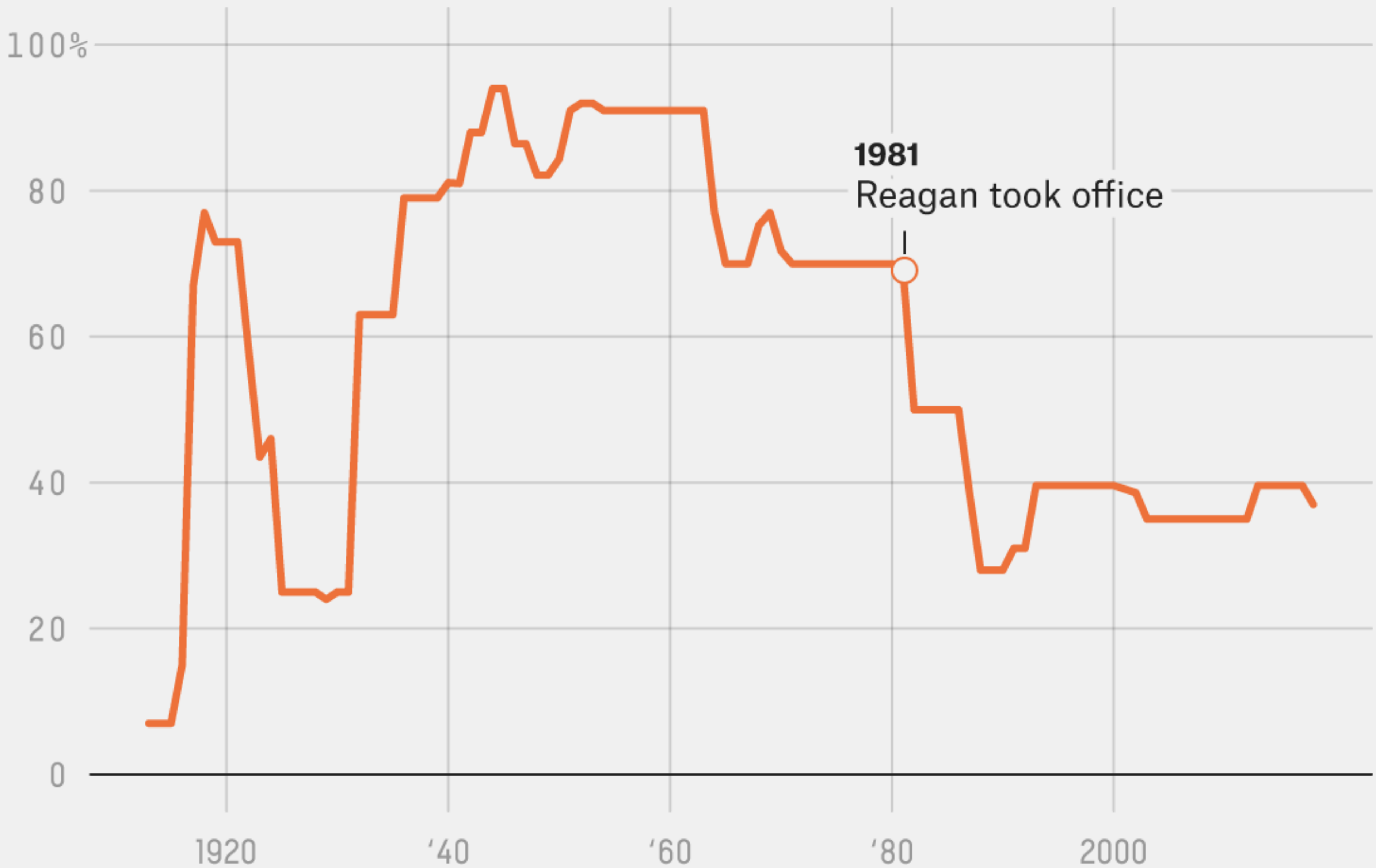
Historically, a 70 percent marginal tax rate is not unusual

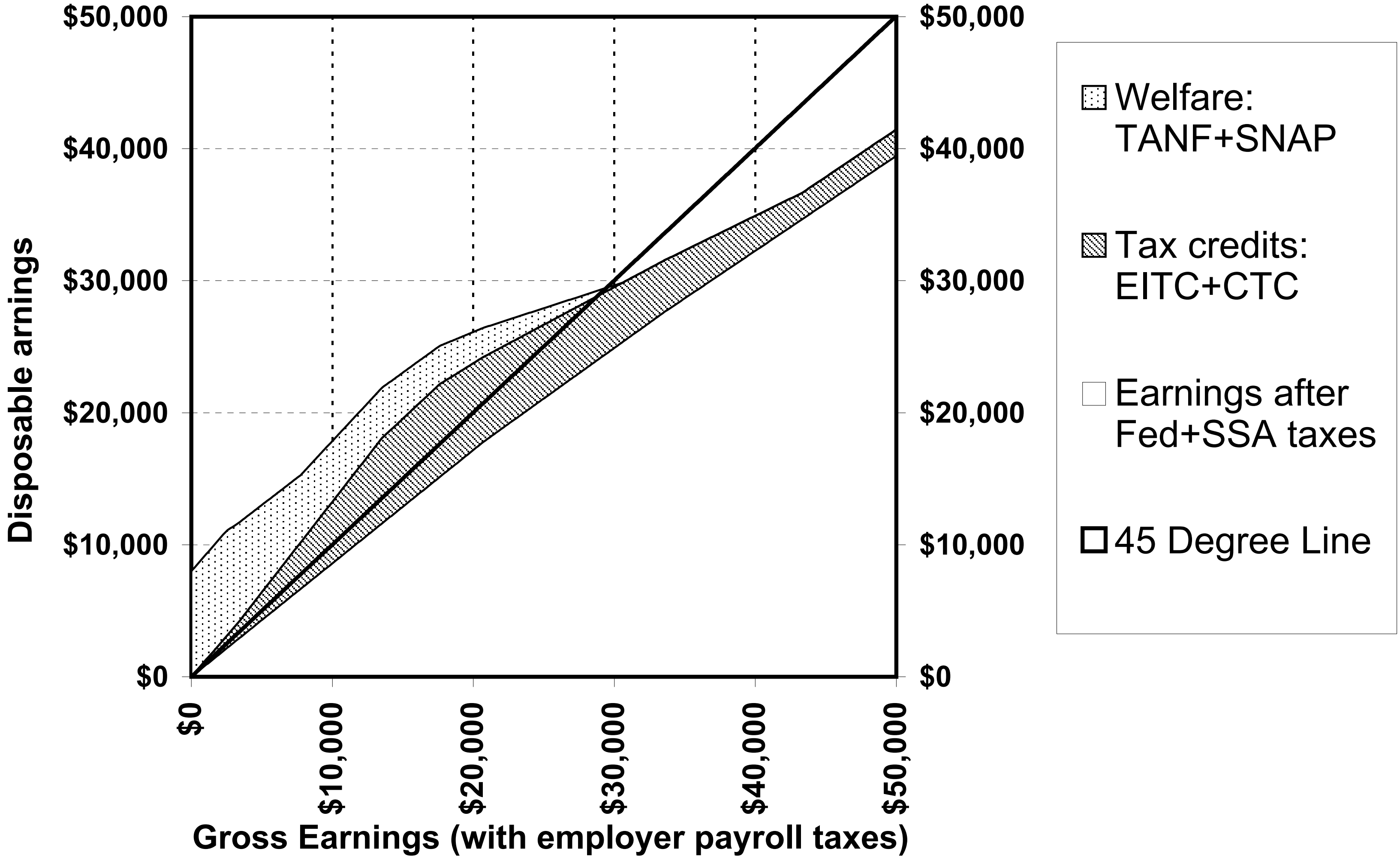
The top marginal income tax rates from 1913 to 2018



