

Louis Kaplow, Holland Medal Recipient: Social Welfare

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Welfarism vs. Fairness Notions

Seminal work: “Fairness versus Welfare” with Steven Shavell (2001).

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

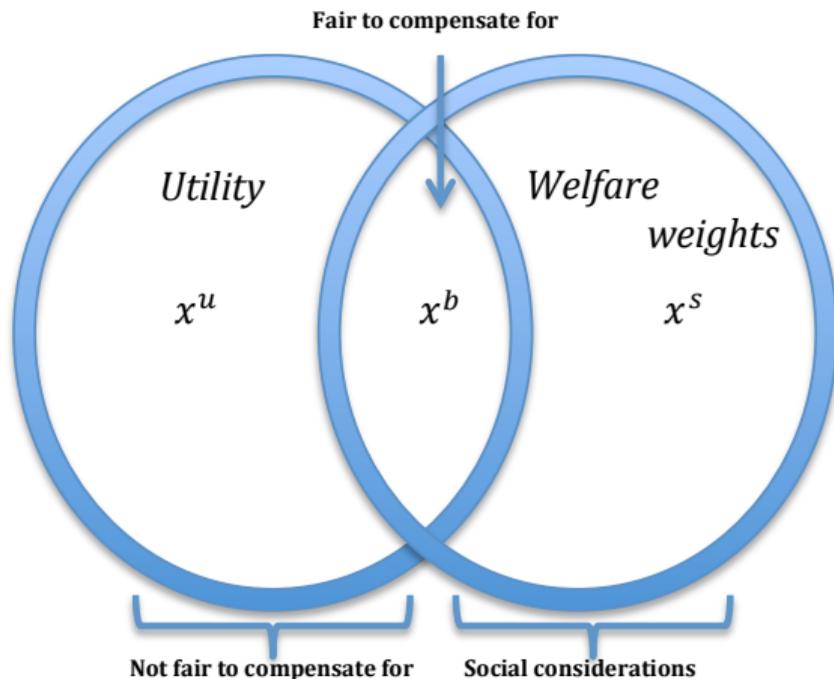
Let g_i be the “marginal social welfare weight” on individual i .

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

Useful when thinking of legal rules, policies, etc.

Generalized social welfare weights approach

$$u_i = u(c_i - v(z_i; x_i^u, x_i^b)) \quad g_i = g(c_i, z_i; x_i^s, x_i^b)$$



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

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Source: survey in Saez and Stantcheva (2013)

Results:

Consumption lover more-deserving 4%	Frugal more deserving 22%	Taste for consumption irrelevant 74%
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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.”*

Hardworking more deserving	Easy-going more deserving	Hours of work irrelevant conditional on total earnings
43%	3%	54%

Calibrating Social Welfare Weights

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

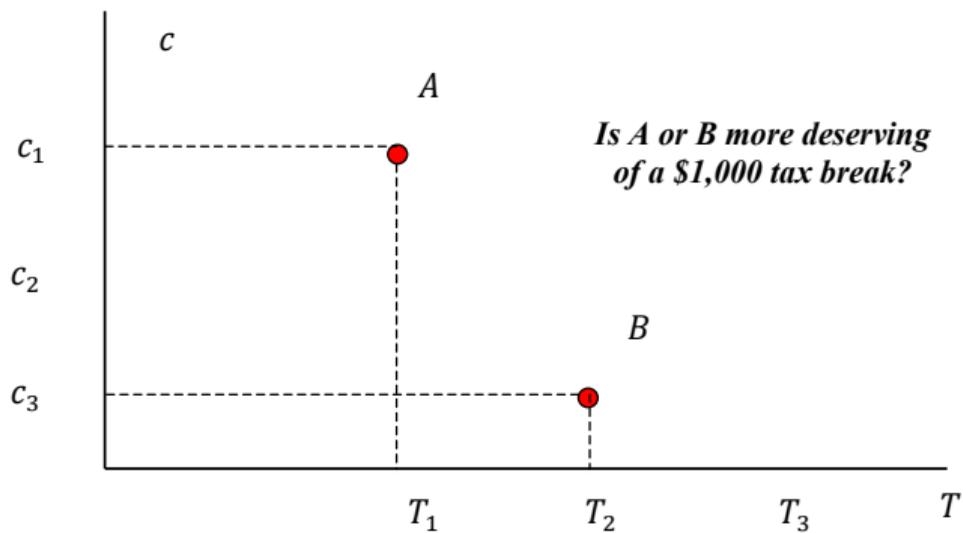
Which of these two families is most deserving of the \$1,000 tax break?

