

Are tastes a possible reference for choosing the income tax?*Serge-Christophe Kolm***Abstract*

It seems that people consider individual's tastes not to be relevant for the determination of the income tax (an issue in "macrojustice"). R. Sturn's proposal of a counter-example is discussed. If, in particular, voters and officials share this view, a theory of this tax derived from tastes will not be applied. Then, an implementable theory of optimum income taxation has to be based on issues of liberties, rights, means and the allocation of the value of given resources and notably given capacities. The post-Musgrave (post-1974) view of Rawls provides such a scheme, endowed with a variety of important meanings. A recent national tax reform proves its implementability with respect to information and incentives.

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1. Tastes and the income tax

In the numerous discussions about what the income tax should be that I have heard and read, by politicians, political parties, tax administrators, various commentators, journalists and ordinary people, I have never met a mention of the taxpayers' tastes. They all seem to find, *for this particular distributive question*, the issue of tastes to be irrelevant. Rawls (1971) makes the similar observation that, for the question of "social justice" which is "macro" and "not micro", tastes are "never used". Similarly, Mirrlees (1971) observes that "differences in tastes raise different kinds of problems" than those relevant for determining the optimum income tax (this theory is used by almost all his followers, although differences in tastes are introduced in Mirrlees 1986). Philosophers largely follow Rawls's conclusion (e.g. Dworkin 1982, Cohen 1985). The most basic fact, however, is that *if* all voters and officials hold that taxpayers' tastes are not relevant for determining the income tax, a theory of this tax using these tastes just cannot be applied (short of a military coup imposing it).

The question of the just and possible overall distribution is doubtlessly a very important one. In his thoughtful review of my volume *Macrojustice, The Political Economy of Fairness*, Richard Sturn finds an objection to the previous remarks in the fact that scholars have proposed "equal sacrifice principles". This is well taken, but the relevant issue for application is, more precisely, "is this principle endorsed by people" and "is it applied" for the problem in question? Of course, the objection may be relevant only if this "sacrifice" is in "satisfaction" or "utility" rather than in money or in effort or labour (in fact, a principle derived in *Macrojustice* amounts to an equal sacrifice in labour for providing equal benefits in money, plus free extra labour and earnings). The fact that the principle is proposed by scholars is not sufficient in itself for the possibility of implementation. Scholars may propose anything. Only the view of the "real people" matters for this question (this is for instance the reference for Rawls). Scholars even frequently propose positions that they do not support when, as citizens, they face the real choice. Moreover, and most importantly, the question here is not *any* issue of distributive justice. It is the choice of the income tax and, more generally, the question of the overall distribution in *macrojustice*, different from issues of microjustice concerned with particular situations, circumstances, goods, needs or people. In particular, this issue is neither of the two following ones in which interpersonal comparisons of variations of satisfaction are frequent. (1) Distribution in communities of people relatively close to one another (e.g. a family). (2) Distribution between suffering people for relieving

their pain (e.g. allocation of emergency care or of organs for transplant). A nation is neither a family nor a hospital. The income tax differs from welfare programs. Even if it would be nice that a nation were like a big family, citizens actually see a difference.

People's acceptance of this "equal sacrifice principle" for the income tax depends on answers they give to the following questions. Consider some other person whom you do not know and assume that neither he nor you are poor. Then, *should you pay a higher income tax than this other person for any of the following reasons:*

- He is a miser very attached to his euros?
- He enjoys cheap beer and hiking as much as you enjoy expensive wines and cruises?
- On the contrary, he is a gourmet who derives sybaritic pleasure from each euro's worth of consumption, and you are not?
- He is an eager poker player?
- He relishes in conspicuous consumption?
- You have a more joyful or serene character than him?
- On the contrary, he has a more joyful character than you, which enables him to be more pleased by each euro spent?
- His right brain is more active than his left brain and you are in the reverse situation (this implies that you suffer less than he does from a given amount taxed away).¹

Should we, indeed, subsidize misery, poker playing, vainglory and non-pathological neurophysiology?

The answers may be affirmative. It is amusing to argue that they should. But you can also defend yourself by arguing that what matters are the actual remaining after-tax incomes. Then, if the other person likes a euro more than you do, equality in utility requires that more money is left to you. Therefore, you should pay a lower income tax from equal before-tax incomes. This conclusion is the opposite of the former ones (and all violate the principle of "horizontal equity" requiring that people with equal incomes pay equal taxes).

However, economists often argue that people should be judged by what they do rather than by what they say. In real life, then, has any tax administration ever tried to gather information about such comparative psychological characteristics to establish income tax liabilities – or just thought about doing it? Could they do it? Or would they think that such

differences in tastes are irrelevant for this general tax; that these personal characteristics are private matters not pertinent for general public policy; and, perhaps, that inquiring about them may be an abusive intrusion into privacy? Have politicians, political parties or commentators ever proposed in earnest to base the income tax on such mental features and traits of character? Has, in fact, anybody ever thought seriously of such seemingly bizarre questions?

Nevertheless, equal sacrifice may in fact well be the best criterion. One argument for this is that such criteria comparing tastes and their variations are common within groups of mutually loving people, such as families; and there is a case for taking such societies of mutual altruists to be the best societies. These criteria are then, more precisely, distributive criteria of the best societies. However, national-level societies are not of this type, although they are bound by sentiments of solidarity and justice. In particular, these criteria are not applied for the income tax, which suggests that people (notably voters and officials) do not find them relevant, adequate, or just *for this purpose*. Therefore, one must resort, for this application, to second-best (morally second-best) applicable criteria, or, if one wants, first-best criteria for such second-best societies (in particular, societies made of second-best people). People will also want Pareto efficiency, but we know that it can be achieved by free exchange from an allocation of the given resources.