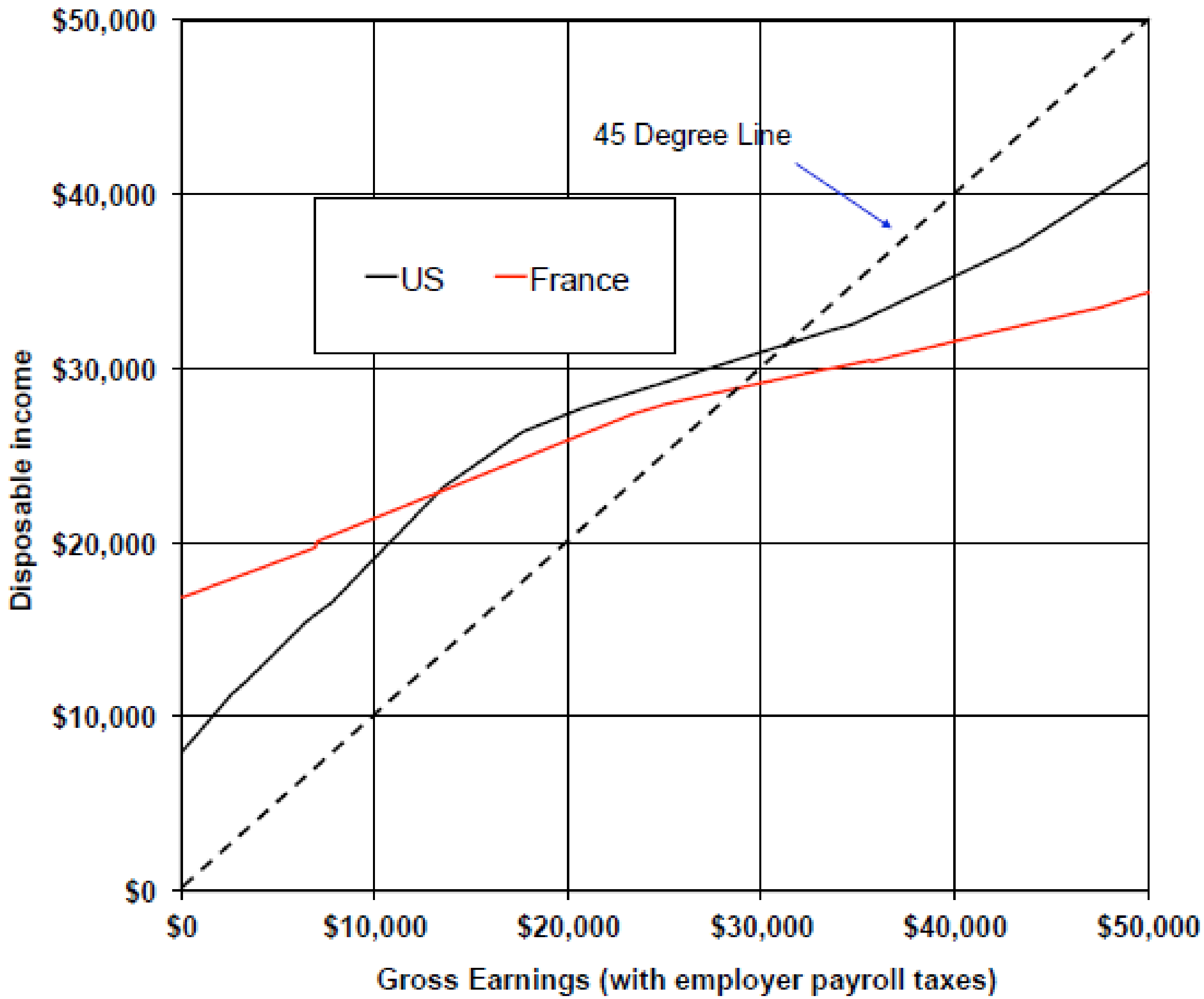
FiveThirtyEight

SOURCE: TAX POLICY CENTER

US Tax/Transfer System, single parent with 2 children, 2009



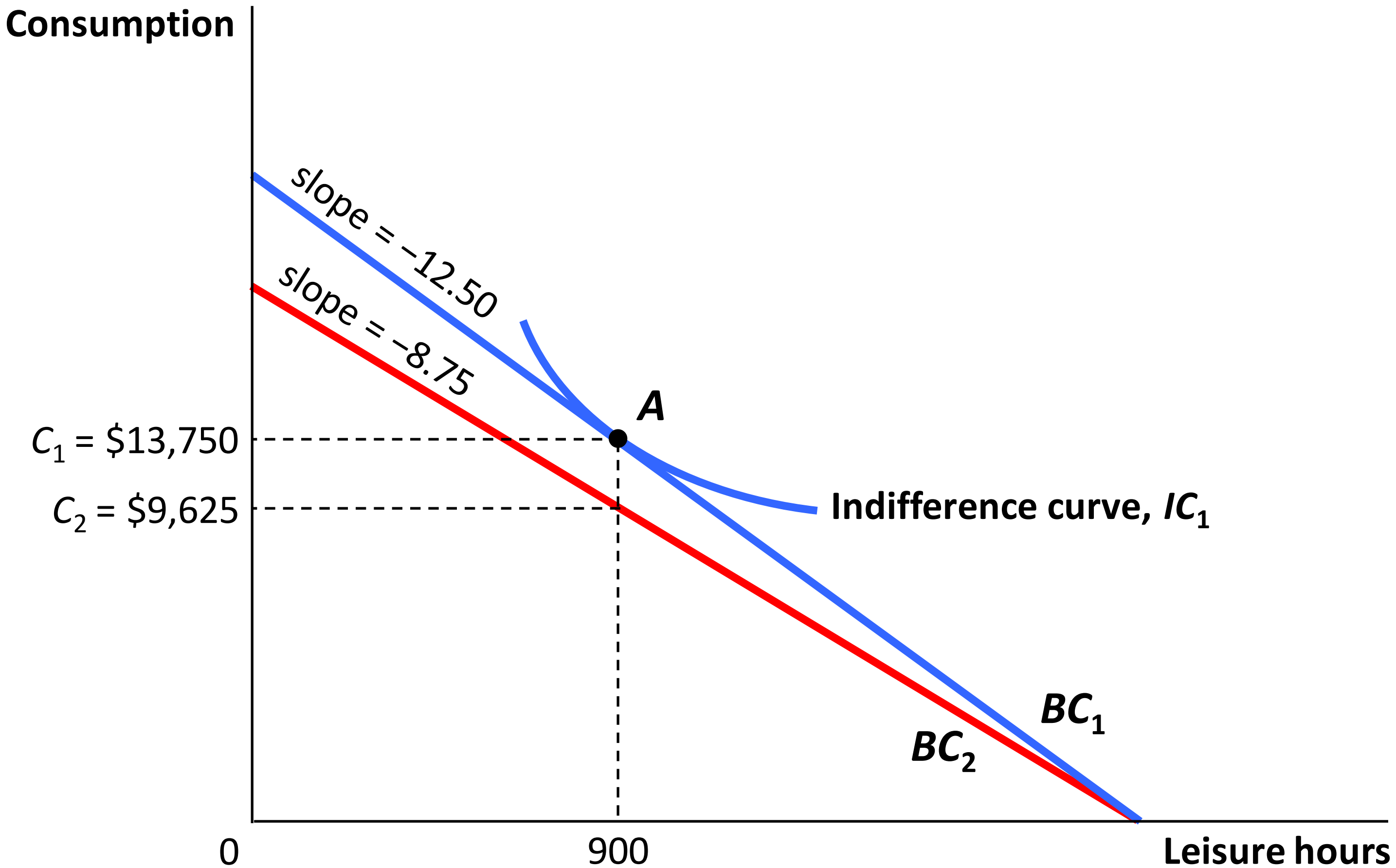
Source: Computations made by Emmanuel Saez using tax and transfer system parameters



Source: Piketty, Thomas, and Emmanuel Saez (2012)

