THE ELGAR GUIDE TO TAX SYSTEMS

edited by EMILIO ALBI and JORGE MARTINEZ-VAZQUEZ

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The Elgar Guide to Tax Systems had the tough luck to appear at about the same time as Dimensions of Tax Design and Tax by Design, the pair of volumes prepared under the guidance of James Mirrlees and published by the Institute for Fiscal Studies (Mirrlees et al., 2010, 2011). Of the 16 authors and co-authors of papers in the Elgar volume, seven also participated in the Mirrlees project — one as an author and six as discussants. Comparing the Elgar volume with the much larger and, one presumes, more lavishly funded IFS effort that extended over a far longer period of time may seem unfair, but it is relevant. The first IFS volume runs to more than 1,300 pages. Its 13 papers, like those of The Elgar Guide, deal with broad topics familiar to students of public economics, such as the taxation of capital and labor income, environmental taxes, tax administration, and so on. The IFS papers are full-blown reviews — many of nearly book length — of theoretical and empirical research on each topic. The second volume, running to more than 500 pages, applies the lessons of the first book to quite specific analysis of tax policy in the United Kingdom. That volume is written by multiple co-authors, but has a single editorial voice.

The Elgar Guide, although a “mere” 455 pages, purports to deal with tax systems throughout the world. When a book deals with a topic as vast and unwieldy as all of the taxes in all of the countries of the world, a strong editorial hand is vital. Yet The Elgar Guide is a conference volume and, like most conference volumes, brings together independently written contributions by authors, each knowledgeable in his or her field, but each writing with his or her own style and particular interests. Having edited papers from several such conferences, I know the challenges that the editors face — despite one’s best efforts, one inevitably ends up with a collection of discrete essays, in diverse styles and of varying quality. Few such efforts — and The Elgar Guide is not an exception — end up with a clear focus or a well-defined audience.
The very scope of The Elgar Guide virtually dooms it to a lack of focus. The various chapters deal with direct versus indirect taxation, the individual income tax, the corporation income tax, wealth and wealth transfer taxes, value-added taxes, excise taxes, environmental taxes, fiscal decentralization, and tax administration. Three other chapters deal with cross-cutting issues concerning developments within the Organisation for Economic Co-operation and Development, political regimes, and the interaction of tax system change and research.

As with any collection of essays on so wide a range of topics, each reader will find some chapters more appealing than others. Several of the chapters that comprise The Elgar Guide are clear and informative and should find themselves referenced in reading lists of courses in public finance or public policy. Many are wise distillations of senior experts who draw on a lifetime of experience in research, teaching, and advising legislators and tax administrators around the world. What follows expresses one reader’s, doubtlessly at least somewhat idiosyncratic, preferences.

Robin Boadway’s 37-page review of the literature on the personal income tax avoids the abiding danger of such reviews by summarizing substantive findings and theoretical ideas rather than listing articles seriatim — X said this, Y said that, and Z said something else. Any review of a literature as vast as that concerning the personal income tax is necessarily selective. Boadway fairly presents the arguments for basing personal taxation on income or consumption bases. As readers of his previous work will anticipate, he ends up favoring the latter over the former. He suggests that to the extent capital is taxed, it is better to do so through Nordic style “dual” or schedular taxes that treat labor and capital income separately, taxing the latter at a relatively low rate.

This discussion feels something like the game of “rock/paper/scissors” — the option one ends up endorsing depends on which problem one considers last or emphasizes. If one focuses on problems of measuring capital income or believes the weight of research favors lower rates of tax on capital income than on labor income, one gravitates toward the consumption base. If one worries about the ease of converting labor into capital income, frets about dynastic wealth accumulation, or recognizes that income-like measures are inescapable in allocating refundable credits and — one is almost forced to say “income-related” — cash transfers, one recognizes that it is difficult or impossible to avoid measuring income. Of course, those considerations lead to discussions of entity-level taxes (the corporation income tax), wealth transfer taxes, and direct transfers, to each of which Boadway devotes a few sensible and balanced paragraphs. One might well suppose that the choice of tax base would depend, among other things, on such institutional and historical considerations as the ability to shift income abroad, the degree of income inequality, and the state of tax administration.