- 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

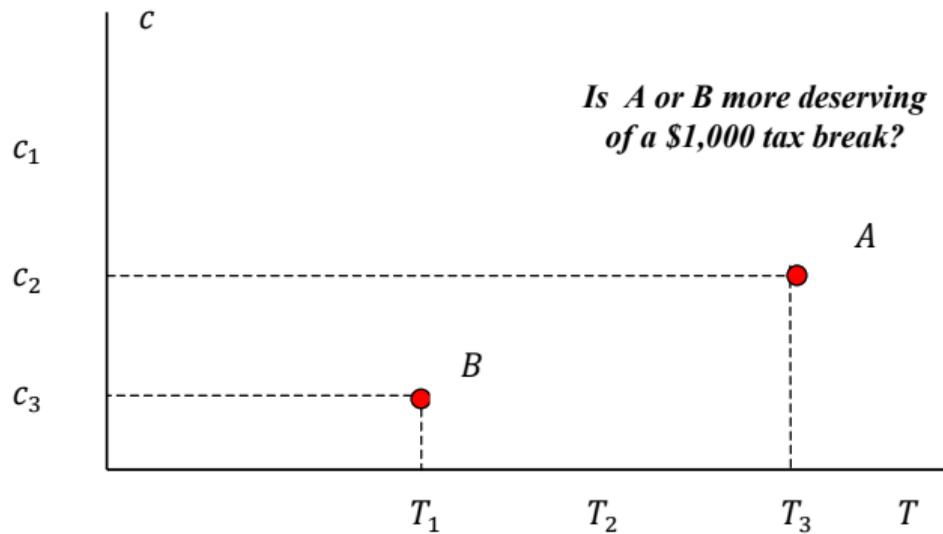
Which of these two families is most deserving of the \$1,000 tax break?

- 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



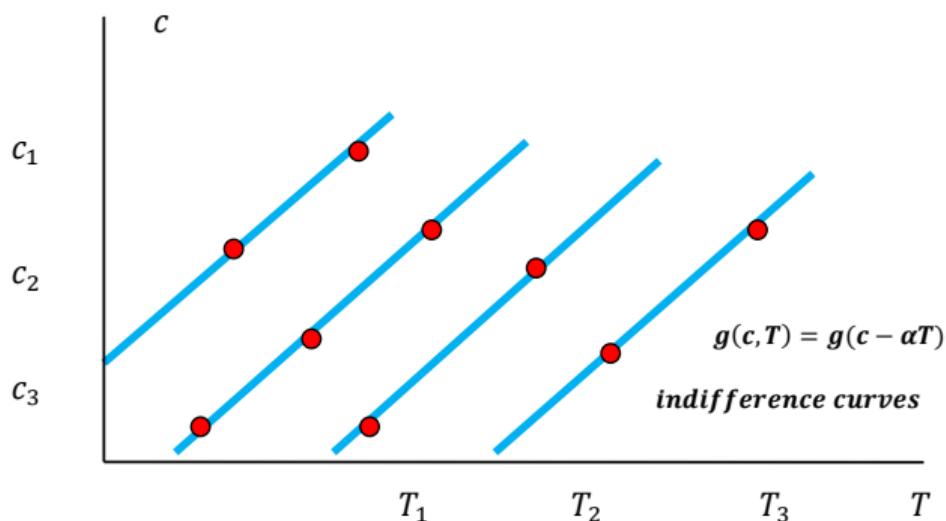
Eliciting Social Preferences



Eliciting Social Preferences

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

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



Eliciting Social Preferences

Sample	Probability of being deemed more deserving in pairwise comparison						
	Full	Excludes cases				Liberal subjects only	Conservative subjects only
		with income of \$1m	with income of \$500K+	with income \$500K+ and \$10K or less	with income \$500K+ and \$10K or less		
(1)	(2)	(3)	(4)	(5)	(6)		
d(Tax)	0.0017*** (0.0003)	0.0052*** (0.0019)	0.016*** (0.0019)	0.015*** (0.0022)	0.00082*** (0.00046)	0.0032*** (0.00068)	
d(Net Income)	-0.0046*** (0.00012)	-0.0091*** (0.00028)	-0.024*** (0.00078)	-0.024*** (0.00094)	-0.0048*** (0.00018)	-0.0042*** (0.00027)	
Number of observations	11,450	8,368	5,816	3,702	5,250	2,540	
Implied α	0.37 (0.06)	0.58 (0.06)	0.65 (0.07)	0.64 (0.09)	0.17 (0.12)	0.77 (0.16)	
Implied marginal tax rate	73%	63%	61%	61%	85%	57%	