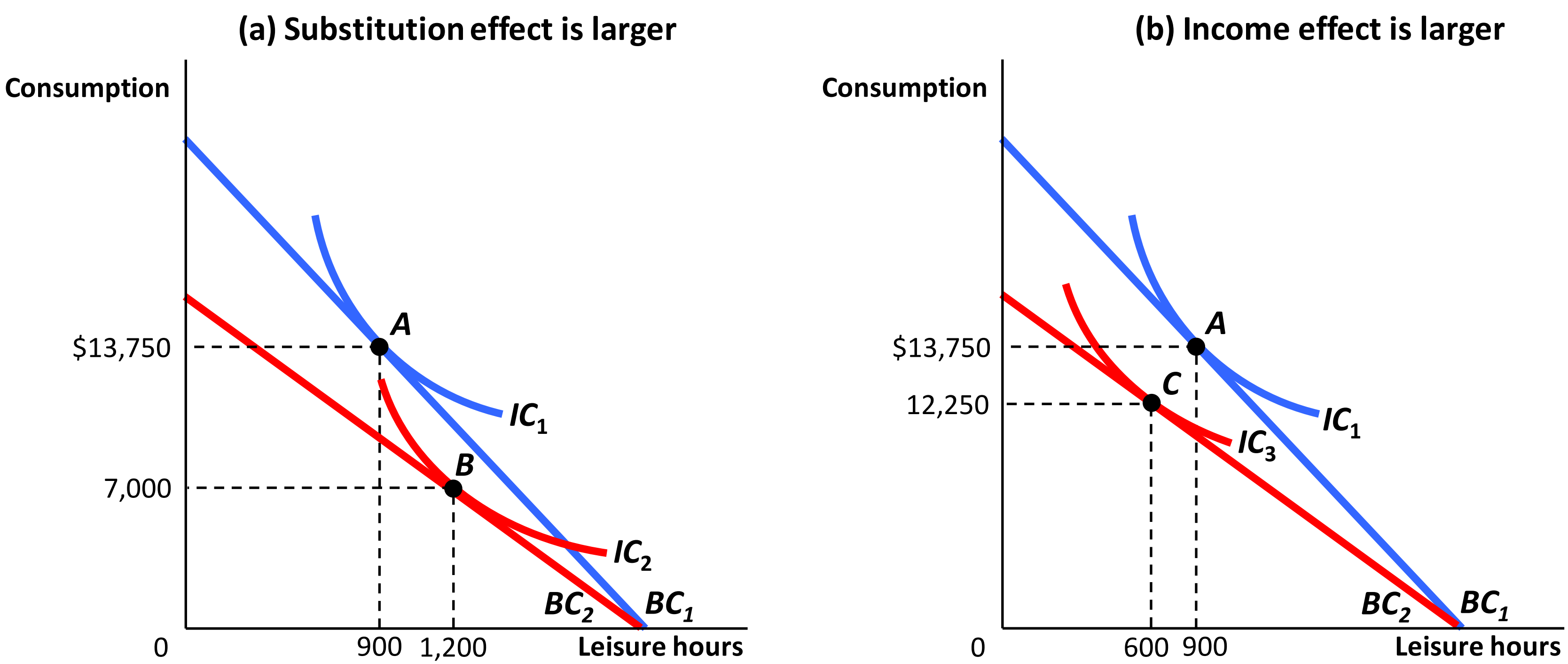
21.1

Basic Theory



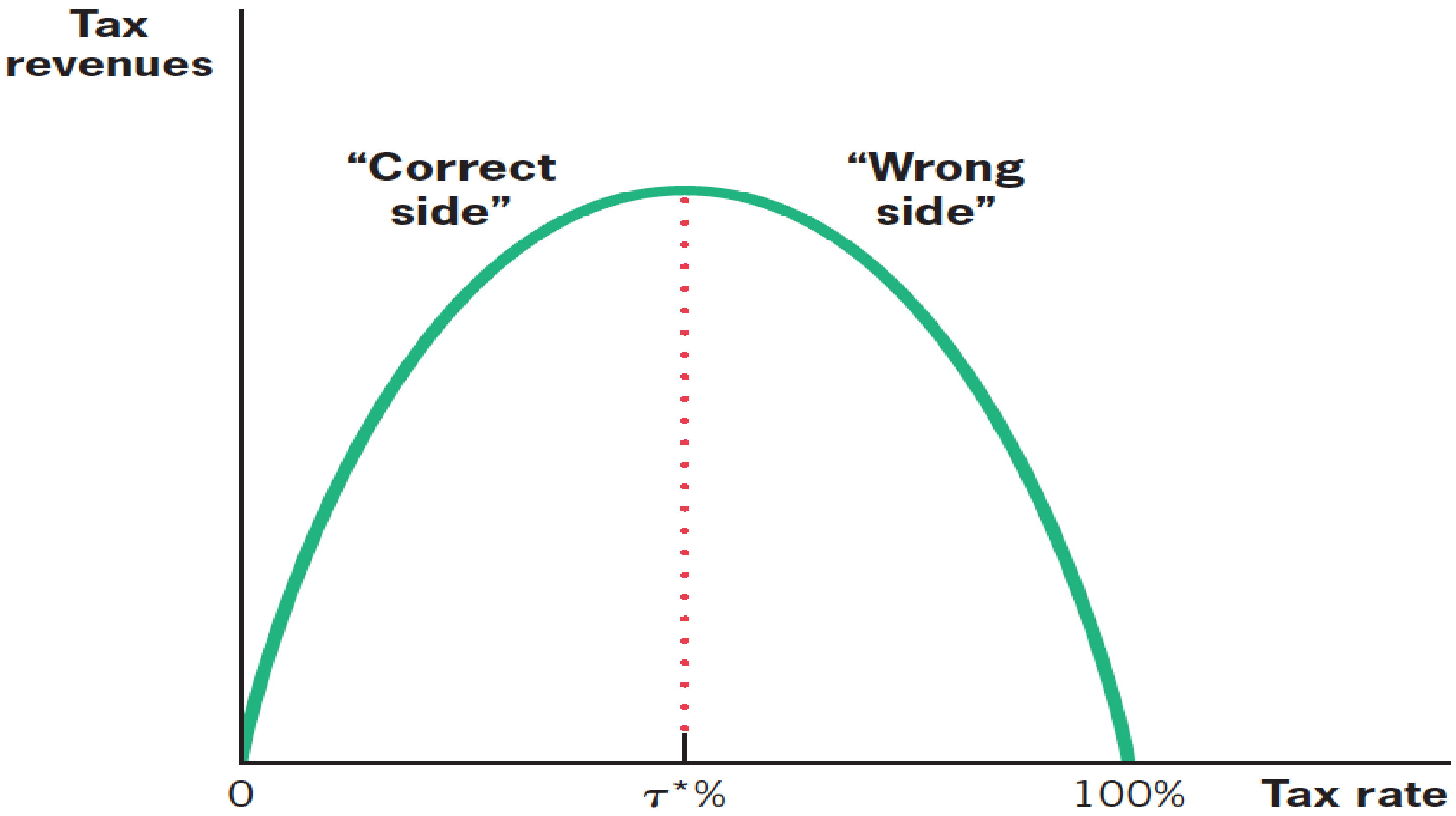
21.1

Substitution versus Income Effect

