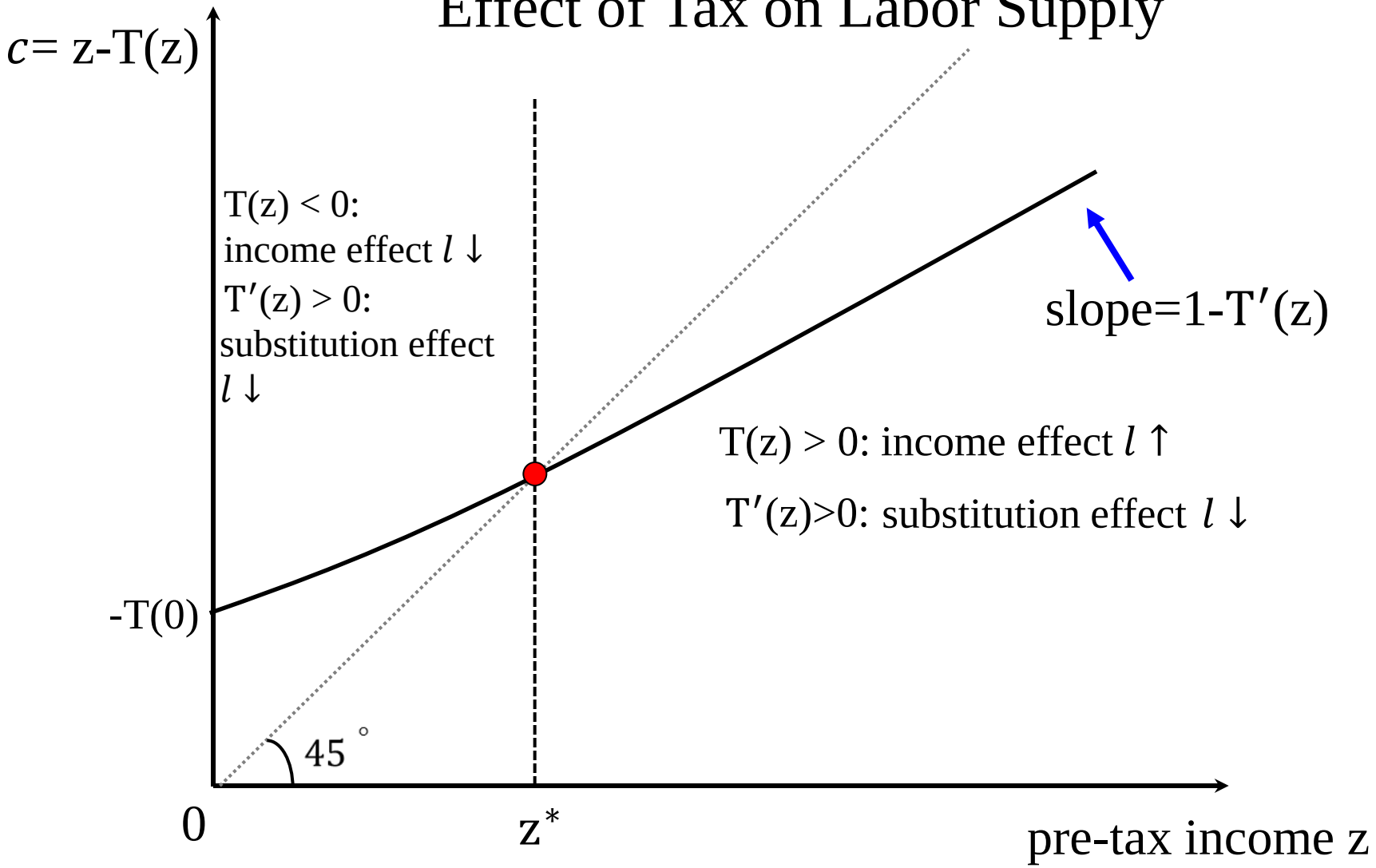



Labor Supply Income Effect
c
R+ΔR
R
0
$l(w, R+\Delta R)$
$l(w, R)$
$\eta = w\frac{\partial l}{\partial R} \leq 0$
labor supply l

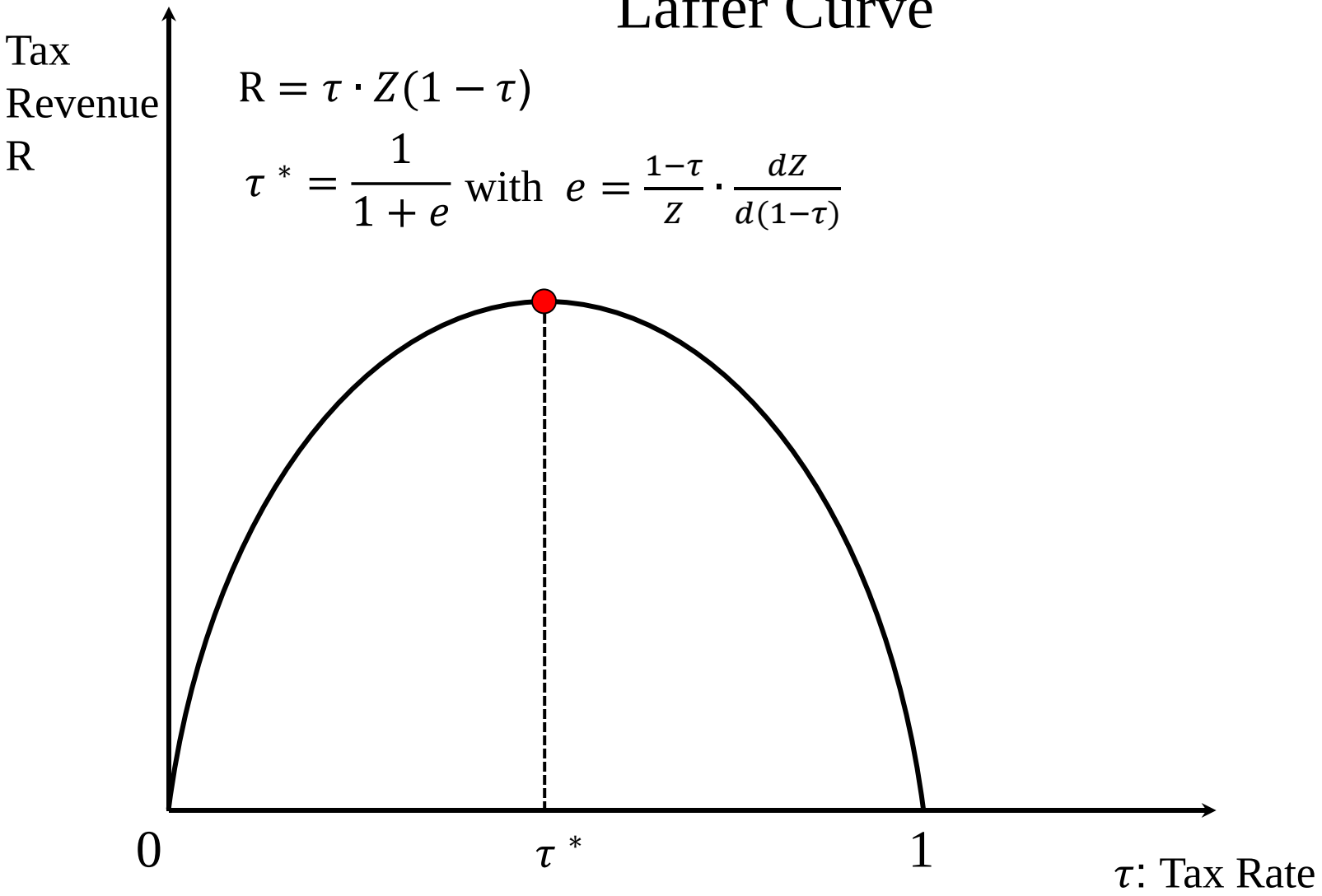

Labor Supply Substitution Effect
c
utility u
slope= $w + \Delta w$
slope= w
$\varepsilon^c = \frac{w}{l}\frac{\partial l^c}{\partial w} > 0$
$l^c(w, u)$
$l^c(w + \Delta w, u)$
0
labor supply l


Uncompensated Labor Supply Effect
c
$\varepsilon^u = \varepsilon^c + \eta$
slope= $w + \Delta w$
income effect
$\eta \leq 0$
slope= w
substitution effect: $\varepsilon^c > 0$
$l(w, R)$
0
$l(w + \Delta w, R)$
labor supply l

