

Just what this downturn demands: A consumption tax

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Recession

- The deepest economic crisis since the Great Depression
- For the new government: crisis is also an opportunity for change (危機)
- It is imperative to increase spending over the short run, regardless how we pay for it

Government spending and tax

- Martin Feldstein (adviser to the campaign of John McCain): “The only way to prevent a deepening recession will be a temporary program of increased government spending”
- How to finance the spending?

Income tax

- Most federal revenue now comes from the income tax, ..., we are effectively taxing savings

$$Y = C + S + \text{tax}$$

$$\text{tax} = \tau Y, \quad \tau \text{ is tax rate.}$$

Hence

$$Y = \frac{1}{1 - \tau} C + \frac{1}{1 - \tau} S.$$

課稅使價格上升。 C 與 S 之價格原為 1, 課稅之後上升為 $1/(1 - \tau)$ 。財富效果: 課稅使 C 與 S 都減少。

Income and consumption tax

政策建議:

- Replacing the **progressive** income tax with a progressive tax on consumption tax
- Example: A family that earns \$60,000, saves \$10,000, has a standard deduction \$30,000 (免稅額), would have taxable consumption of \$20,000

Consumption tax

$$Y = C + S + \text{tax}$$

$$\text{tax} = \tau(Y - S - D), \quad D \text{ is deduction.}$$

Hence

$$Y = \frac{1}{1 - \tau}C + S - \frac{\tau}{1 - \tau}D.$$

- C is more expensive than S .
替代效果: C 減少, S 增加 (鼓勵儲蓄)。
- As τ is higher (progressive tax), C will be lower

Effects of consumption tax

- Encourages saving
- High-income consumers might consume less and save more (substitution effect)
- **Comment:** it is not clear that why this is “one of the most effective ways” to raise tax revenue

Other changes

- Taxes on carbon
Taxes on carbon have positive side effects:
resulting in reductions in pollution and
congestion
- **Save More Tomorrow:** workers can allocate a
portion of future salary increases to
retirement savings accounts [skip this part]