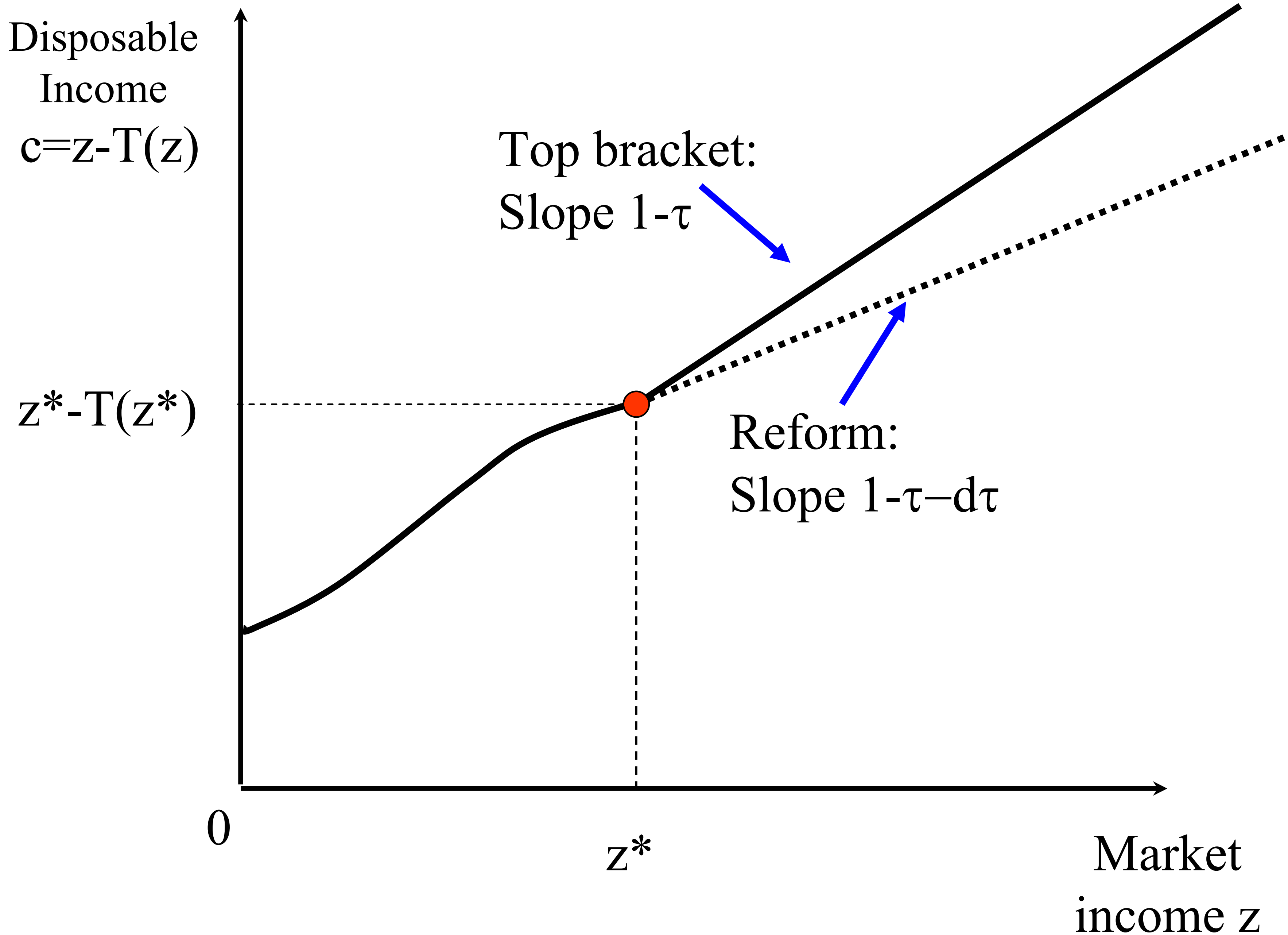


20.3

The Laffer Curve

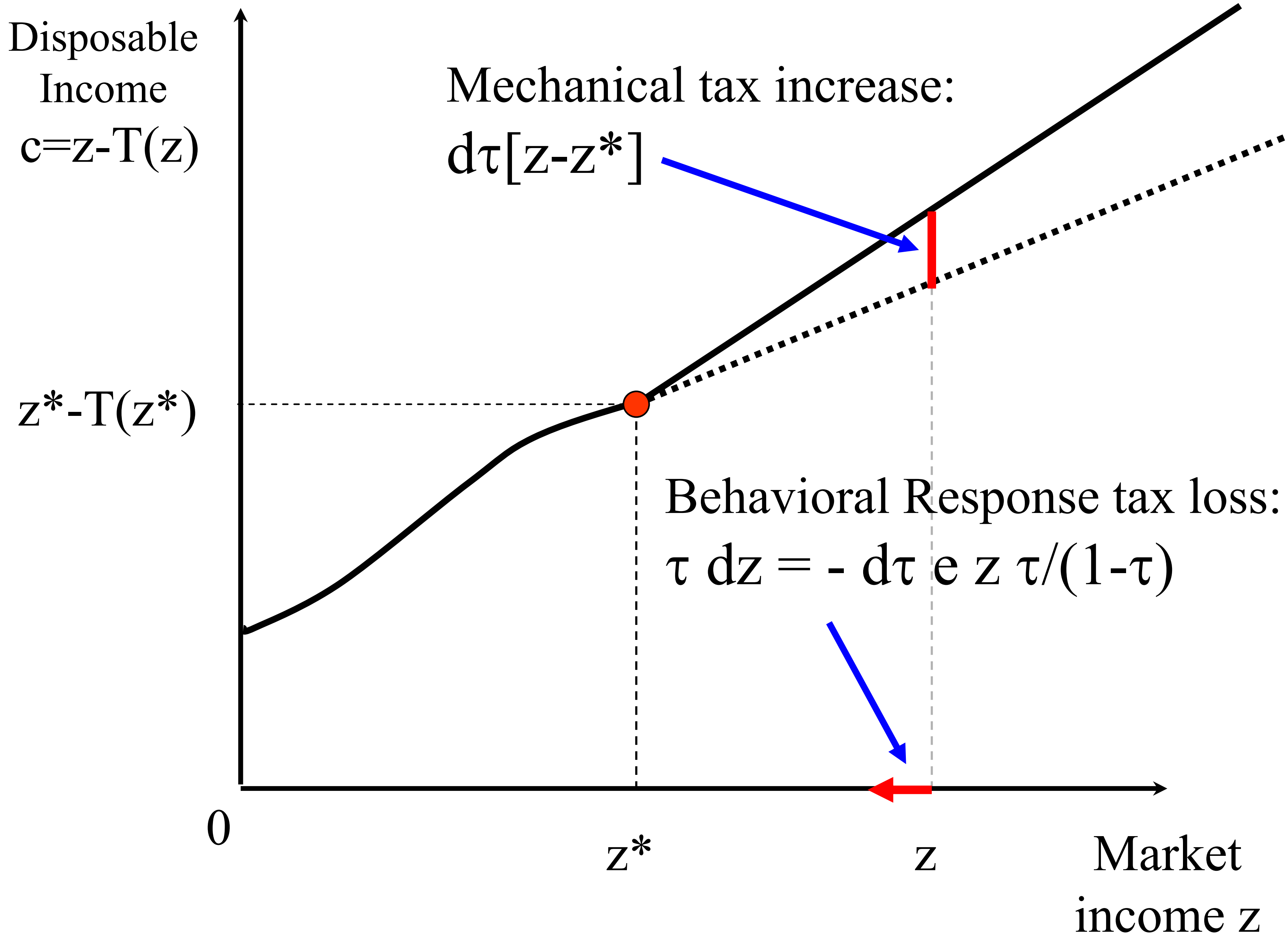


Optimal Top Income Tax Rate (Mirrlees '71 model)