Boadway’s essay is not intended as a full tour de horizon of the economics of personal taxation. For that, students would be better advised to read the three essays and multiple comments in the Mirrlees et al. (2010) report on labor supply and taxes (by Costas Meghir and David Phillips), on the base for direct taxation (by James Banks and Peter Diamond), and on the effects on consumption and saving of taxing asset returns (by Orazio Attanasio). But when they are done with that near-text-book-length effort, Boadway’s honest, clear, and fair summary of a wide range of conflicting views on important topics will help them interpret that vast literature.
Helmuth Cremer and Pierre Pestieau begin their excellent review of wealth taxes and wealth transfer taxes by emphasizing the critical point that how these taxes affect behavior depends upon why people save. Do people accumulate wealth in order to smooth life-cycle consumption, to maximize inter-generational (dynastic) welfare, to enhance their capacity to bestow gifts in general on recipients whose behavior they wish to control, or to simply to have more assets than others do? The presence and weight of these motivations define each individual’s objective function and drive one’s conclusions about the impact and desirability of such taxes. Alas, there is not much evidence on the quantitative significance of each motive, which puts much of the theory into the “well, that’s interesting, but what do I do with it?” category. Cremer and Pestieau spend considerable time evaluating the theoretical conclusion dating from the mid-1980s that the optimal tax on capital income is zero. They conclude that if the only motive for saving is life-cycle consumption smoothing, the case for exempting capital income from taxation is “rather weak” (p. 196). When other motivations are considered, the optimal tax can be positive, zero, or negative. To the extent that wealth transfers are accidental, taxes on them impose little or no excess burden and high or even confiscatory tax rates are desirable. But the other motivations for saving for bequests all imply less-than-100-percent tax rates. Not surprisingly, Cremer and Pestieau reach the conclusion that the right rate is somewhere in between, noting also that because some bequests are accidental but gifts rarely are, estate tax rates should be higher than gift tax rates.

Sijbren Cnossen presents a short, informative essay on excise taxation. Since environmental taxation is left to a separate chapter, Cnossen begins with the eyebrow-raising assertion that the economic analysis of excise taxation begins with the classic 1976 article by Anthony Atkinson and Joseph Stiglitz, but when he turns quickly to Pigouvian taxes intended to offset externalities, it is clear that he (like Atkinson and Stiglitz (1976)) is referring only to taxes on individual commodities that have no motive other than to raise revenue equitably and efficiently. While such taxes may have once been of interest, they have ceased to be of much significance in modern economies. Advocates of taxes on alcohol, tobacco, and energy claim that they do much more than simply raise revenue. Cnossen reviews the various motivations for differential taxes on the use or purchase of particular goods: sin taxes that can offset people’s failure adequately to appreciate the damage that consumption of such harmful commodities as tobacco do to the consumers themselves; and taxes to internalize the costs imposed on others by the use of public goods (roads), congestion, pollution, or direct injuries. While he treats the subject rather lightly, his is one of the few chapters in this volume to point out that it is possible to deal with these problems not only with taxation, but also with prohibitions or other regulations. Given the varied costs, both financial and political, of these alternative instruments, this choice probably merits more space than Cnossen gives it. He draws on his vast experience with tax coordination and harmonization within the European Community to warn of the misuse of excise taxation as concealed trade barriers.

Cnossen ends his essay with a single page on a topic that sits oddly in this chapter — the question of whether and when to earmark taxes to particular expenditures. This topic is of some interest in the case of excise taxes — for example, should gasoline taxes be
earmarked for highway construction, or should tobacco taxes be earmarked for public health or to support anti-smoking programs. But it is of much greater importance in other cases. Payroll taxes finance pensions in many countries and health care in some. And the thus-far-abortive debate in the United States on carbon taxes has foundered in large measure over the question of whether and how much of the revenues generated by such taxes should be earmarked to direct expenditures and what expenditures should be favored, how much to direct income subsidies, and how much to deficit reduction.

Agnar Sandmo provides a characteristically clear essay on the theory of environmental taxation. Most excise taxes reduce efficiency more than do broad-based taxes that raise the same revenue. But excises on goods whose use damages the environment may be an exception. They are a particular instance of Pigouvian taxes on goods whose use generates negative externalities, which thus may improve social welfare. They also, however, may shift the income distribution in undesired ways. And it is even conceivable that they will not improve efficiency, a “cross-elasticity” problem that can occur if the taxes induce a shift in demand from clean to dirty goods other than the one that is taxed. He notes that when the negative externalities span national borders, as is the case with emission of greenhouse gases, the challenge of finding an acceptable tax framework is even harder because of the lack of an effective supra-national enforcement mechanism and because huge cross-country differences in per capita incomes magnify the challenge of fairly distributing tax burdens. While much of the literature on environmental taxes is cast in terms of differential incidence — the prospect of enjoying a “double dividend” by reducing environmental insults while collecting revenue and thus reducing other distortionary taxes — Sandmo notes that debate about environmental taxes often gets swept up in the eternal liberal/conservative dispute about the size of government.

This chapter, like several others, would have benefitted from description of how the theory bears on particular real-world situations. I find it remarkable that a chapter on environmental taxes could be written without mentioning “Kyoto.” There is only a brief reference to the report on global warming authored by the committee chaired by Nicholas Stern (2007), and none to the theoretical questions that this report generated, such as the critical issue of the treatment of so-called “tail risk.” No reference can be found to the struggles within the European Community or in the United States to formulate internal policies to promote a clean environment, including environmental offsets. More generally, taxes are but one way to discourage environmental degradation; to understand environmental taxes, it is helpful if not essential to say something about alternative instruments that might be used.