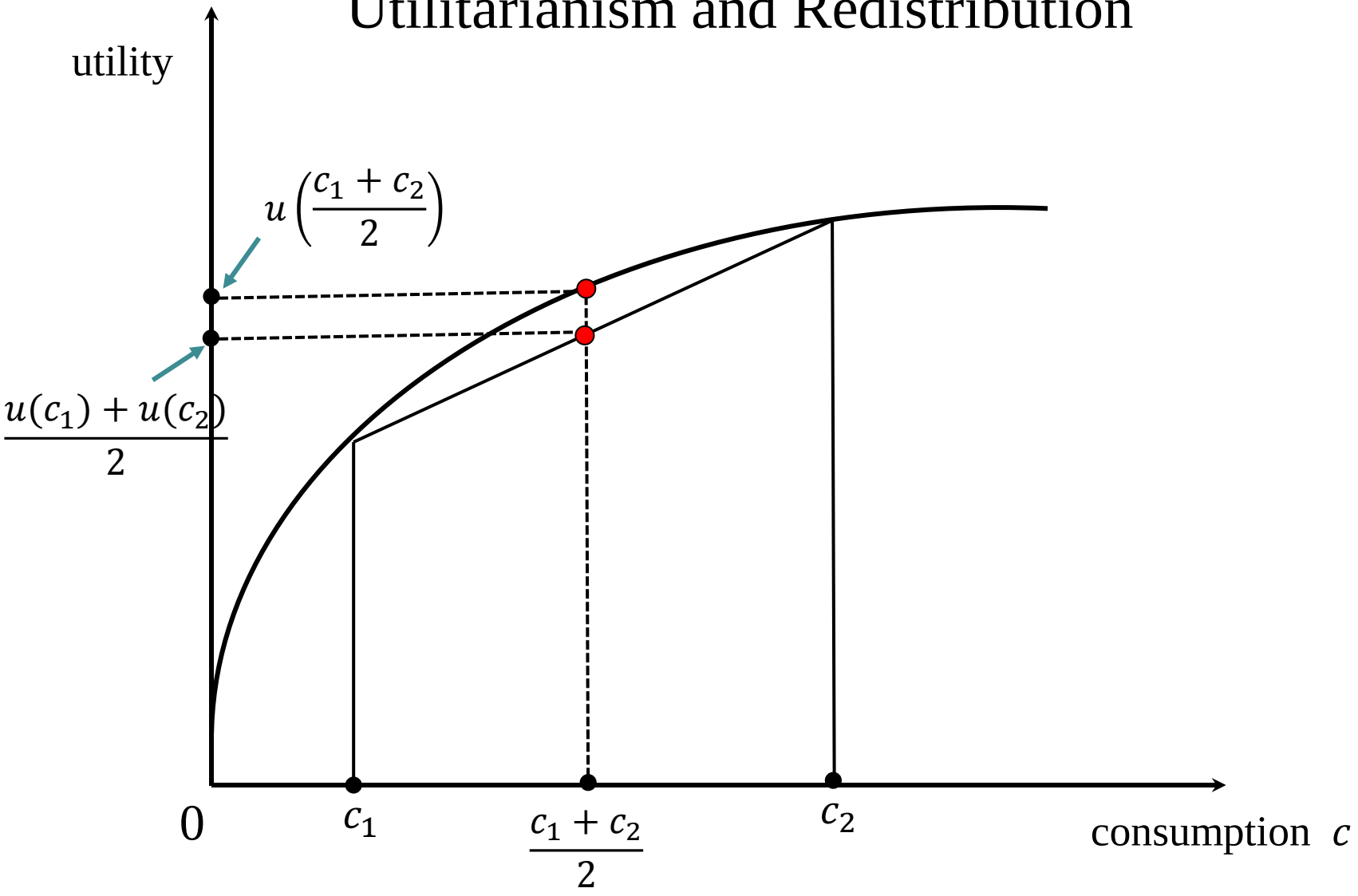
Effect of Tax on Labor Supply

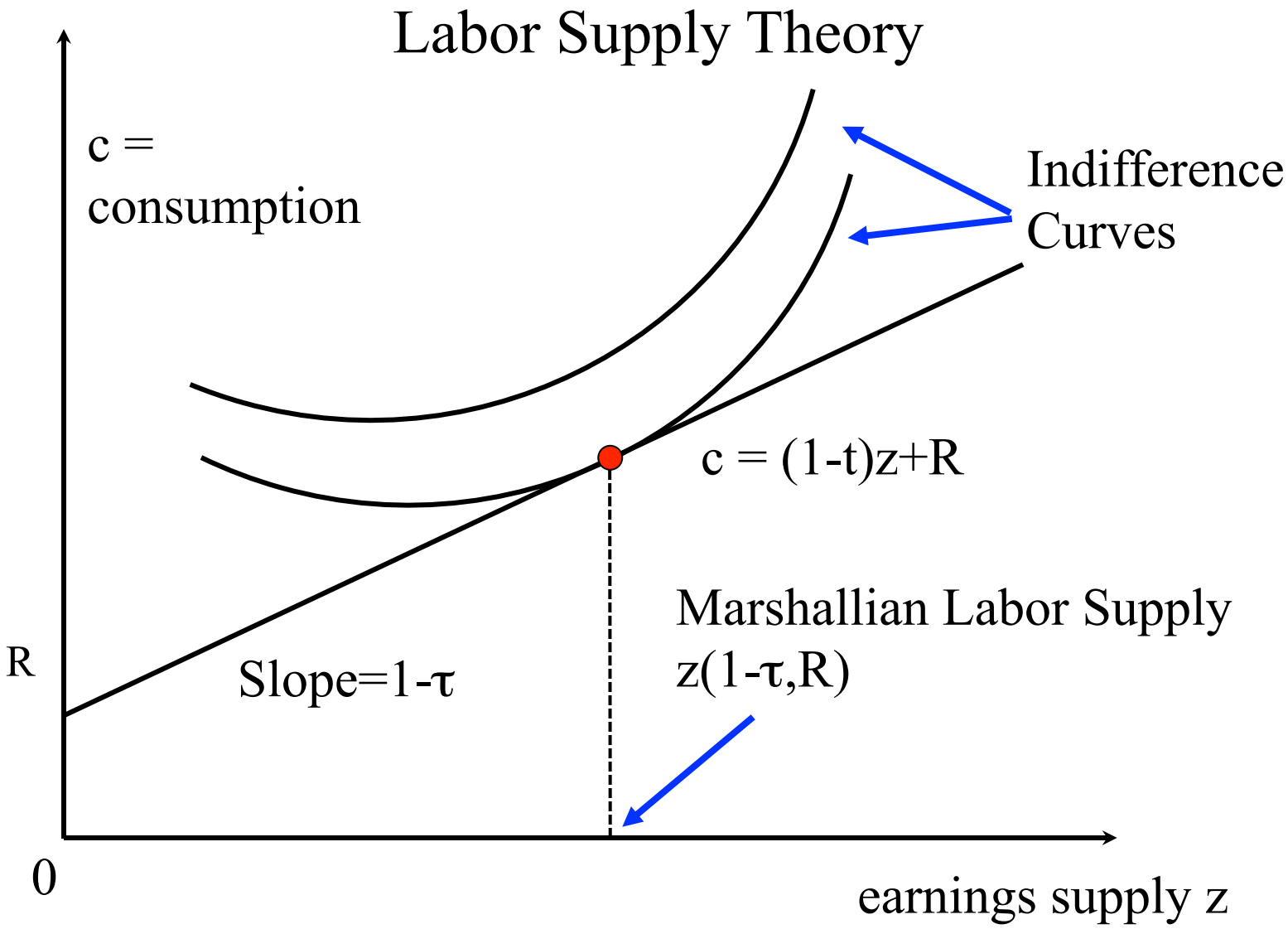


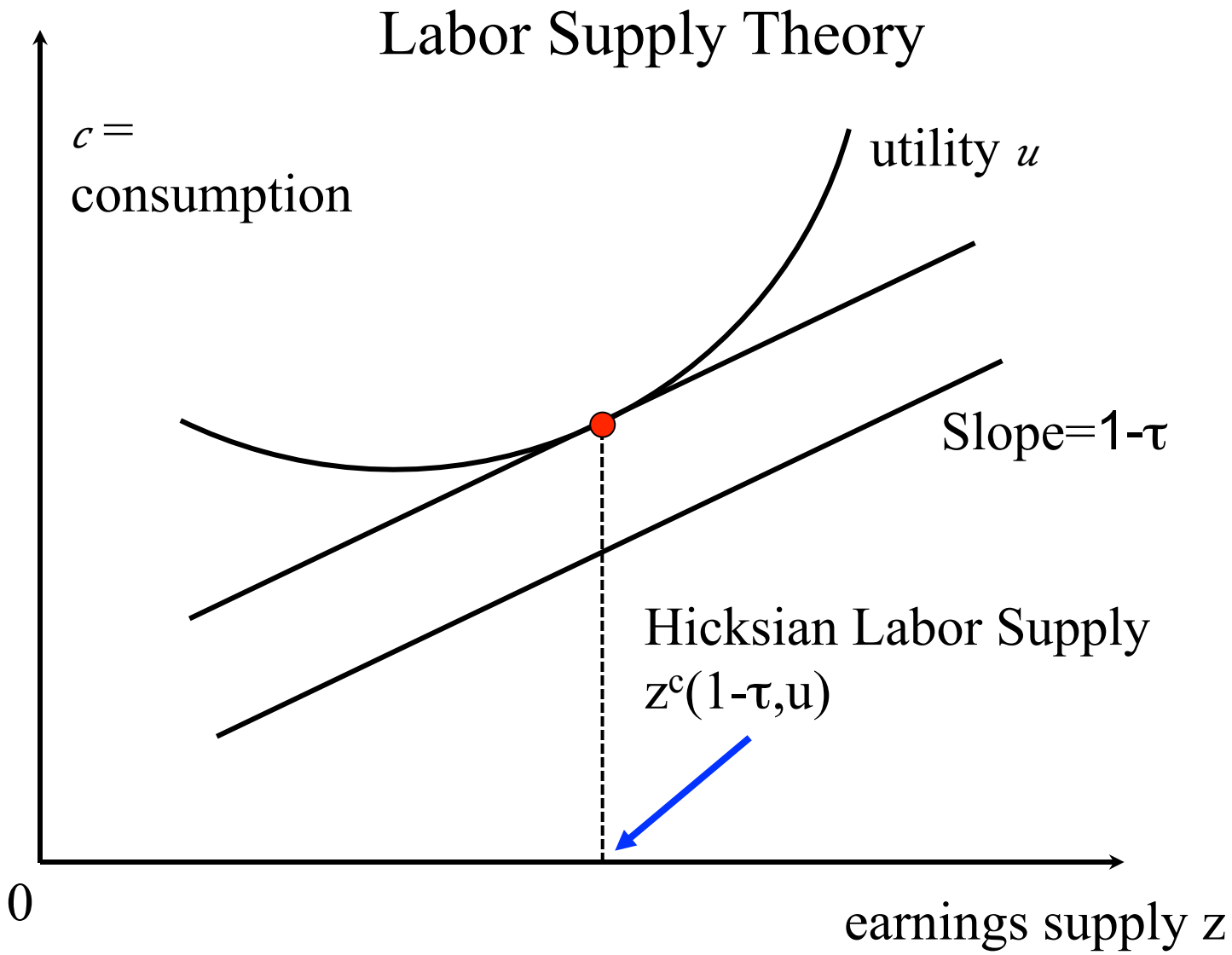
Laffer Curve

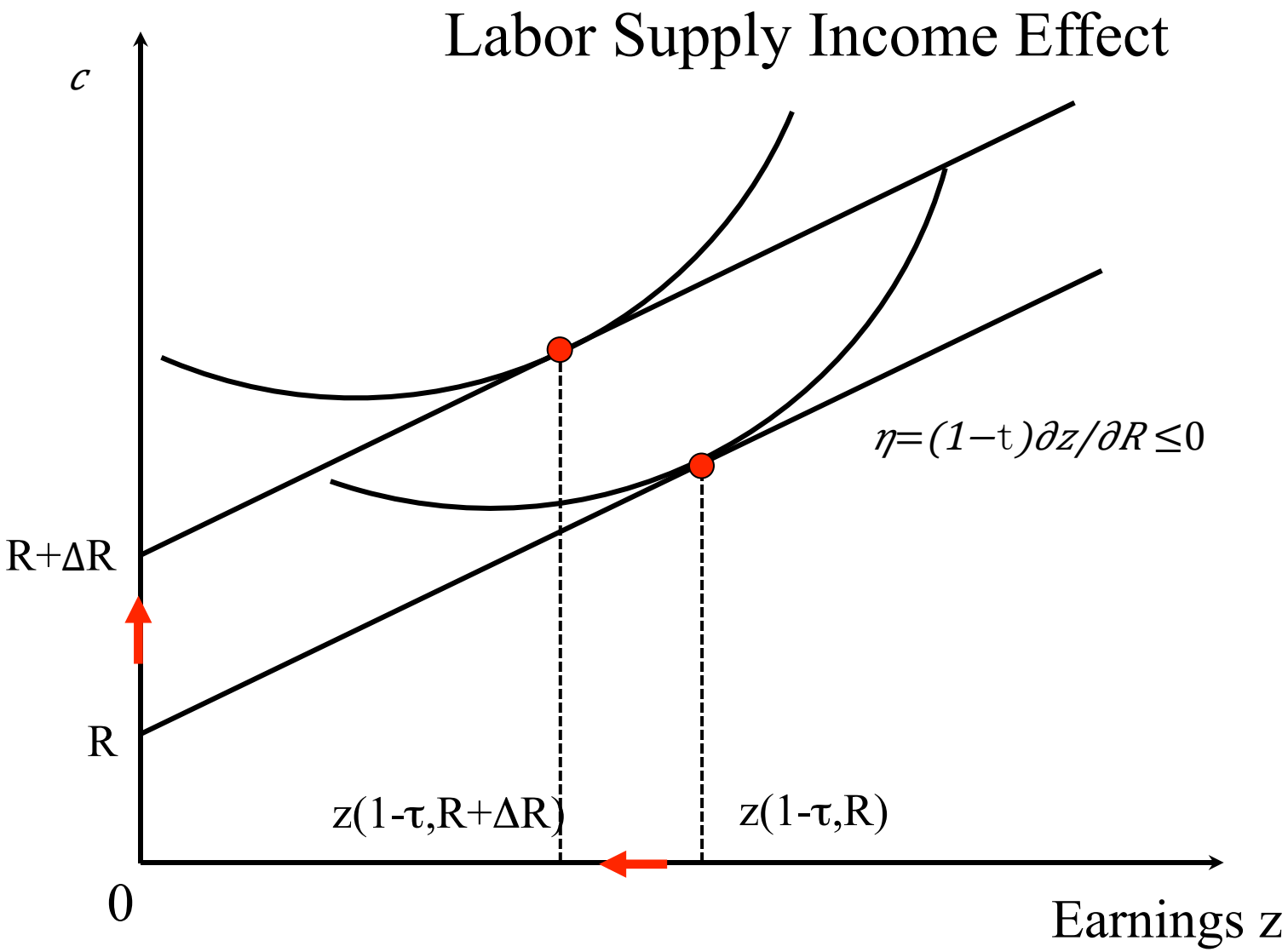


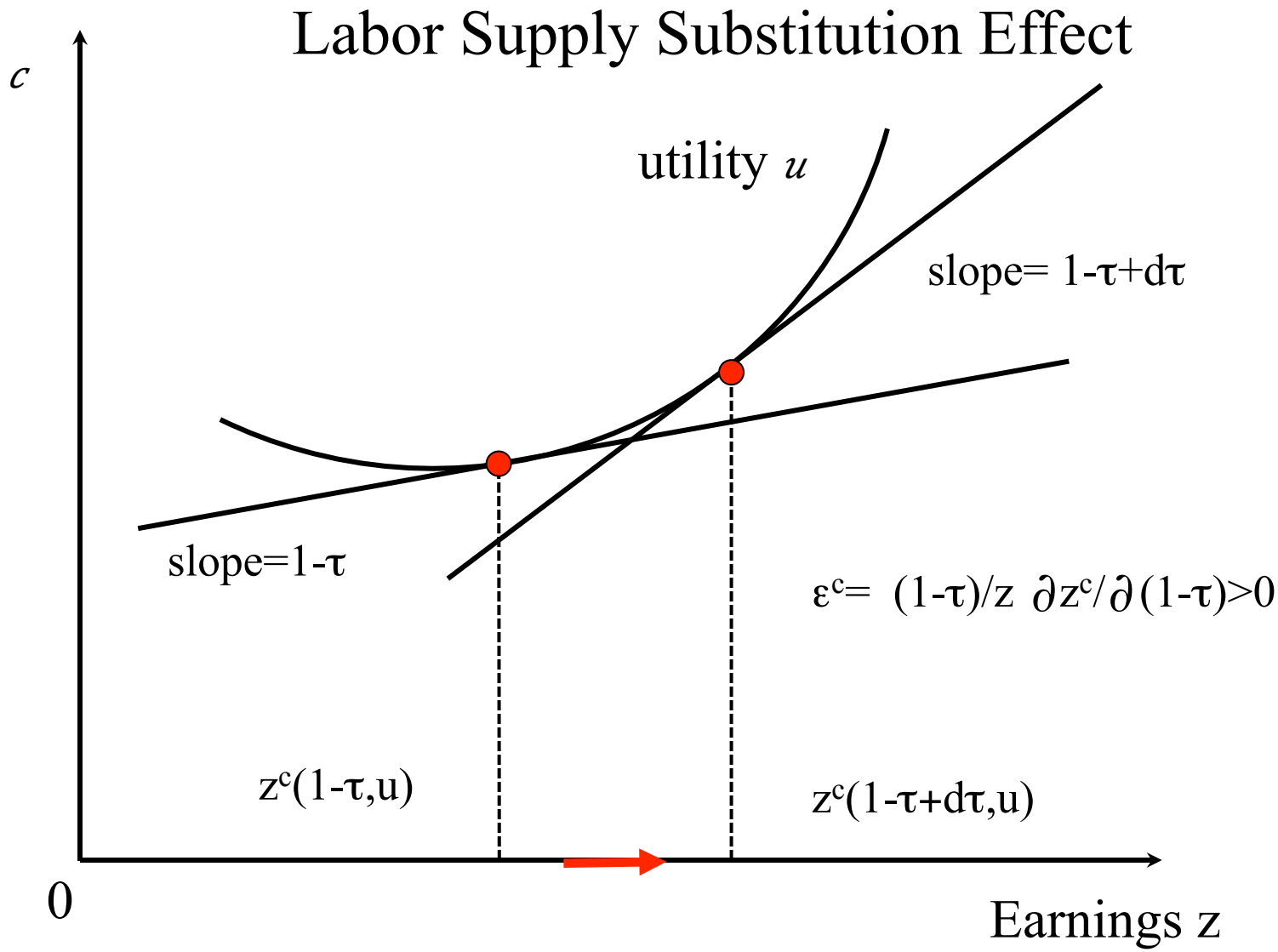