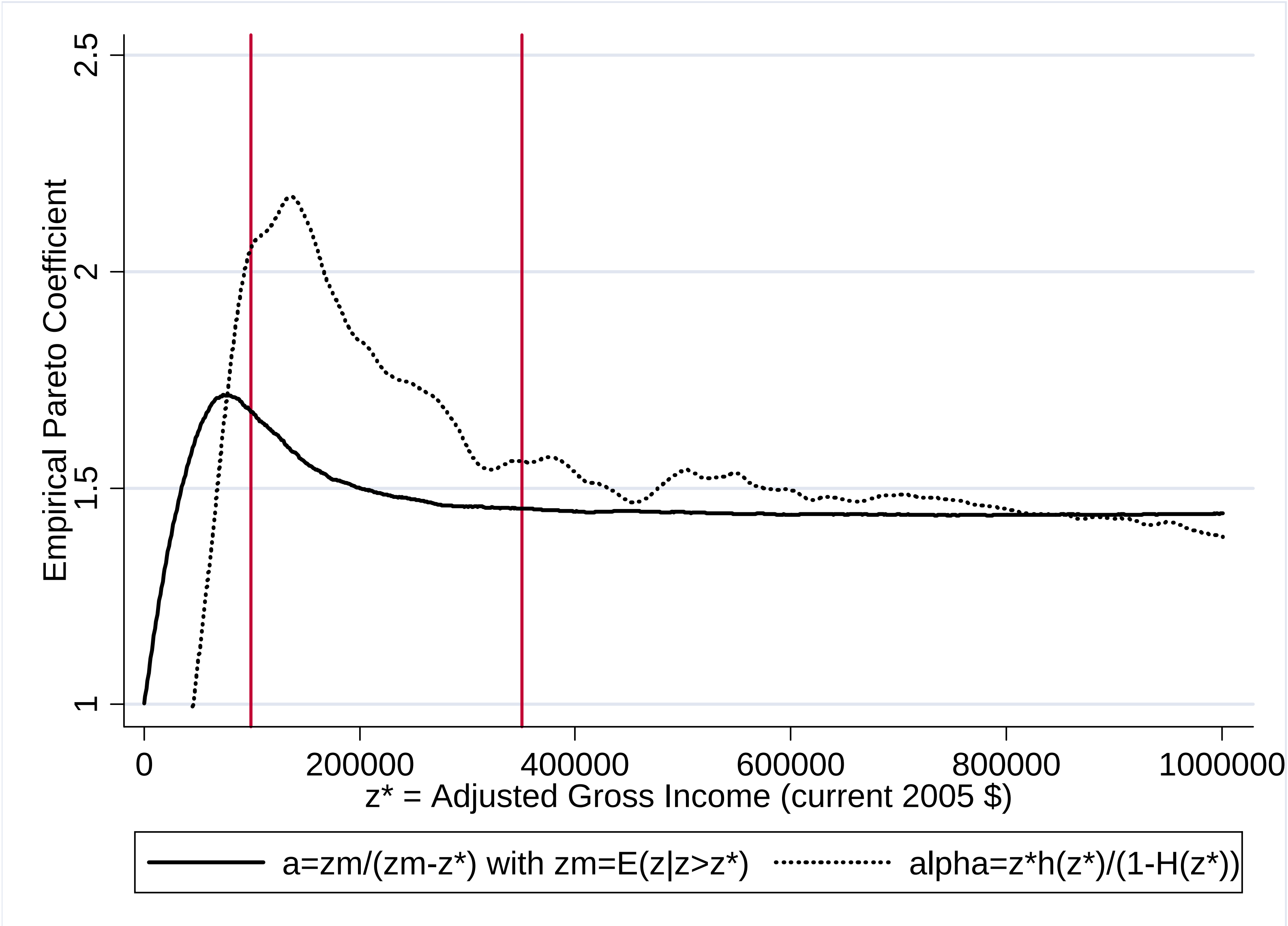


Source: Diamond and Saez JEP'11

Optimal Top Income Tax Rate (Mirrlees ’71 model)

