Louis Kaplow, Holland Medal Recipient: Social Welfare

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November 2019
Welfarism vs. Fairness Notions


Contrast two approaches: based on “Welfarist” rules versus on “notions of fairness.”

Welfarist rules depend only on individual utilities, nothing more, nothing less.

Notions of fairness can depend on anything: “eye for eye,” corrective.

Guiding Principle: Welfarist rules should be used to evaluate legal rules (policies overall?)
Welfare Weights

Let $g_i$ be the “marginal social welfare weight” on individual $i$.

How much, as a society we value $1$ to individual $i$?

Useful when thinking of legal rules, policies, etc.
Generalized social welfare weights approach

\[ u_i = u(c_i - v(z_i; x_i^u, x_i^b)) \quad \quad g_i = g(c_i, z_i; x_i^s, x_i^b) \]
Welfarism: A broad view

Welfarism is based on individual utilities...

.. but individual utilities can be very complex and themselves depend on altruism, equity concerns.

Any “non-standard” concern could be in individual utilities.

But the social objective should not depend on anything else than individuals’ welfare.
Which of the following two individuals do you think is most deserving of a $1,000 tax break?

Individual A earns $50,000 per year, pays $10,000 in taxes and hence nets out $40,000. She greatly enjoys spending money, going out to expensive restaurants, or traveling to fancy destinations. She always feels that she has too little money to spend.

Individual B earns the same amount, $50,000 per year, also pays $10,000 in taxes and hence also nets out $40,000. However, she is a very frugal person who feels that her current income is sufficient to satisfy her needs.

- Individual A is most deserving of the $1,000 tax break
- Individual B is most deserving of the $1,000 tax break
- Both individuals are exactly equally deserving of the tax $1,000 break

Source: survey in Saez and Stantcheva (2013)
Results:

<table>
<thead>
<tr>
<th>Consumption lover</th>
<th>Frugal</th>
<th>Taste for consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>more-deserving</td>
<td>more deserving</td>
<td>irrelevant</td>
</tr>
<tr>
<td>4%</td>
<td>22%</td>
<td>74%</td>
</tr>
</tbody>
</table>
Does society care about effort to earn income?

- **Hard-working vs. Easy-going person with same net income**
- "A earns $30,000 per year, by working in two different jobs, 60 hours per week at $10/hour. She pays $6,000 in taxes and nets out $24,000. She is very hard-working but she does not have high-paying jobs so that her wage is low."
- "B also earns the same amount, $30,000 per year, by working part-time for 20 hours per week at $30/hour. She also pays $6,000 in taxes and hence nets out $24,000. She has a good wage rate per hour, but she prefers working less and earning less to enjoy other, non-work activities."

<table>
<thead>
<tr>
<th>Hardworking more deserving</th>
<th>Easy-going more deserving</th>
<th>Hours of work irrelevant conditional on total earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>43%</td>
<td>3%</td>
<td>54%</td>
</tr>
</tbody>
</table>
Calibrating Social Welfare Weights

- Calibrate $\tilde{g}(c, T) = \tilde{g}(c - \alpha T)$
- 35 fictitious families, with different net incomes and taxes
- Respondents rank them pair-wise (5 random pairs each)

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Which of these two families is most deserving of the $1,000 tax break?

- Family earns $100,000 per year, pays $50,000 in taxes, and hence nets out $50,000
- Family earns $25,000 per year, pays $1,250 in taxes, and hence nets out $23,750

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Which of these two families is most deserving of the $1,000 tax break?