Utilitarianism and Redistribution

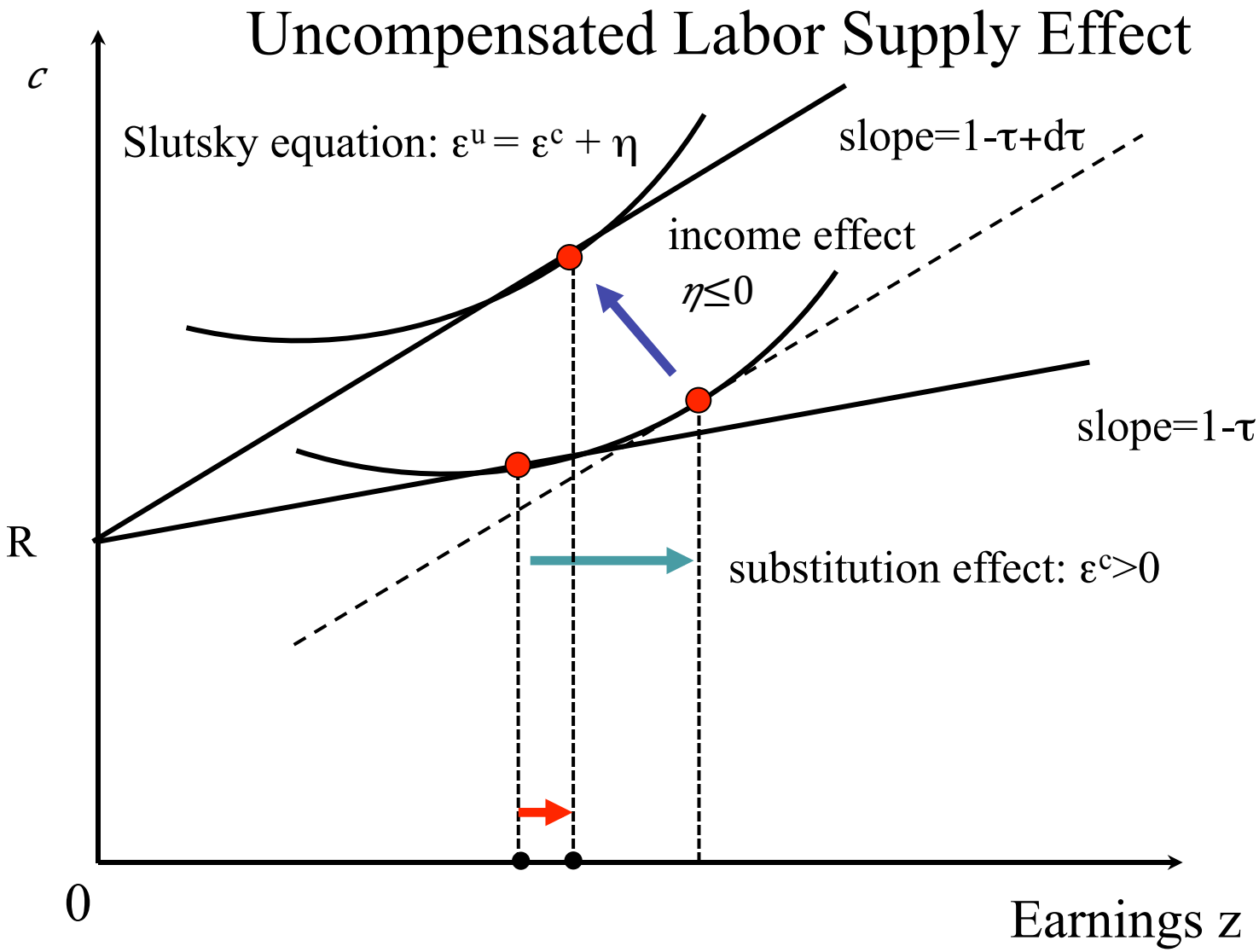


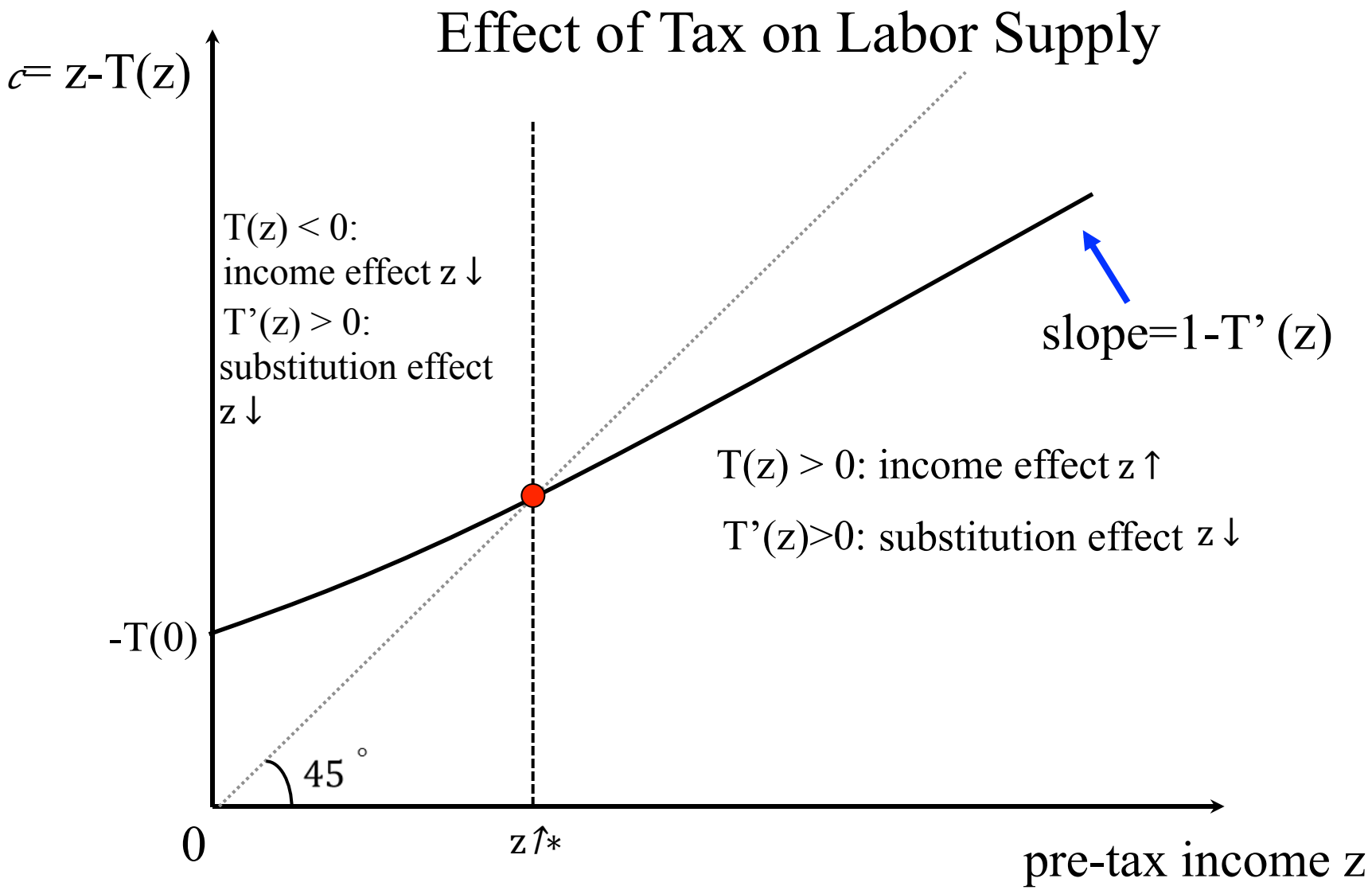

Labor Supply Theory
c =
consumption
Indifference
Curves
c = (1-t)z+R
Marshallian Labor Supply
z(1-τ,R)
R
Slope=1-τ
0
earnings supply z