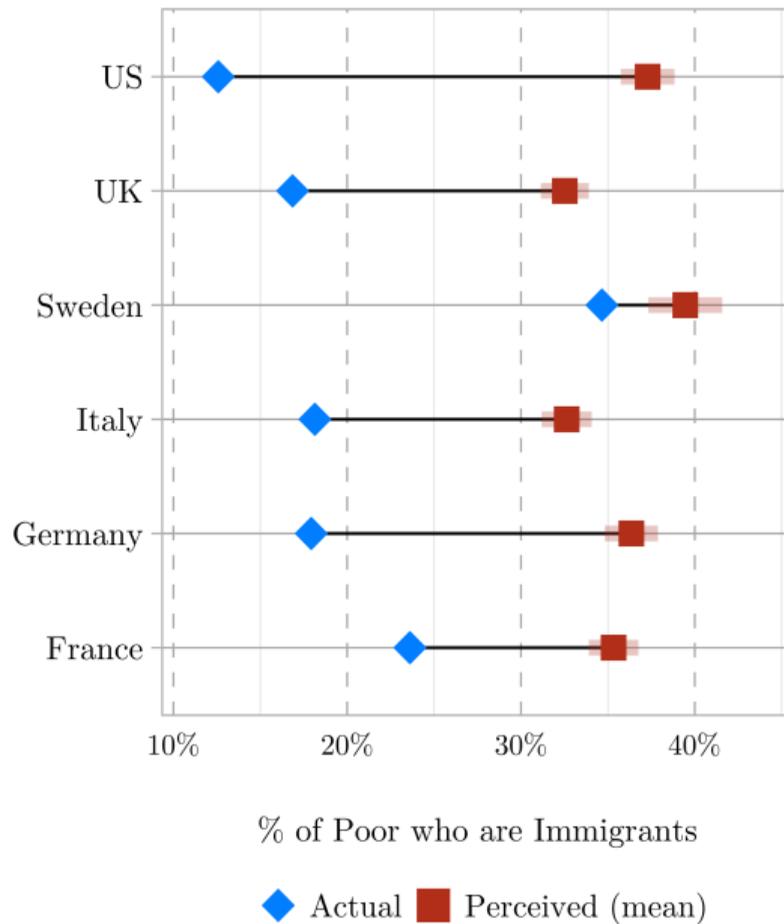
Other Concerns Based On Survey Experiments (I)

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



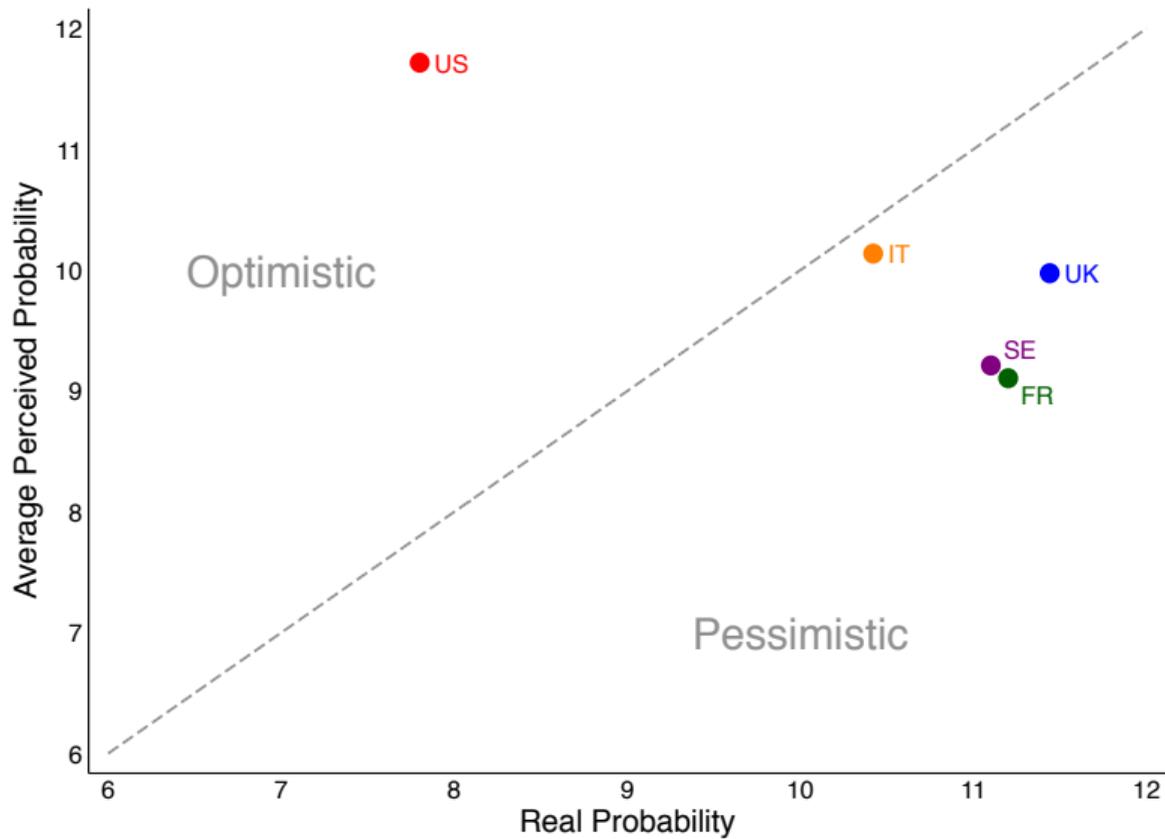
Other Concerns Based On Survey Experiments (II)

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)



Thank you Louis for making us think about these critical
issues!