- Family earns $50,000 per year, pays $2,500 in taxes, and hence nets out $47,500
- Family earns $500,000 per year, pays $170,000 in taxes, and hence nets out $330,000
Eliciting Social Preferences

Is A or B more deserving of a $1,000 tax break?
Eliciting Social Preferences

Is A or B more deserving of a $1,000 tax break?
Eliciting Social Preferences

$S_{ijt} = 1$ if $i$ ranked 1st in display $t$ for respondent $j$, $\delta T_{ijt}$ is difference in taxes, $\delta c_{ijt}$ difference in net income for families in pair shown.

$$S_{ijt} = \beta_0 + \beta_T \delta T_{ijt} + \beta_c \delta c_{ijt} \quad \alpha = \frac{\delta c}{\delta T} \mid s = -\frac{\beta_T}{\beta_c} = -\text{slope}$$

![Diagram of indifference curves showing $g(c, T) = g(c - \alpha T)$](image-url)
### Table 5: Calibrating Social Welfare Weights

<table>
<thead>
<tr>
<th>Sample</th>
<th>Full</th>
<th>Excludes cases with income of $1m</th>
<th>Excludes cases with income of $500K+</th>
<th>Excludes cases with income of $500K+ and $10K or less</th>
<th>Liberal subjects only</th>
<th>Conservative subjects only</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
</tr>
<tr>
<td>d(Tax)</td>
<td>0.0017*** (0.0003)</td>
<td>0.0052*** (0.0019)</td>
<td>0.016*** (0.0019)</td>
<td>0.015*** (0.0022)</td>
<td>0.00082*** (0.00046)</td>
<td>0.0032*** (0.00068)</td>
</tr>
<tr>
<td>d(Net Income)</td>
<td>-0.0046*** (0.00012)</td>
<td>-0.0091*** (0.00028)</td>
<td>-0.024*** (0.00078)</td>
<td>-0.024*** (0.00094)</td>
<td>-0.0048*** (0.00018)</td>
<td>-0.0042*** (0.00027)</td>
</tr>
<tr>
<td>Number of observations</td>
<td>11,450</td>
<td>8,368</td>
<td>5,816</td>
<td>3,702</td>
<td>5,250</td>
<td>2,540</td>
</tr>
<tr>
<td>Implied $\alpha$</td>
<td>0.37 (0.06)</td>
<td>0.58 (0.06)</td>
<td>0.65 (0.07)</td>
<td>0.64 (0.09)</td>
<td>0.17 (0.12)</td>
<td>0.77 (0.16)</td>
</tr>
<tr>
<td>Implied marginal tax rate</td>
<td>73%</td>
<td>63%</td>
<td>61%</td>
<td>61%</td>
<td>85%</td>
<td>57%</td>
</tr>
</tbody>
</table>
Other Concerns Based On Survey Experiments (I)

Immigrants: Generosity does not travel well across ethnic, religious, national lines:

Simply making people think about immigrants reduces desired redistribution

Perceptions are very off.
Perceived Share of Poor that are Immigrants

% of Poor who are Immigrants

- US
- UK
- Sweden
- Italy
- Germany
- France

Actual vs. Perceived (mean)
Belief in the “American Dream:”

Those who believe in more equality of opportunity want less redistribution.

Too optimistic about the American Dream.
Probability of Moving to Top Quintile (Actual vs. Perceived)

US
UK
FR
IT
SE

Pessimistic
Optimistic

Average Perceived Probability
Real Probability

20 1
What Should Be the Goal of a Good Income Tax System?
Main Shortcomings of the Estate Tax?

Many loopholes allow wealthy individuals to avoid paying the estate tax, even when they are already worth millions of dollars. Some wealthy people take advantage of these loopholes, which can give them an unfair advantage over those who work hard to accumulate wealth.

Inheritance taxes seem unfair to many people, especially those in the middle class and low-income families. These taxes can take away a portion of the wealth that people have worked hard to accumulate, which can be a serious burden for their heirs.

The estate tax system is often criticized for its high rates, which can make it difficult for people to leave an inheritance to their loved ones. Some people argue that the estate tax is an unfair burden on the wealthy, while others believe that it is necessary to generate revenue for the government.

The estate tax is also criticized for its complexity and the many rules that govern it. People may struggle to find ways to avoid paying the tax, which can be a source of stress and anxiety for those who are trying to leave an inheritance to their loved ones.

Overall, the estate tax is a complex and controversial issue that continues to be a point of debate among policymakers and the general public.
Thank you Louis for making us think about these critical issues!