Labor Supply Theory
c =
consumption
utility u
Slope=1-τ
Hicksian Labor Supply
z^c(1-τ,u)
0
earnings supply z

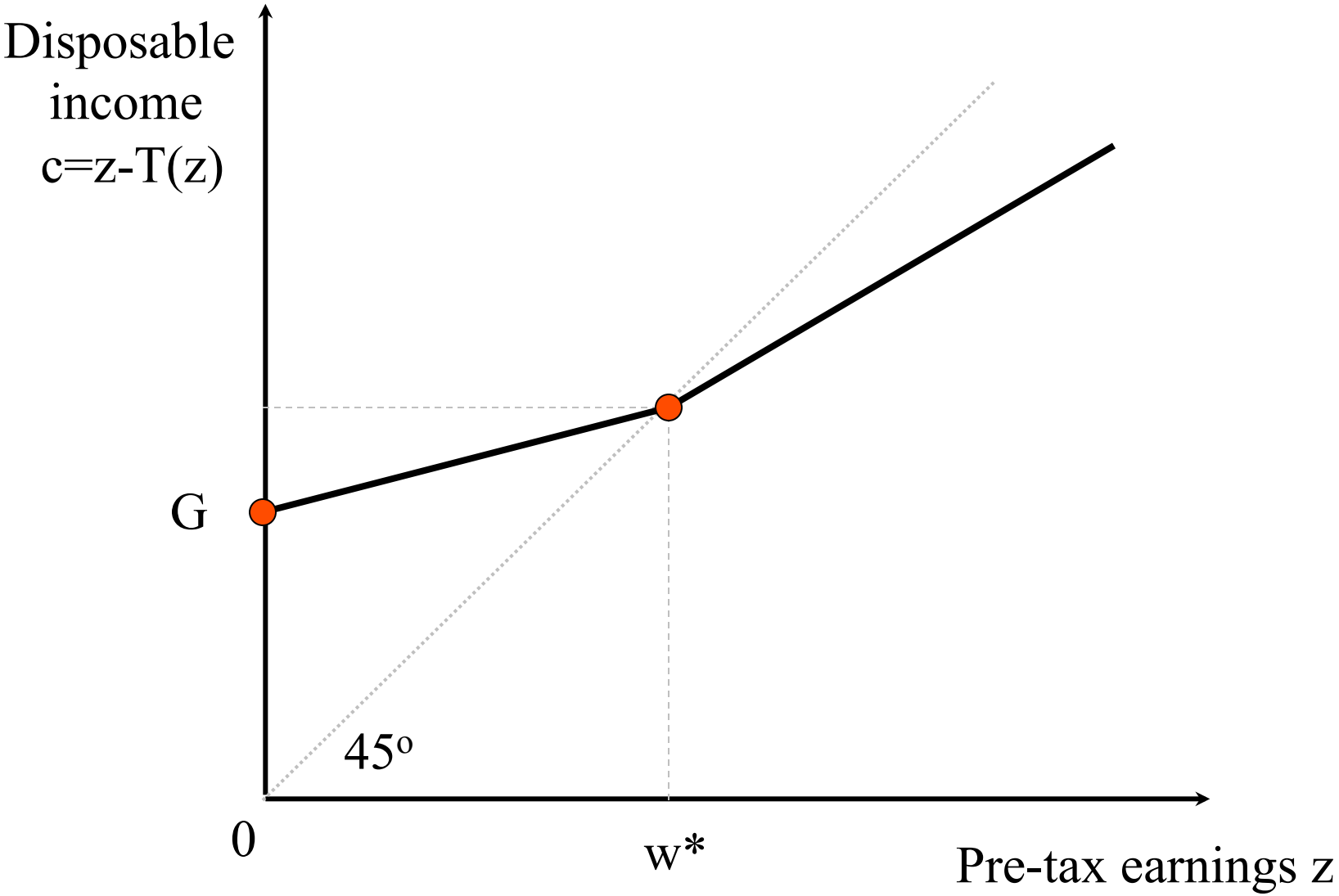

Labor Supply Income Effect
c
$\eta=(1-t)\partial z/\partial R\leq 0$
R+ΔR
R
z(1-τ,R+ΔR)
z(1-τ,R)
0
Earnings z


Labor Supply Substitution Effect
c
utility u
slope= 1-τ+dτ
slope=1-τ
εc= (1-τ)/z ∂zc/∂(1-τ)>0
zc(1-τ,u)
zc(1-τ+dτ,u)
0
Earnings z


Uncompensated Labor Supply Effect
c
Slutsky equation: $\varepsilon^u = \varepsilon^c + \eta$
slope=1-τ+dτ
income effect
$\eta \leq 0$
slope=1-τ
R
substitution effect: $\varepsilon^c > 0$
0
Earnings z


Effect of Tax on Labor Supply
c= z-T(z)
T(z) < 0:
income effect z ↓
T'(z) > 0:
substitution effect
z ↓
slope=1-T' (z)
T(z) > 0: income effect z ↑
T'(z)>0: substitution effect z ↓
-T(0)
45 °
0
z↑*
pre-tax income z

