The Trade-Off

Efficiency Losses

When we tax wage income or consumption there is an efficiency loss.

And there is an efficiency loss.

So too when we tax capital income.

We could eliminate all government spending.

So what are we to do?

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So What are we to Do?

Eliminate the Government?
Eliminate the Government?

We could eliminate all government spending.

Recognize that efficiency losses are a cost of government spending. So what are we to do?

Efficiency Losses from Wage and Sales Taxes

Efficiency Losses from Taxes on Capital Income

Efficiency Losses from Taxes on Capital Income

Rotate the Graph

Efficiency Losses $\frac{D}{H^*}\tau H^*$

$\tau_r$ is the efficiency loss

So what are we to do?

$\tau_r$ is the efficiency loss

Sum of Efficiency Losses
The Trade-Off

And The Number is

• This graph is not to scale, and the general point is obvious: a balance is called for.
• But can we put a number?

A Formula from the Past

\[
\frac{\tau_a}{\tau_d} = \frac{\frac{R_{T_2}}{EL_{T_2}}}{\frac{R_{T_1}}{EL_{T_1}}} 
\]

Updated

\[
\frac{\tau_r}{\tau_w} = \frac{\frac{R_{T_2}}{EL_{T_2}}}{\frac{R_{T_1}}{EL_{T_1}}} \]

Putting Some Numbers

\[
\frac{\tau_r}{\tau_w} = \frac{\frac{R_{T_2}}{EL_{T_2}}}{\frac{R_{T_1}}{EL_{T_1}}} < 1 
\]

End

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