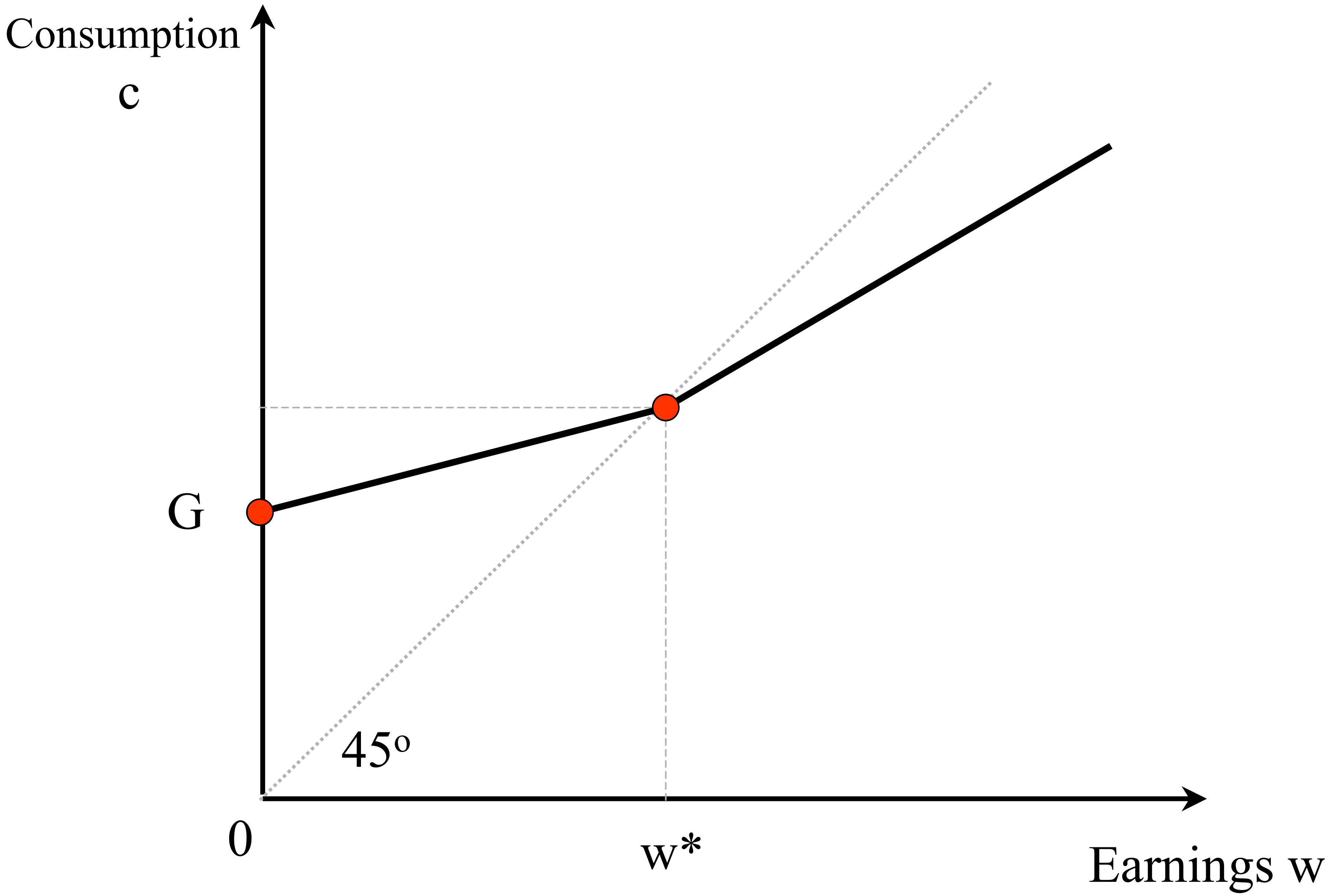


Source: Diamond and Saez JEP'11



Source: Diamond and Saez JEP'11

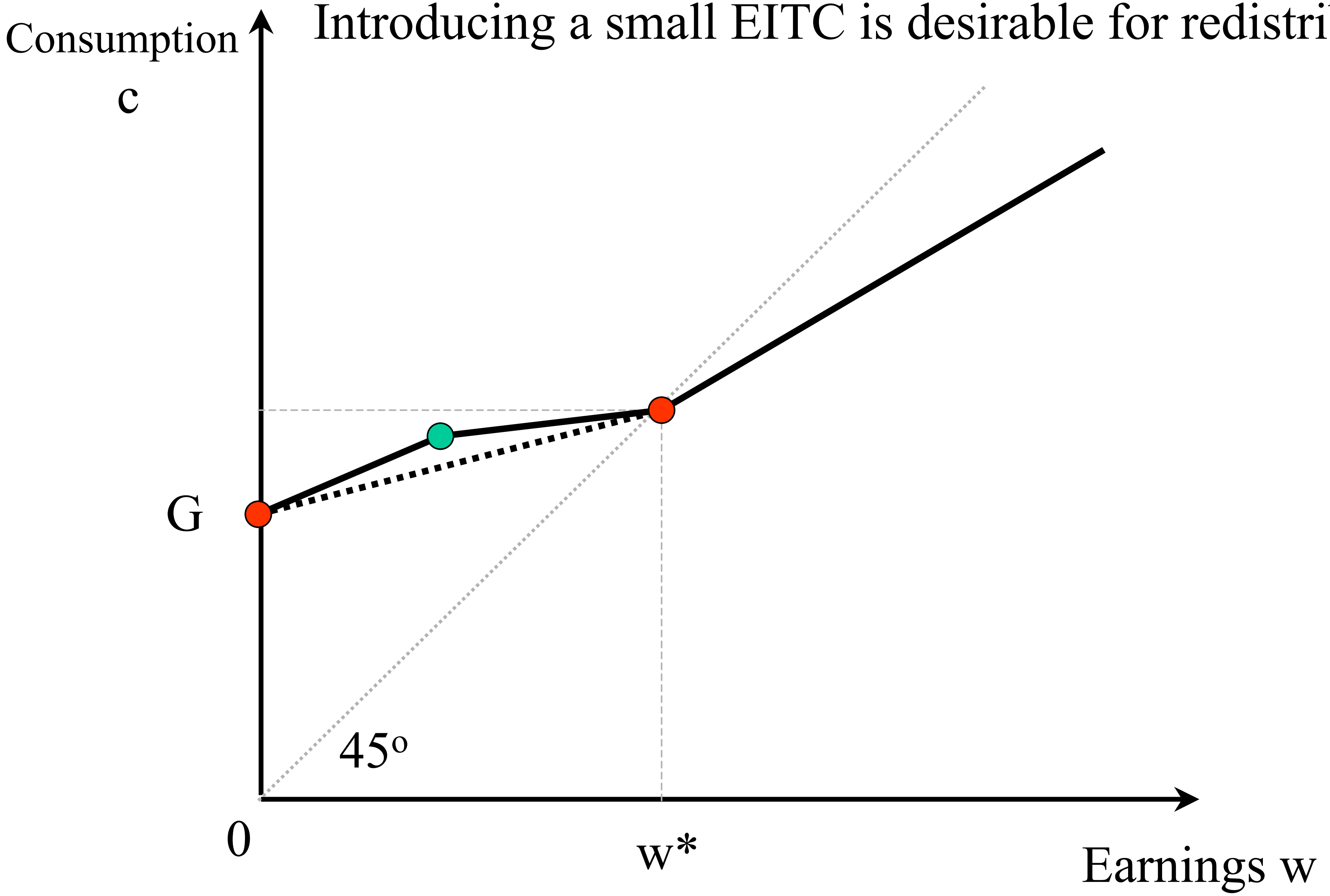
Starting from a Means-Tested Program