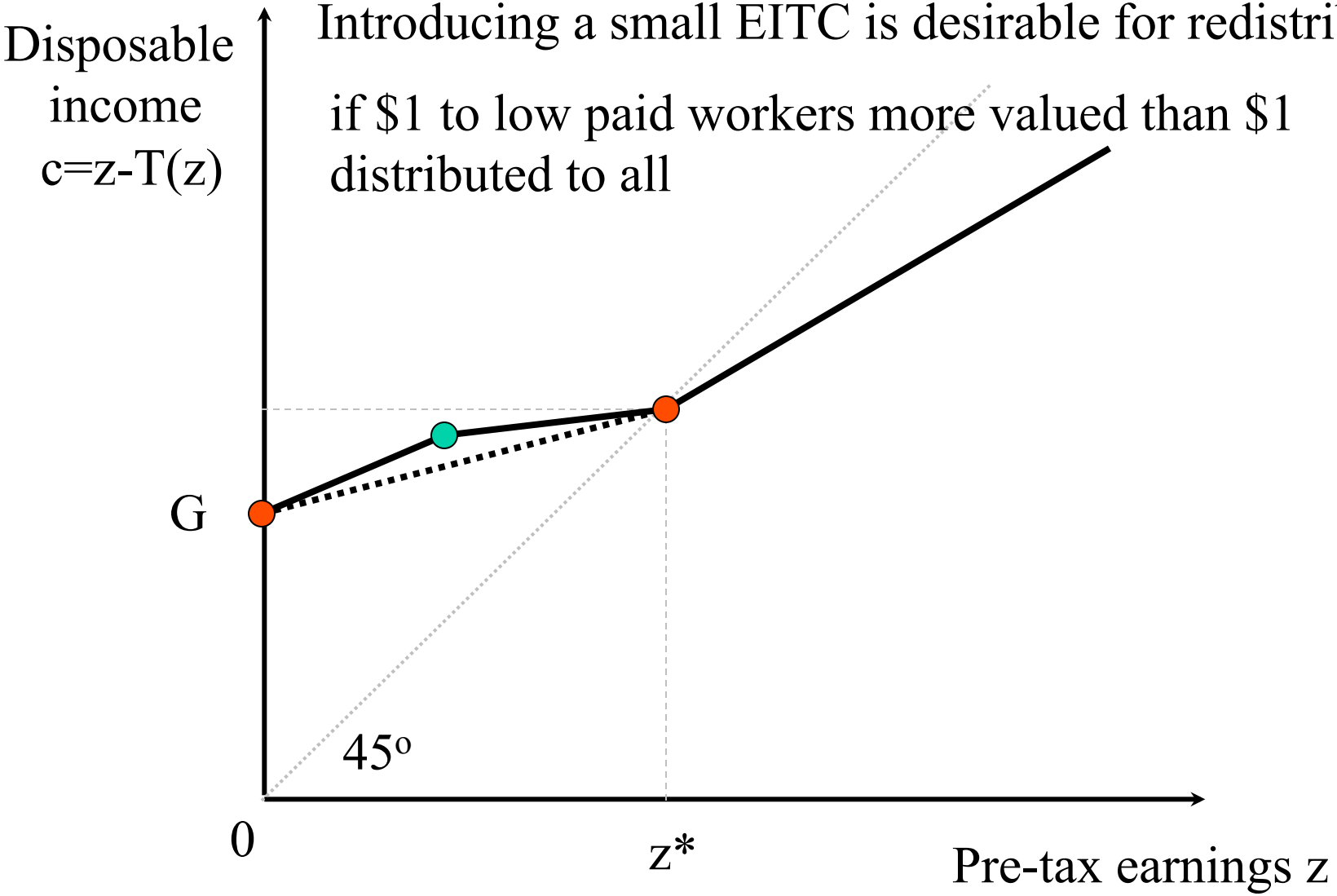
Starting from a Means-Tested Program



Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

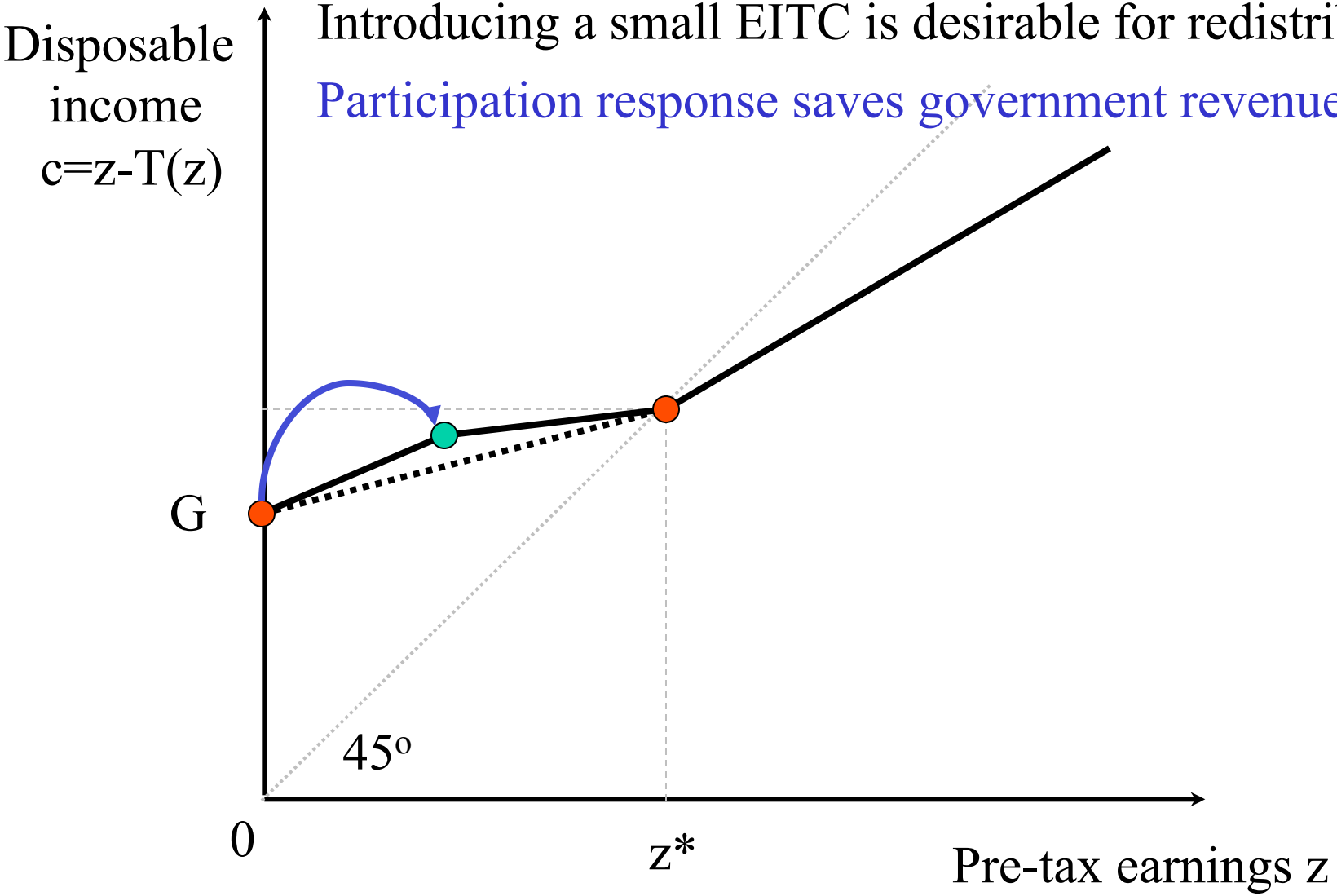
if $1 to low paid workers more valued than $1 distributed to all



Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

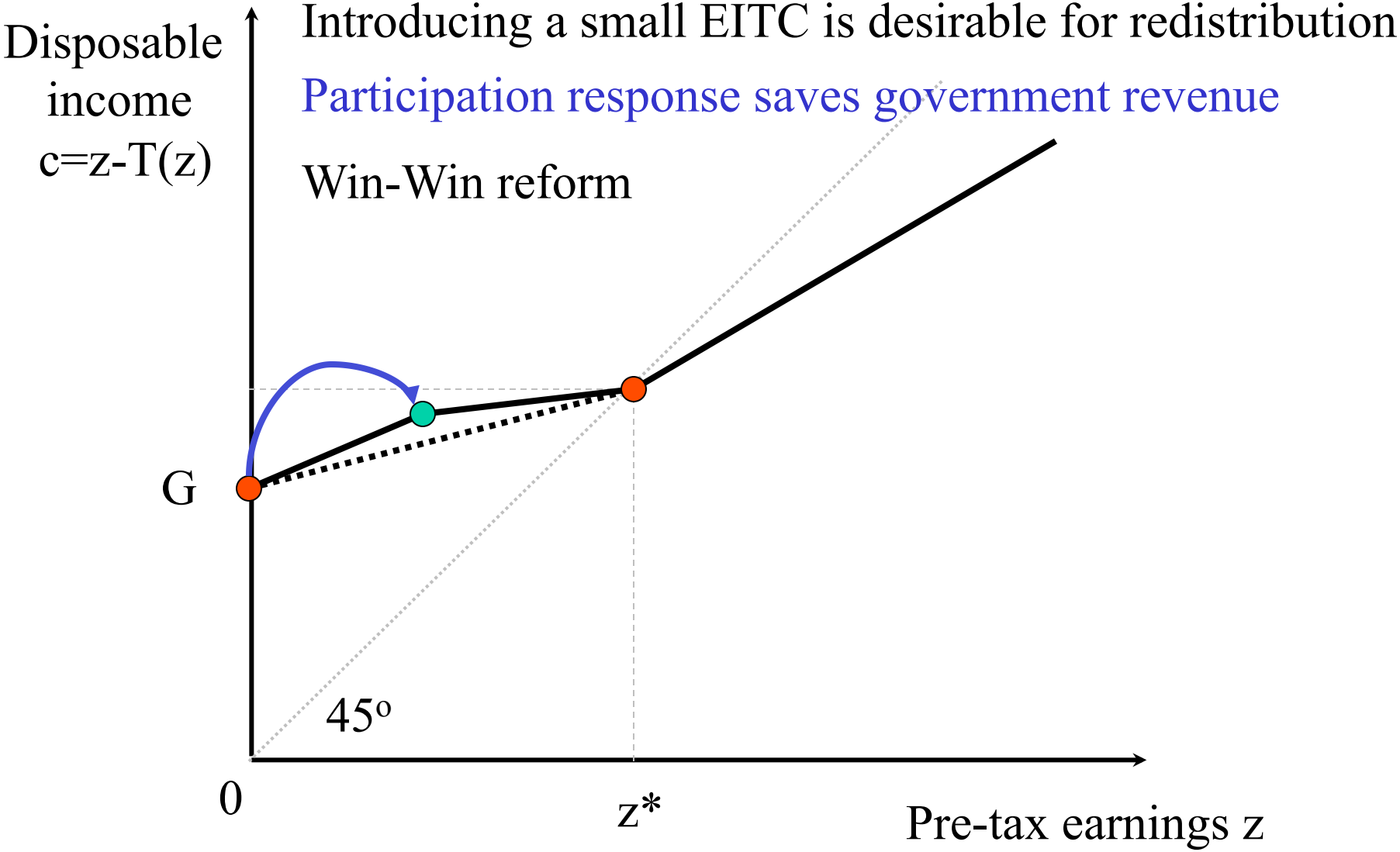


Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

Win-Win reform

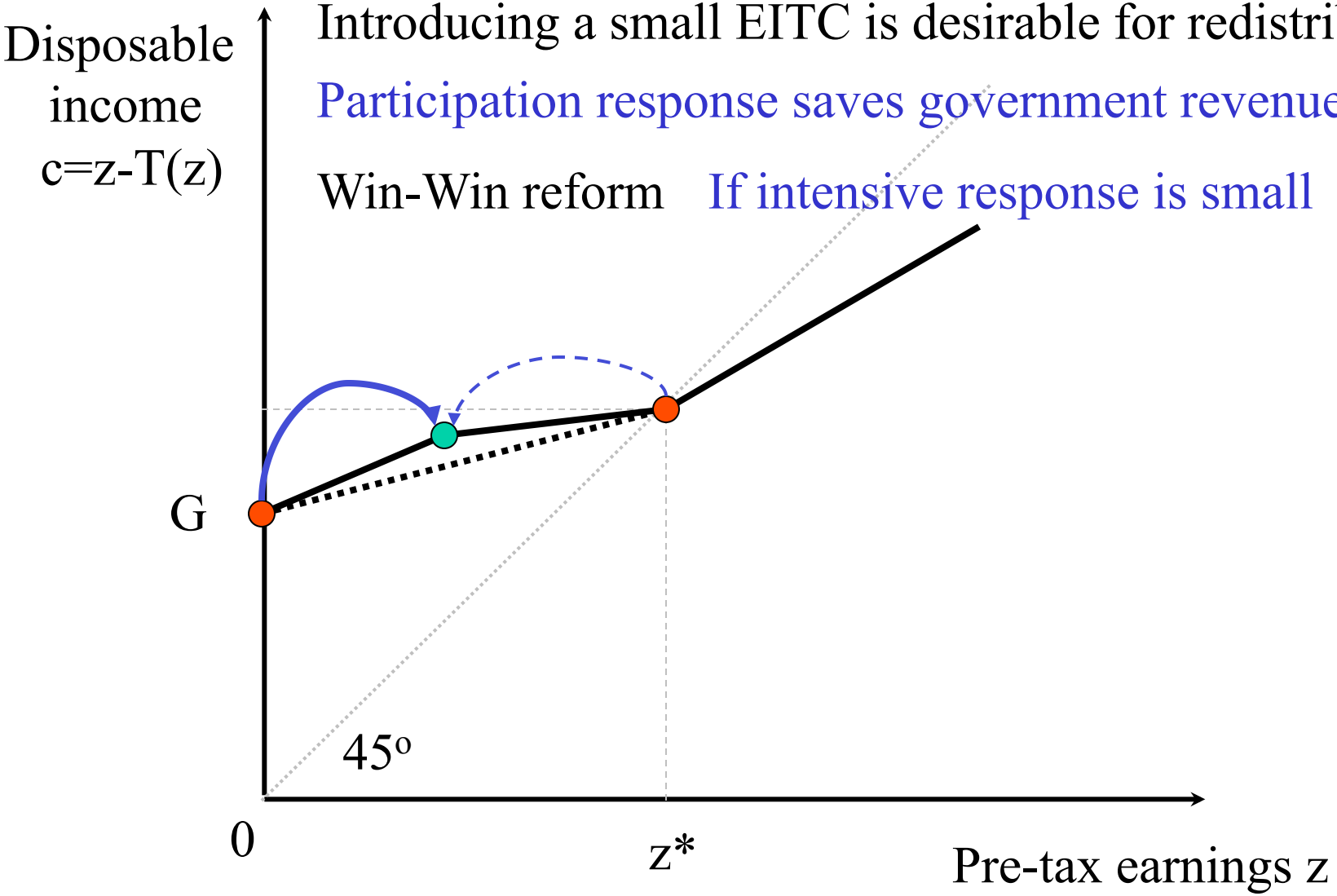


Starting from a Means-Tested Program

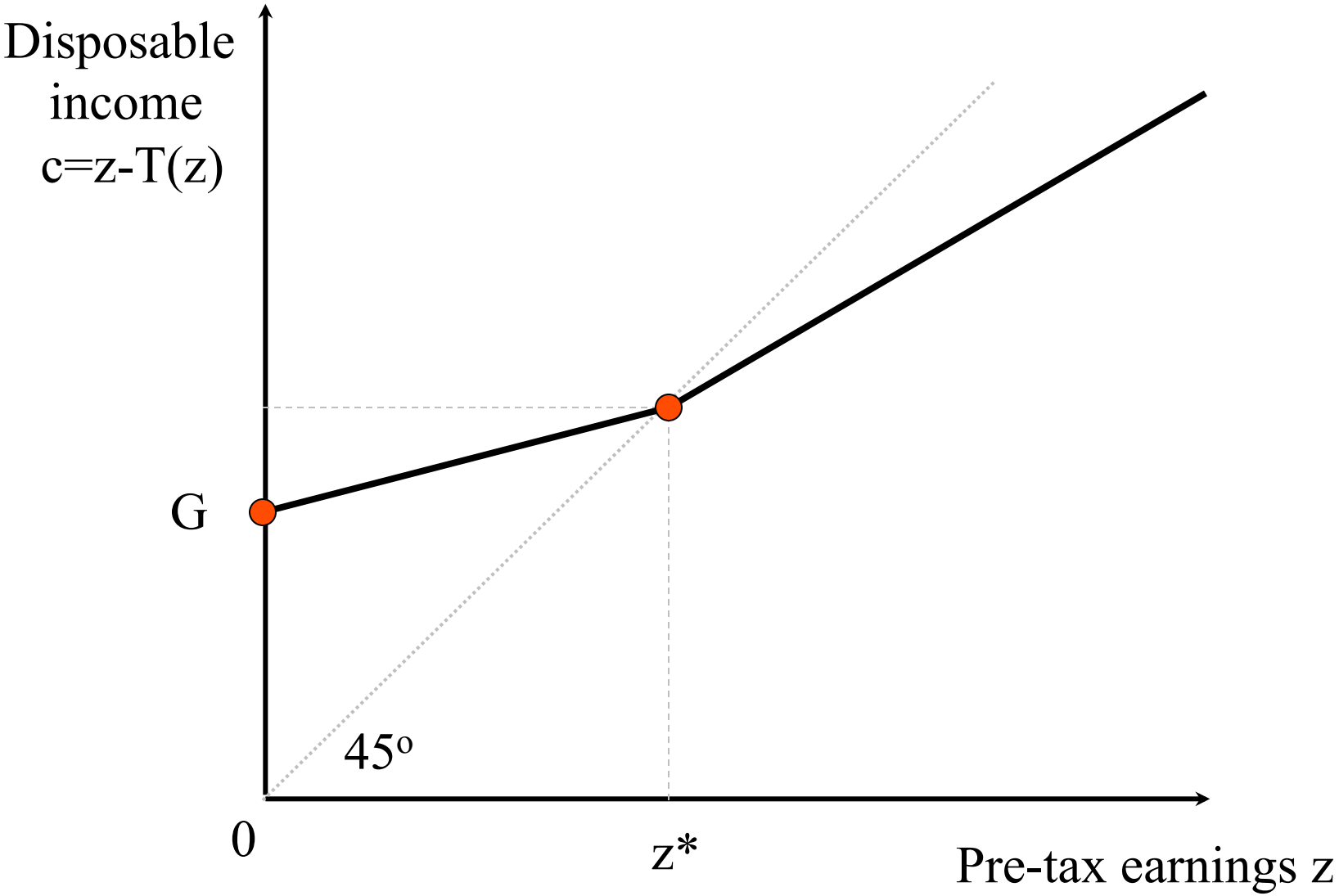
Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

