

Taxation and Economic Efficiency

ABSTRACT

This paper analyzes the distortions created by taxation and the features of tax systems that minimize such distortions (subject to achieving other government objectives). It starts with a review of the theory and practice of deadweight loss measurement, followed by characterizations of optimal commodity taxation and optimal linear and nonlinear income taxation. The framework is then extended to a variety of settings, initially consisting of optimal taxation in the presence of externalities or public goods. The optimal tax analysis is subsequently applied to situations in which product markets are imperfectly competitive. This is followed by consideration of the features of optimal intertemporal taxation. The purpose of the paper is not only to provide an up-to-date review and analysis of the optimal taxation literature, but also to identify important cross-cutting themes within that literature.

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