Source: revised version of Saez (2002), p. 1050

Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

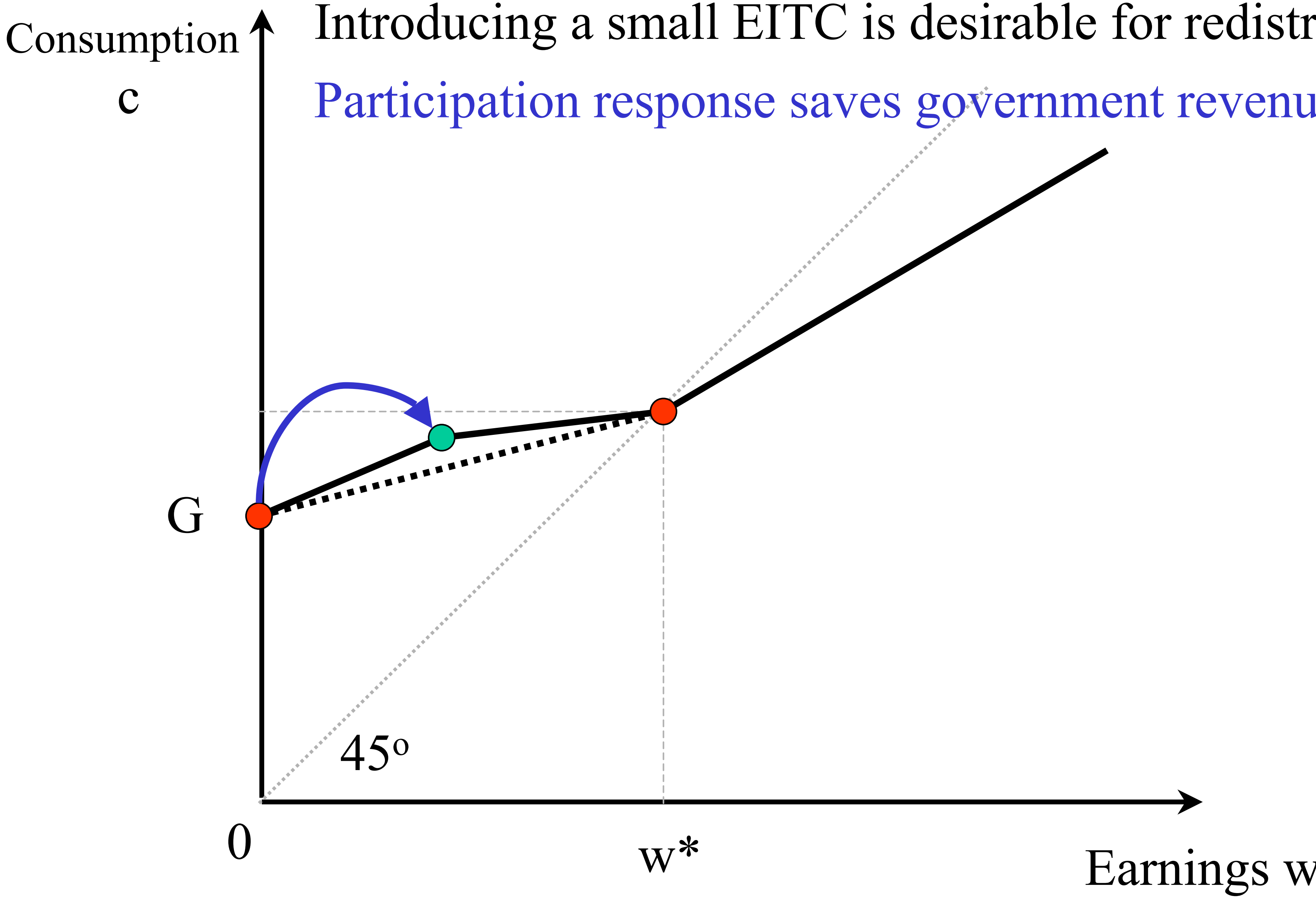


Source: revised version of Saez (2002), p. 1050

Starting from a Means-Tested Program

