Discussion of

Mikhail Golosov and Thomas J. Sargent

Taxation, redistribution, and debt in incomplete market economies with aggregate shocks

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• Two of my favorite economists writing on one of my favorite topics

• A paper for theorists—comparison of implications of different models of fiscal policy dynamics, some old, some new

• Useful thing to do: a jungle of different approaches out there, little agreement on questions to ask, best choice of simplifying assumptions

• Paper provides rigorous, useful comparisons—as we have all just seen
My plan: Step back and ask

- What are positive, normative questions we want fiscal theory to answer?

- What progress has been made?

- What needs to be done?
Positive tax analysis

- Major progress in 1980s due to Chamley, Judd, Auerbach and Kotlikoff, Summers, others

- Explicit models calibrated to U.S. economy, incorporating descriptions of actual taxes, government spending

- Simulations of way equilibrium would be altered by other tax structures holding government spending fixed
• Estimate welfare gain (or losses) by finding consumption changes chosen to make everyone indifferent

(Need type-specific transfers to do this with heterogeneous agents)

• Method defines a partial ordering of interesting sets of possible resource allocations

• Partial order a problem? For Pareto a virtue
• Contributions of this Ramsey approach?

  – Coherent analysis of cost of inflation (Bailey, 1956)

  – Discovery of large free-lunch from reductions in capital taxation (see above)

  – Reasonable explanation for persistent 30-40% gdp gap between U.S. and Europe (Prescott, 2002)

• As applied economics goes, Ramsey has taken us a long way
• Moreover, specific assumptions easily varied: Chamley, Judd used representative agent. Auerbach/Kotlikoff, Summers used realistically parameterized age distribution: 40 or so types.

• Tax structures too simple? Lucas (1990), Prescott (2002) used affine: 
  \[ \tau(y) = a_i + by. \]

• Varied \( b \) to get the marginal wedges right; type-specific \( a_i \) to get total revenues right.

• Still too simple? Try your own. Many now use NBER TAXSIM
• But many important issues not dealt with it all

• In U.S. in 2010, government consumption $g \sim \$2500\text{ b.};$ transfers $\sim \$2300\text{ b}$

• No room for transfers in Ramsey with identical agents: just a waste

• Need a way to think about the welfare state: social insurance when markets don’t provide it?

• Or is equality a value to be sought, along with freedom and efficiency?

• Issue addressed by Mirrlees and in various ways by NDPF
• See Golosov-Tsyvinski analysis of disability insurance as model of way mechanism design might be applied to improve “safety net”, “social insurance”

• A specific response to a specific question

• Current paper at an awkward level of generality: Not directed at very specific problem yet not general enough to encompass lots of different problems
• Some key assumptions:

  – individual productivity type $\theta_i$ permanent feature of infinitely-lived agent (dynasty?)

  – revealed to planner at $t = 1$ [correct?] but planner is committed from $t = 0$ never to use this info

  – lump-sum transfers used in implementation but cannot be type-specific

  – no-one (not even the government) can issue state-contingent debt

• Should we think of these as steps toward descriptive realism?

• Are they introduced to ensure desirable social outcomes?
• I needed more help on both these questions

• True that mechanism design approach gives us optimal solutions to well-formulated (if arbitrary) question, not the partial order and case-by-case searches for Pareto improvements that Pareto and Ramsey offered us

• But sometimes it can seems pretty close to delegating control to planner and letting him tell us all what to do