Win-Win reform If intensive response is small



Starting from a means-tested program

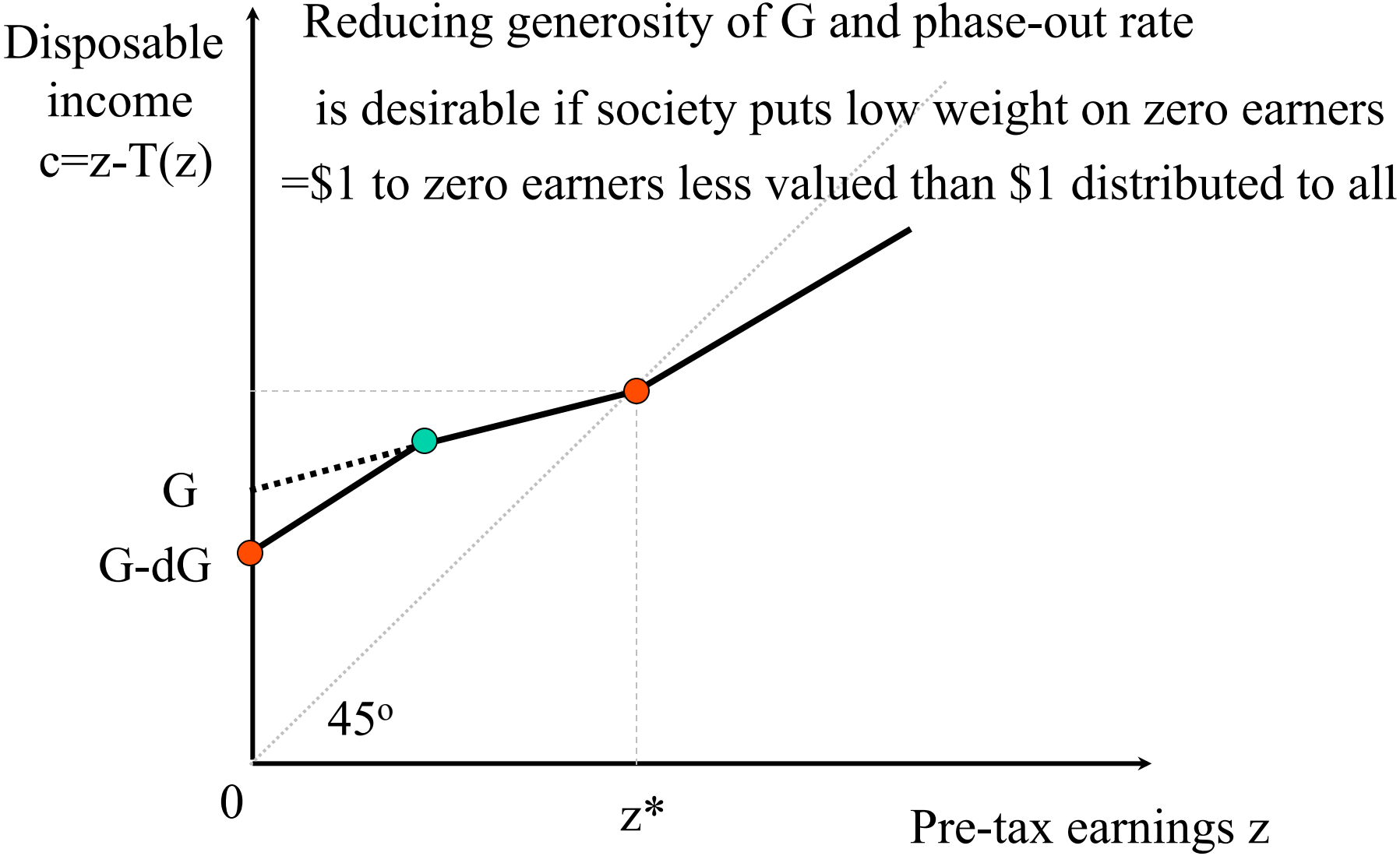


Starting from a means-tested program

Reducing generosity of G and phase-out rate

is desirable if society puts low weight on zero earners

=$1 to zero earners less valued than $1 distributed to all



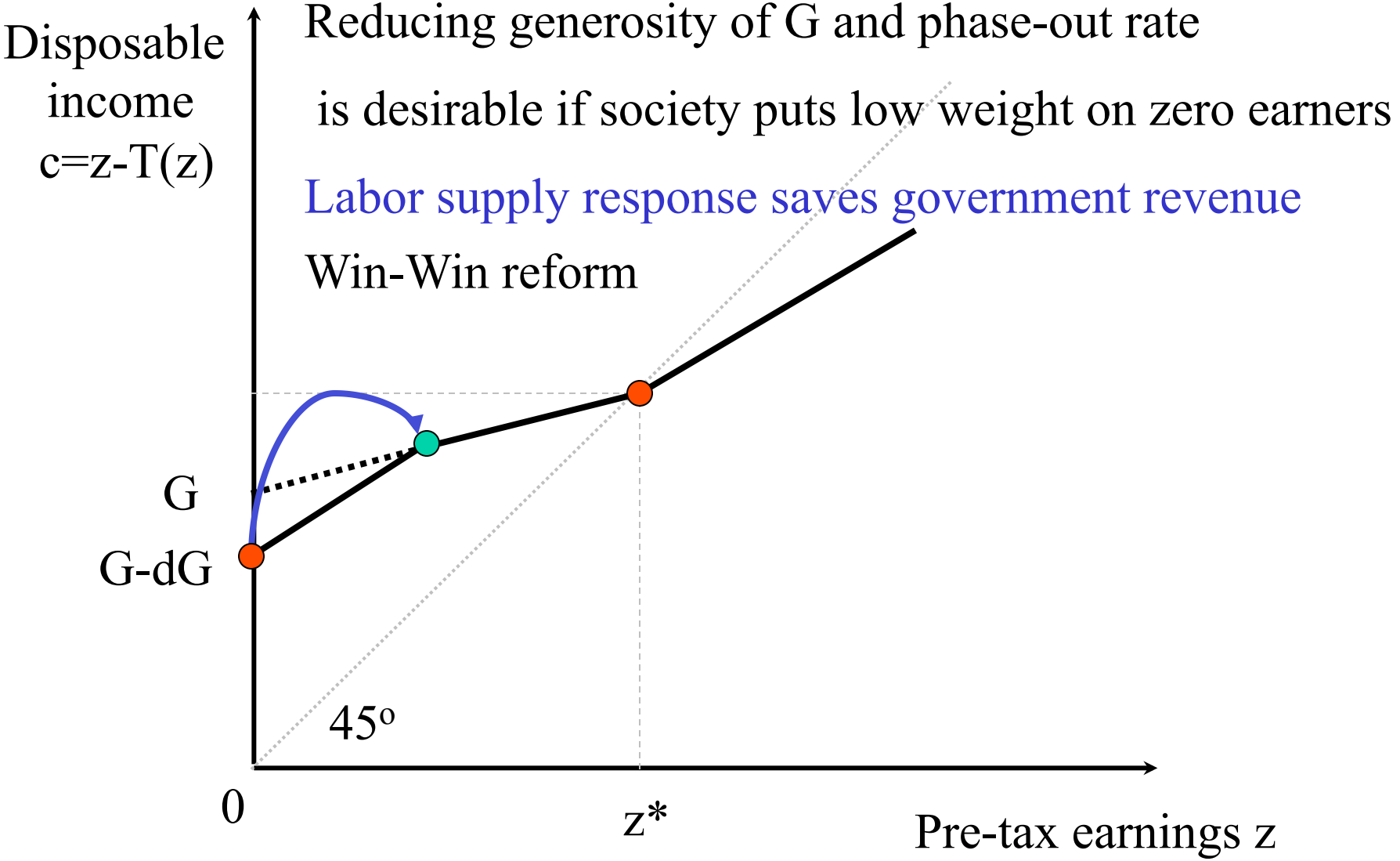
Starting from a means-tested program

Reducing generosity of G and phase-out rate

is desirable if society puts low weight on zero earners

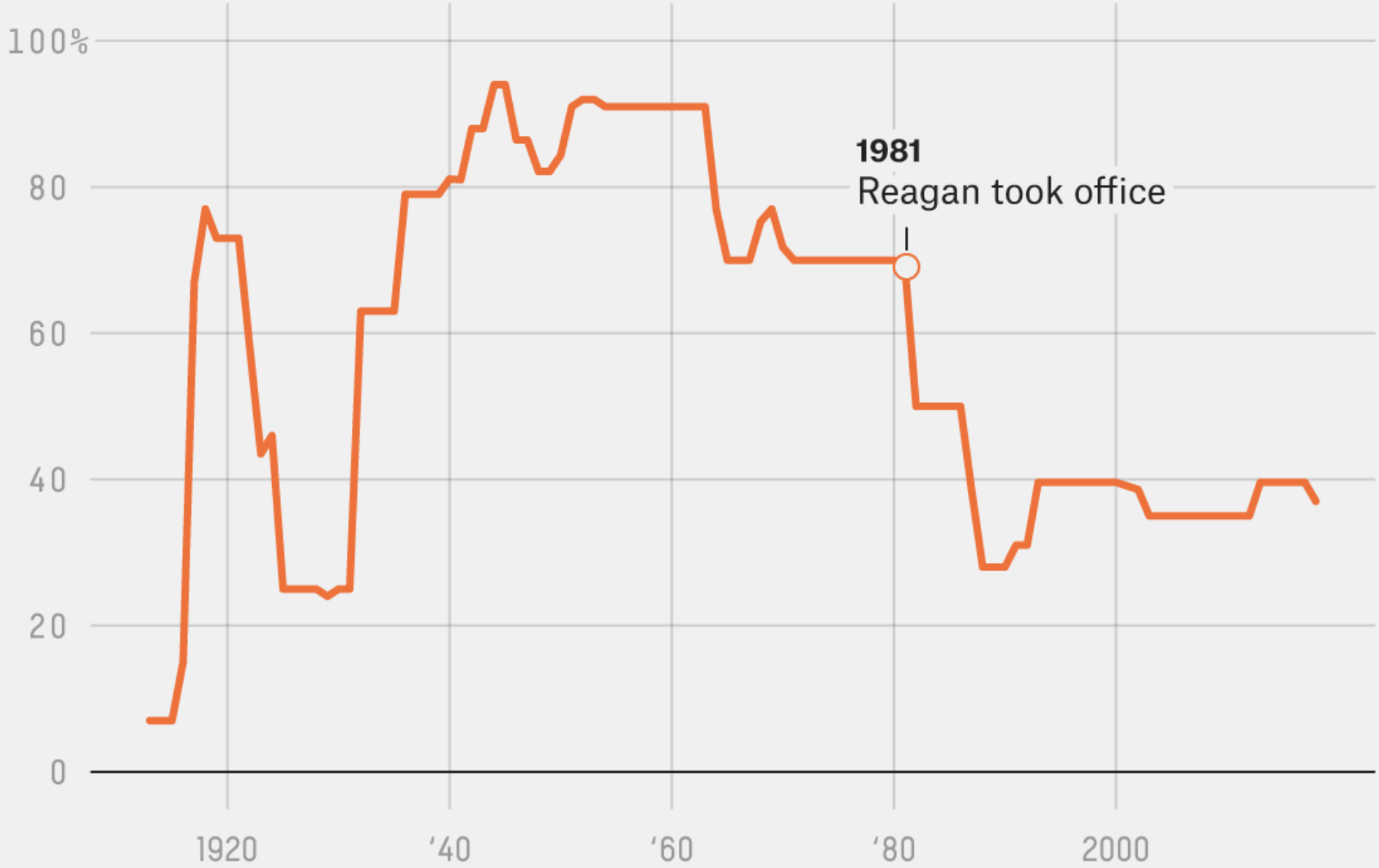
Labor supply response saves government revenue

Win-Win reform



Historically, a 70 percent marginal tax rate is not unusual

The top marginal income tax rates from 1913 to 2018



FiveThirtyEight

SOURCE: TAX POLICY CENTER

Table 2: Revealed Social Preferences

	(1)	(2)	(3)	(4)
A. Consumption lover vs. Frugal				
	Consumption lover > Frugal	Consumption lover = Frugal	Consumption lover < Frugal	
# obs. = 1,125	4.1%	74.4%	21.5%	
B. Hardworking vs. leisure lover				
	Hardworking > Leisure lover	Hardworking = Leisure lover	Hardworking < Leisure lover	
# obs. = 1,121	42.7%	54.4%	2.9%	
C. Transfer Recipients and free loaders				
# obs. = 1,098	Disabled person unable to work	Unemployed looking for work	Unemployed not looking for work	Welfare recipient not looking for work
Average rank (1-4) assigned	1.4	1.6	3.0	3.5
% assigned first rank	57.5%	37.3%	2.7%	2.5%
% assigned last rank	2.3%	2.9%	25.0%	70.8%

Notes: This table reports preferences for giving a tax break and or a benefit increase across individuals in various scenarios. Panel A considers two individuals with the same earnings, same taxes, and same disposable income but high marginal utility of income (consumption lover) vs. low marginal utility of income (frugal). In contrast to utilitarianism, 74% of people report that consumption loving is irrelevant and 21.5% think the frugal person is most deserving. Panel B considers two individuals with the same earnings, same taxes, and same disposable income but different wage rates and hence different work hours. 54.4% think hours of work is irrelevant and 42.7% think the hardworking low wage person is more deserving. Panel C considers transfer recipients receiving the same benefit levels. Subjects find the disabled person unable to work and the unemployed person looking for work much more deserving than the abled bodied unemployed or welfare recipient not looking for work.

We assume now that the government can increase benefits by $1,000 for some recipients of government benefits.

Which of the following four individuals is most deserving of the $1,000 increase in benefits?

Please drag and drop the four individuals into the appropriate boxes on the left. The upper box, marked 1 should contain the individual you think is most deserving. The box labeled "2" should contain the second most-deserving individual, etc.. Please note that you can put two individuals in the same box if you think that they are equally deserving.

Individual A gets $15,000 per year in Disability Benefits because she cannot work due to a disability and has no other resources.

Individual B gets $15,000 per year in Unemployment Benefits and has no other resources. She lost her job and has not been able to find a new job even though she has been actively looking for one.

Individual C gets $15,000 pear year in Unemployment Benefits and has no other resources. She lost her job but has not been looking actively for a new job, because she prefers getting less but not having to work.

Individual D gets $15,000 per year in Welfare Benefits and Food Stamps and has no other resources. She is not looking for a job actively because she can get by living off those government provided benefits.

Source: survey in Saez and Stantcheva (2013)

Which of the following two individuals is most deserving of a $1,000 tax break?

Individual A earns $30,000 per year, by working in two different jobs, 60 hours per week at $10/hour. She pays $6,000 in taxes and nets out $24,000. She is very hard-working but she does not have high-paying jobs so that her wage is low.

Individual B also earns the same amount, $30,000 per year, by working part-time for 20 hours per week at $30/hour. She also pays $6,000 in taxes and hence nets out $24,000. She has a good wage rate per hour, but she prefers working less and earning less to enjoy other, non-work activities.

- ◯ Individual A is most deserving of the $1,000 tax break
- ◯ Individual B is most deserving of the $1,000 tax break
- ◯ Both individuals are exactly equally deserving of the $1,000 tax break

>>

Source: survey in Saez and Stantcheva (2013)

Which of the following two individuals do you think is most deserving of a $1,000 tax break?

Individual A earns $50,000 per year, pays $10,000 in taxes and hence nets out $40,000. She greatly enjoys spending money, going out to expensive restaurants, or traveling to fancy destinations. She always feels that she has too little money to spend.

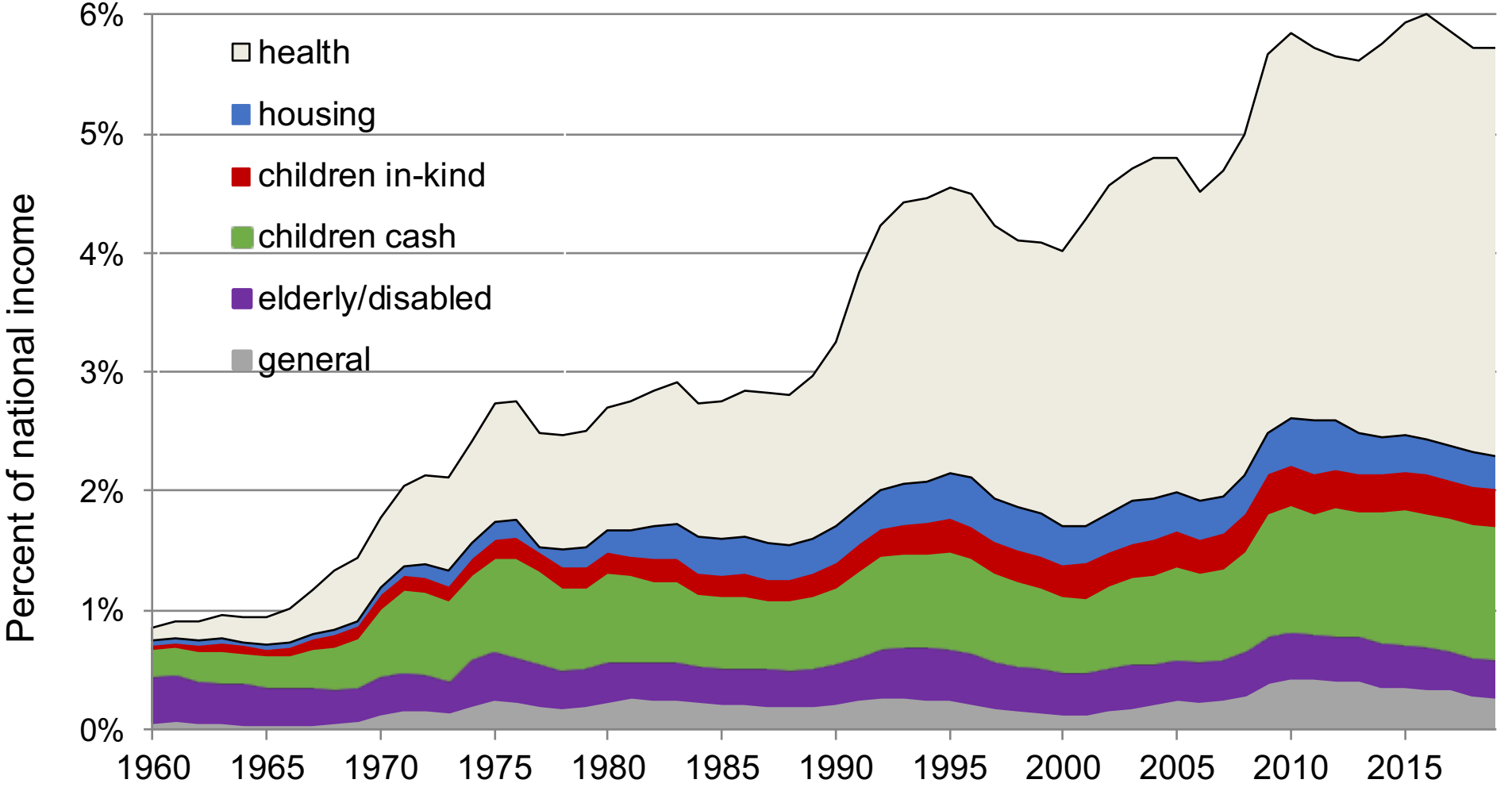
Individual B earns the same amount, $50,000 per year, also pays $10,000 in taxes and hence also nets out $40,000. However, she is a very frugal person who feels that her current income is sufficient to satisfy her needs.