2. Consequences: the two paradigms of optimum income taxation and distribution

However, Rawls's and Mirrlees's remarks of 1971 are slightly different. Rawls thinks that tastes are considered irrelevant, whereas Mirrlees's article proposes that differences in tastes are. Yet if individual tastes are relevant for determining the income tax, it happens that differences in them influence the resulting tax (as in Mirrlees 1986). And individual tastes are actually different. Therefore, if these differences should not affect the tax, this implies that tastes should be taken as irrelevant for this purpose, i.e. Rawls's position (for instance). Rather than endorsing this conclusion, Mirrlees, in 1971, directly discards differences in tastes by the logical device of assuming that all individuals have the same utility function, and this is followed by almost all the abundant literature he inspired. Actually, however, people do not have the same utility function. Hence, this function is not their utility function (except, perhaps, for one of them). It represents neither their welfare nor their choice. Moreover, this unique utility function determines the optimum tax schedule, but what such function should

we choose? These questions led Mirrlees to abandon this theory fifteen years later (1986) – by introducing differences in individual tastes, however.

Rawls does not meet this kind of problems since deleting tastes, and hence the individual utility functions that represent them, from individual choices, leaves one with individuals' possibilities. Therefore, the just allocation should concern “a principle of equal liberty” and “*rights and opportunities* and the *means* of satisfaction”. Rawls operationalizes this conclusion by proposing the standard basic rights and an ideal of equality in “primary goods” including one economic primary good, income. However, equalizing earned incomes leads to distortionary taxation. Then, Rawls first resorted to maximin in primary goods, but the economist Richard Musgrave (1974) pointed out to him that this distortion is due to the fact that the complement of labour, leisure, is not taxed and equalized because it is not a primary good, and proposed to consider it as one. Rawls (1974) accepted this and now had two economic primary goods, income and leisure.

Then, it is possible to give to all individuals the same equal basic allocation of primary goods, “by the use of which individuals' ends may be equitably pursued” (Rawls). It suffices to share equally the proceeds of the same labour of all individuals (with their different productivities). This equal labour corresponds to a complementary equal leisure. Then, from the same basic right of free exchange they use when they buy consumption goods with their income, individuals can freely put some part of this leisure to work in order to earn extra income which does not give rise to a distributive tax since optimum allocation and distribution is already achieved by the basic initial policy. This post-1974 Rawlsian distributive principle is “equal-labour income equalization” (ELIE). It amounts to an equal sharing of the value or product of the same fraction of individuals' productive capacities, to a universal basic income financed by an equal labour of each individual, to each yielding to each other the product of the same labour in a general labour reciprocity (a property emphasized by Rawls) and – it is shown – to an equal liberty provided by domains of choice that are different for individuals with different productivities and wage rates.² The full theory considers all the dimensions of labour, in particular formation and intensity in addition to time. The other public expenditures can be financed by benefit taxation or also by “equal sacrifice” measured in labour, i.e., “from each according to her capacities”.

Practically, this distributive tax is based on wage rates measuring given productive capacities. Mirrlees (1971) proposes ways of knowing wage rates and of “estimating a man’s skill-level” (although his models and the literature they inspired base the tax on the full earned income). The present French tax law implements *Macrojustice* simply by exempting overtime labour from the income tax (over a low benchmark).³ 9/10 of labour income is wage income. Firms do not cheat because affecting the pay-sheet programs is too complex and could not escape the attention of the tax authorities. Cheating is therefore very much lower than with the previous law basing the tax on full earned income, which induced substantial under-reporting of overtime labour.⁴ The issues of other dimensions of labour (intensity, formation), part-time labour, unemployment, non-wage labour, etc. are discussed in the volume *Macrojustice* and partly applied. Hence, this optimum income tax paradigm has begun to be applied a few quarters after publication,⁵ whereas the other has never been after nearly four decades, perhaps because of the lack of endorsement of its ethic suggested above (hence the difficulty of either knowing all individual tastes or choosing a common utility function has not been actually faced).

Finally, Richard Sturn discusses the methods for obtaining society’s choice of the degree of redistribution and equalization (the notional equalization labour), but this question, and in part these methods, would apply as well for the other paradigm of optimum taxation, for the choice of the appropriate social welfare function (with more complexity).⁶

Trying to derive the optimum income tax from tastes is applying to macrojustice a principle which exists in microjustice. This is similar to applying quantum theory, which explains microphysics well, to cosmology ruled by general relativity. The result of the model is not possible in the real world.

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¹ See Davidson (1992, 2000).

² See Kolm (2005, 2008, and chapter 1 in Gamel and Lubrano, 2008).

³ Expressed in hours, or in days per year for executives.

⁴ These observations are noted here because, when they are shown the exemption of overtime labour, a number of economists answer, as by a Pavlovian reflex, that firms and employees will agree to cheat by declaring as overtime labour that is not. This just does not happen, for reasons of practicability and control.

⁵ The volume *Macrojustice* was published in 2005. A presentation beginning with the exemption of overtime labour appeared in an economic newspaper at the end of this year. This was taken by a presidential candidate who made it the center of his program. This candidate won the election and had a Parliament elected along his lines, and the tax law was immediately voted. This was applied a few months later and we now have the experience of its easy implementability.

⁶ These issues are analyzed further in the contributions to two collective books edited by Gamel and Lubrano (2008), and Fleurbaey, Salles and Weymark (2008), and in Schokkaert (2008) and Kolm (2008).