Discussion of "Taxing Capital in the Presence of Trickle-Down Effects: A Sufficient Statistics Approach"

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Summary reaction

- **"Trickle-down" effect:** low taxes on capital induce investment, which in turn increases the demand for labor. Wage boost benefits poorer households.

- **This paper:** study theoretically and quantitatively this effect in an environment encompassing many standard macro, public finance frameworks.

- Very good paper with some neat theoretical results and significant quantitative results. Highlights the role of the GE effects.

- Room for improvement on the both fronts.

Paper in One Slide

- Starts with general environment, nesting several important benchmark models as special cases.

- Derive testable optimality condition for the capital income tax as function of key elasticities: $\bar{\epsilon}_{K_t,1-\tau_k}$, $\bar{\epsilon}_{L_t,1-\tau_k}$ and $\bar{\epsilon}_{w,1-\tau_k}$. The challenge: these are **unobserved, policy elasticities**.

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- Derive testable optimality condition for the capital income tax as function of key elasticities: $\bar{\epsilon}_{K_t,1-\tau_k}$, $\bar{\epsilon}_{L_t,1-\tau_k}$ and $\bar{\epsilon}_{w,1-\tau_k}$. The challenge: these are **unobserved, policy elasticities**.
- **Key contribution of the paper:** recover these elasticities from estimated, sufficient statistics: (i) $K-L$ substitution elasticity (ii) capital and labor income shares (iii) taxes (iv) wage elasticity of labor supply (v) capital supply elasticity.
- Quantify the policy elasticities and capital taxes: (i) The optimal capital tax is falling with the total gross income (ii) Hhs up to 75th percentile would benefit from further tax increase relative to exogenous prices.

Comments (1)

1. Ruling out **wealth effects on labor supply** simplifies algebra, but:

    - Empirical evidence of wealth effects on labor supply: Golosov, Graber, Mogstad, Novgorodsky (2021)
    - They interact with capital taxation: wealth and productivity are positively correlated → increase in capital income tax implies negative wealth effect → wealthy-productive work more, poor-unproductive work less (transfers) → labor productivity rises in the economy.

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    - They interact with capital taxation: wealth and productivity are positively correlated $\rightarrow$ increase in capital income tax implies negative wealth effect $\rightarrow$ wealthy-productive work more, poor-unproductive work less (transfers) $\rightarrow$ labor productivity rises in the economy.
2. Sufficient statistic approach:
    - Inherently **local formulas** evaluated around the current tax system. Yet the optimality calls for more than doubling capital tax. How valid is the local approximation?

Comments (2)

3. What is the real world counterpart of the capital income tax in the model?
    - The U.S. tax system **pools together capital and labor income** and taxes them according to the personal income tax code.
    - The paper has two separate instruments and conducts the analysis holding the labor income tax fixed.

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4. The key object for quantitative results: **capital supply elasticity**
   - Poorly measured in the U.S.. Paper uses elasticity of wealth w.r.t. to wealth tax from Danish data.
   - Though the object that matters for the GE effects is **elasticity of productive capital** w.r.t. capital tax.
   - Wealth vs. Productive capital. In the model, they are the same, in the data not (housing).
   - Exploit the estimated elasticities of the capital stock following the corporate tax rate changes in the U.S.?