- ◯ Individual A is most deserving of the $1,000 tax break
- ◯ Individual B is most deserving of the $1,000 tax break
- ◯ Both individuals are exactly equally deserving of the tax $1,000 break

>>

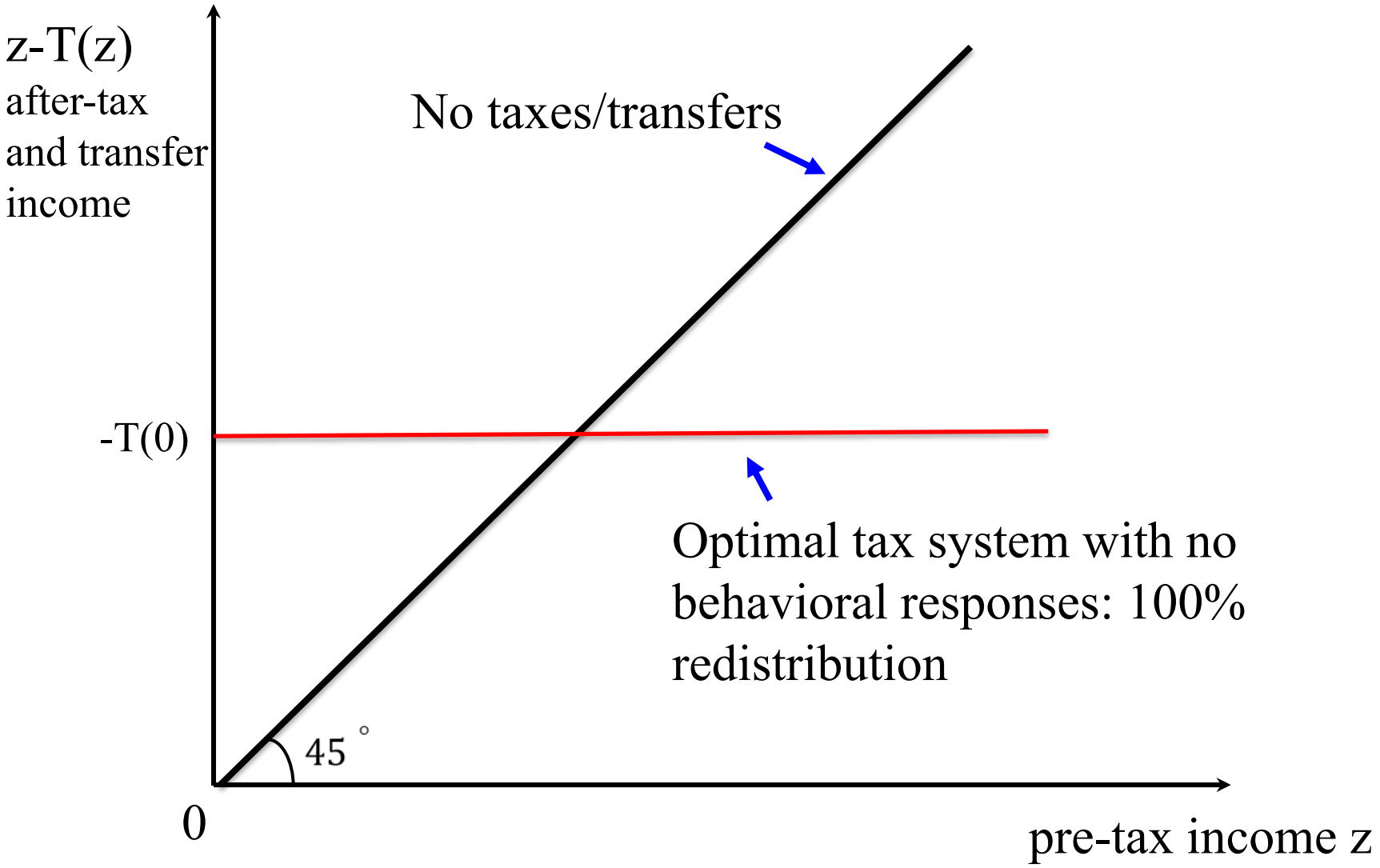
Source: survey in Saez and Stantcheva (2013)

Means-tested Transfers in the US, 1960-2019

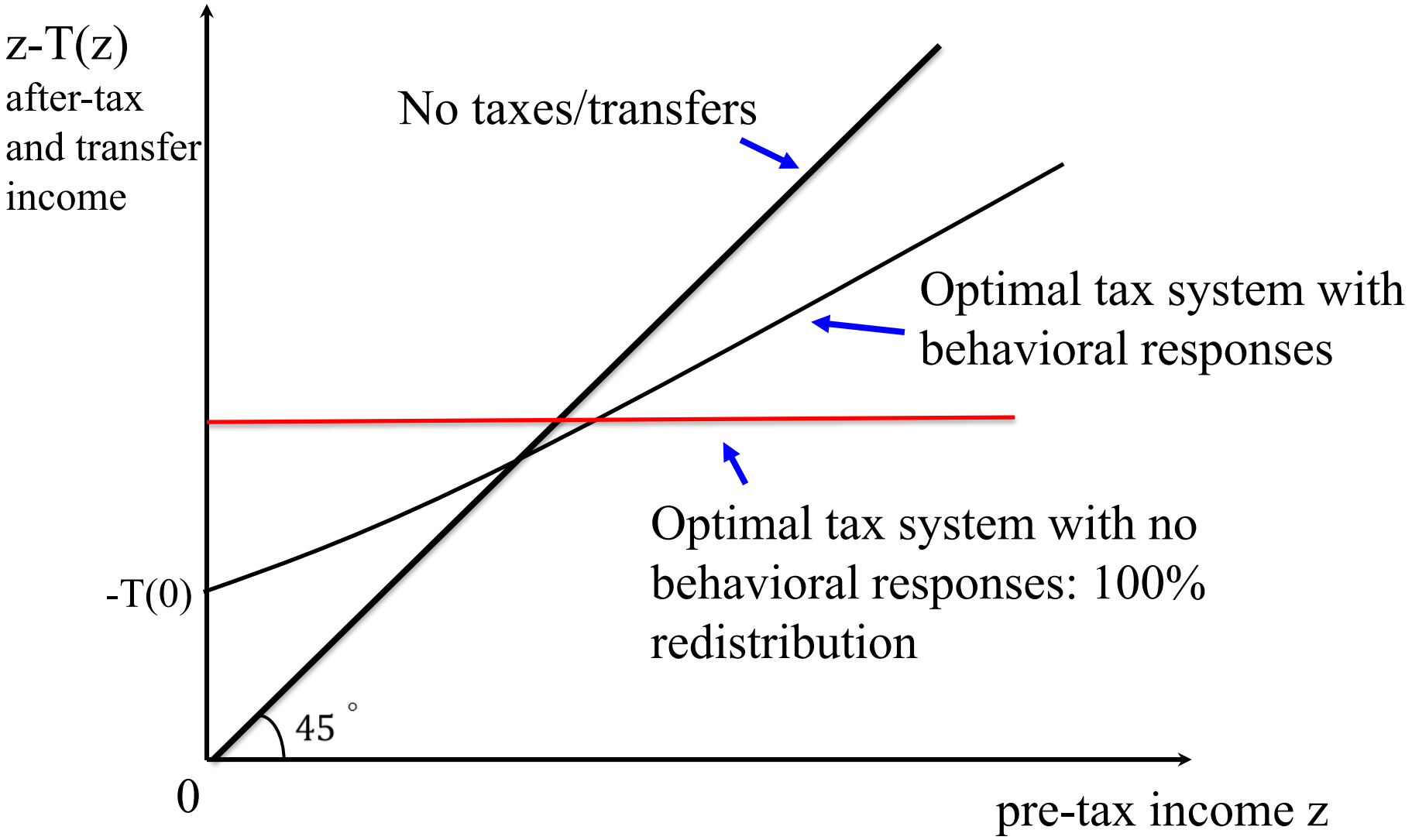


Source. National Accounts. Includes all individualized and means-tested transfers. General is untargetted (SNAP and general assistance for adults). Children cash includes refundable tax credits (EITC+CTC), TANF, and SNAP for children. Health is mostly Medicaid.

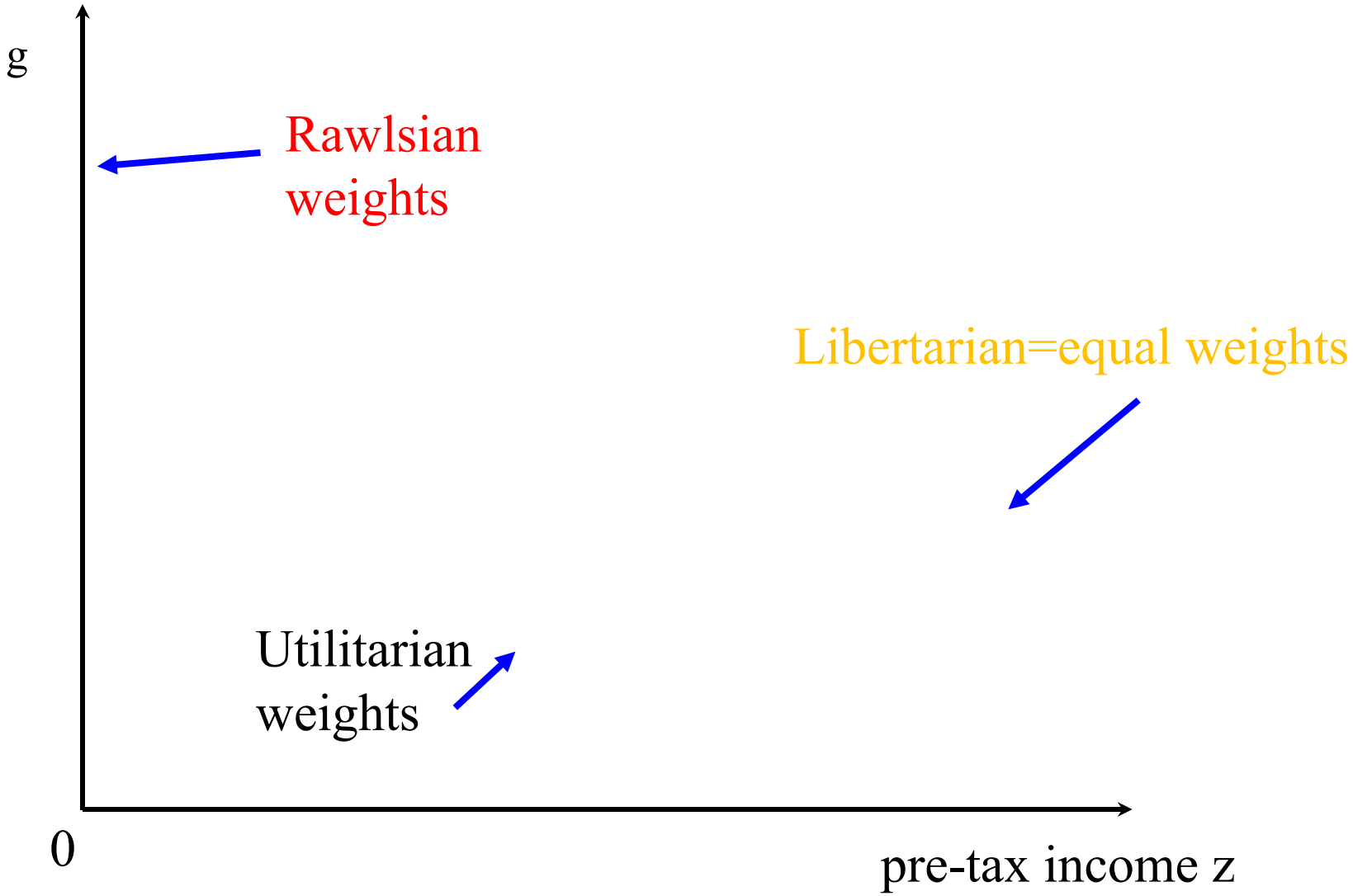
Optimal Tax/Transfer Systems



Optimal Tax/Transfer Systems



Social Marginal Welfare Weights



Social Marginal Welfare Weights