Jorge Martinez-Vazquez and Richard Bird contribute a 60-page chapter on the value-added tax (VAT) to the volume. To my taste, the most valuable part of this chapter comes at the end, a superlative 10-page guide to VAT administration and politics. The fruits of the lifetimes of experience the authors have amassed through study and practical experience are on display. Is the VAT easier than other taxes to administer? The answer is that it is hard to tell, as all taxes pose administrative problems. About all one can say is that the problems raised by a VAT are different from those posed by other taxes. Is the VAT easier or harder to evade than are other taxes? Pretty much the same answer
holds here. How could the design of VATs be improved? Martinez-Vazquez and Bird stress that VAT design should vary with the stage of economic development. The largest problems are the widely varying sizes among countries of the informal sector and differences in the importance of small businesses. This raises a difficult problem of tax system design: try to apply the VAT strictly to too many small businesses and they will over-burden administration, but apply it to too few, and the scope of evasion balloons.

My sense is that a person who reads this short section carefully and explores some of the sources they reference will come away with a decent set of practical tools, be able to evaluate actual value-added tax systems in different countries and, if asked to do so, will have a reasonable chance of designing a sensible one.

While all of the authors represented in this book are highly regarded scholars and practitioners of public economics, many of the chapters would have benefitted from a requirement to respond to structured and specific questions and from aggressive editing. I shall focus on aspects of many chapters that I found not just annoying, but indicative of undisciplined exposition. Page after page is devoted to what seem to be table dumps from various readily available sources that convey very little of genuine value. More pages are filled with regression coefficients from models that are either not presented or have no plausible theoretical base. Page 21 presents a table showing top marginal personal income tax rates in seven different years for 30 different countries. But one cannot know what it means because it doesn’t show what proportion of the population actually faces such rates. Half of pages 40–44 is taken up by graphs showing taxes as a share of GDP or particular taxes as a share of total taxes averaged over varying groups of 32, 75, or 116 countries. It is a technical quibble, I suppose, that readers aren’t told if these are weighted or unweighted averages — a quibble because the value of these data are obscure in either case. Why would one care if the average share of total taxes raised by consumption taxes averaged over 116 countries climbed from about 25 percent in 1972 to about 32 percent in 1989 and then fell back to 30 percent in 2005? If one wants to tell readers that “consumption taxes are used more now than in the past,” I just did and it takes 10 words. Pages 55–56 report regression coefficients that ostensibly show what the authors say are “determinants,” but which are actually correlates, of tax mix in scores of countries with no indication of how these coefficients might influence anything that anyone would do. Pages 226–229 are devoted to showing measures of different indicators of tax performance for various years for more countries that I have the patience to count that might be of interest to tax officials in these countries, but certainly not to any student or teacher of public economics who does not treat his or her time as a free good. Virtually the entirety of the chapter on “political regimes, institutions, and the nature of tax systems” is devoted to a model that the authors do not feel required to share with the readers of the volume and to concepts that are not fully explained.

Some chapters strike me as out of place in this volume. The subject of tax administration is of first order importance. It is the subject of a lengthy chapter in Dimensions of Tax Design written by three authors with comments by three discussants (including John Hasseldine, the author of the short chapter on administration in The Elgar Guide). It has taken the efforts of Joel Slemrod and a handful of other analysts to rescue the topic of
tax administration from utter neglect by economists. Even now, it is not exactly at the heart of any graduate course in public economics, although the costs of administration are of the same general magnitude as deadweight losses, with which public finance has wrestled for decades. A modest body of theory and empirical findings on tax administration now exists. The most important points are that in evaluating the cost of any tax, both administrative and distortionary costs count, that there may be trade-offs between them, and that it is wrong to ignore either. Some framework is necessary for measuring and combining both of these costs. Unfortunately, the chapter on tax administration for The Elgar Guide provides none. It contains many more or less ex cathedra observations (“... the UK needs to spend more time in understanding the role of professional advisors ...” (p. 365); “... there is a growing concern at large companies’ ability to successfully avoid huge amounts of taxes ...” (p. 366); “... it might be expected that tax administration would be regarded as a science; however I believe it is more of an art” (p. 371). These and other observations may — or, for all of the evidence presented, may not — be true, but one is left adrift, wondering what to do with them or, in some cases, even exactly what they mean.

I shall not comment on the other chapters specifically. As noted at the outset, The Elgar Guide to Tax Systems vastly differs from the two volumes of the Mirrlees Review, Dimensions of Tax Design and Tax by Design, in scope and, doubtless, in budget. Nonetheless, comparisons between these two projects although, perhaps, unfair, are inescapable. Several chapters of The Elgar Guide are excellent. On balance, however, the treatments of largely the same issues are generally both more thorough and more insightful in the Mirrlees Review — which would clearly be my choice for a comprehensive exposition of the current state-of-the-art in the most important topics of public economics.

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REFERENCES


