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 $g \simeq$ \$2500 b.; transfers $\simeq$ \$2300 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 θ_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