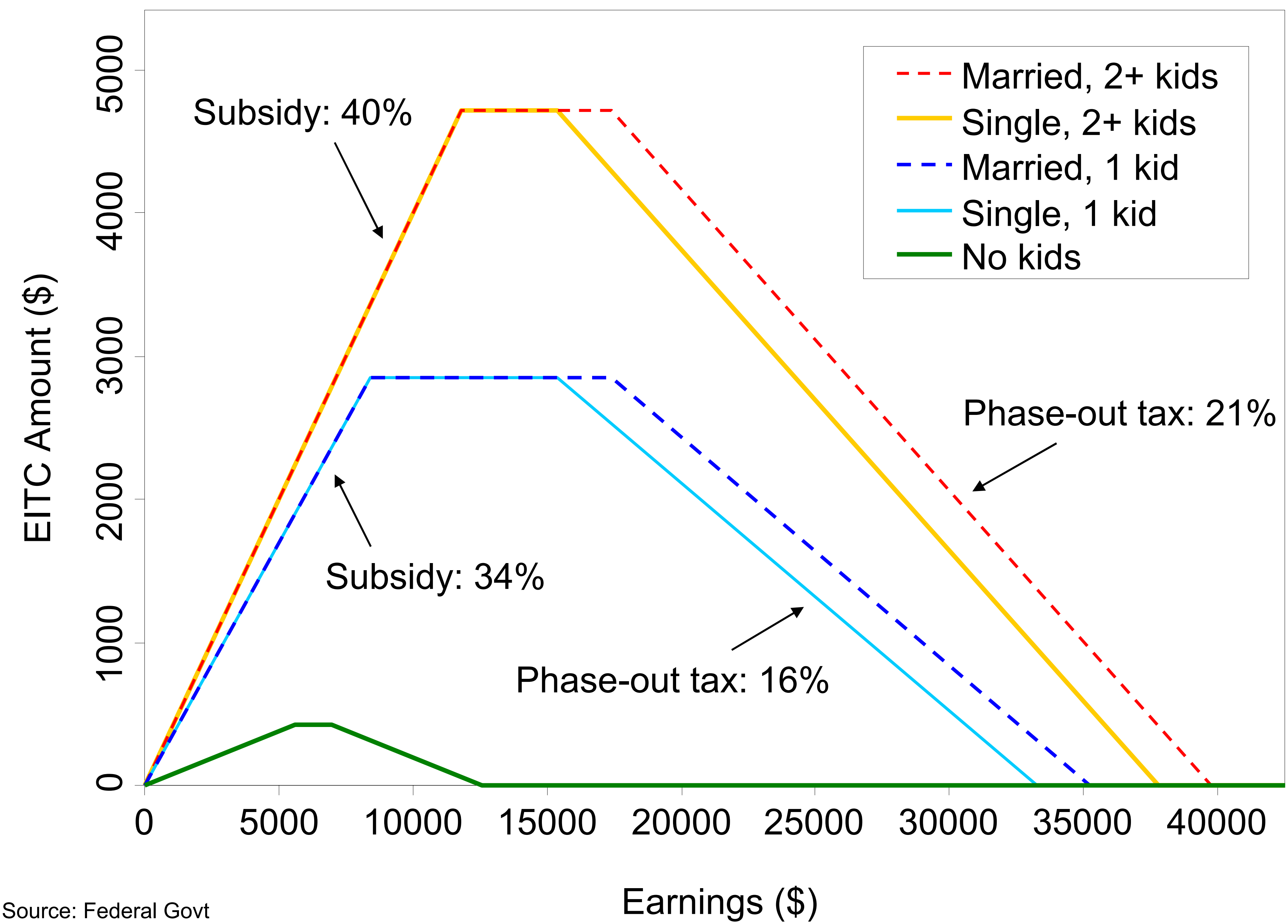
Introducing a small EITC is desirable for redistribution

Participation response saves government revenue



Source: revised version of Saez (2002), p. 1050

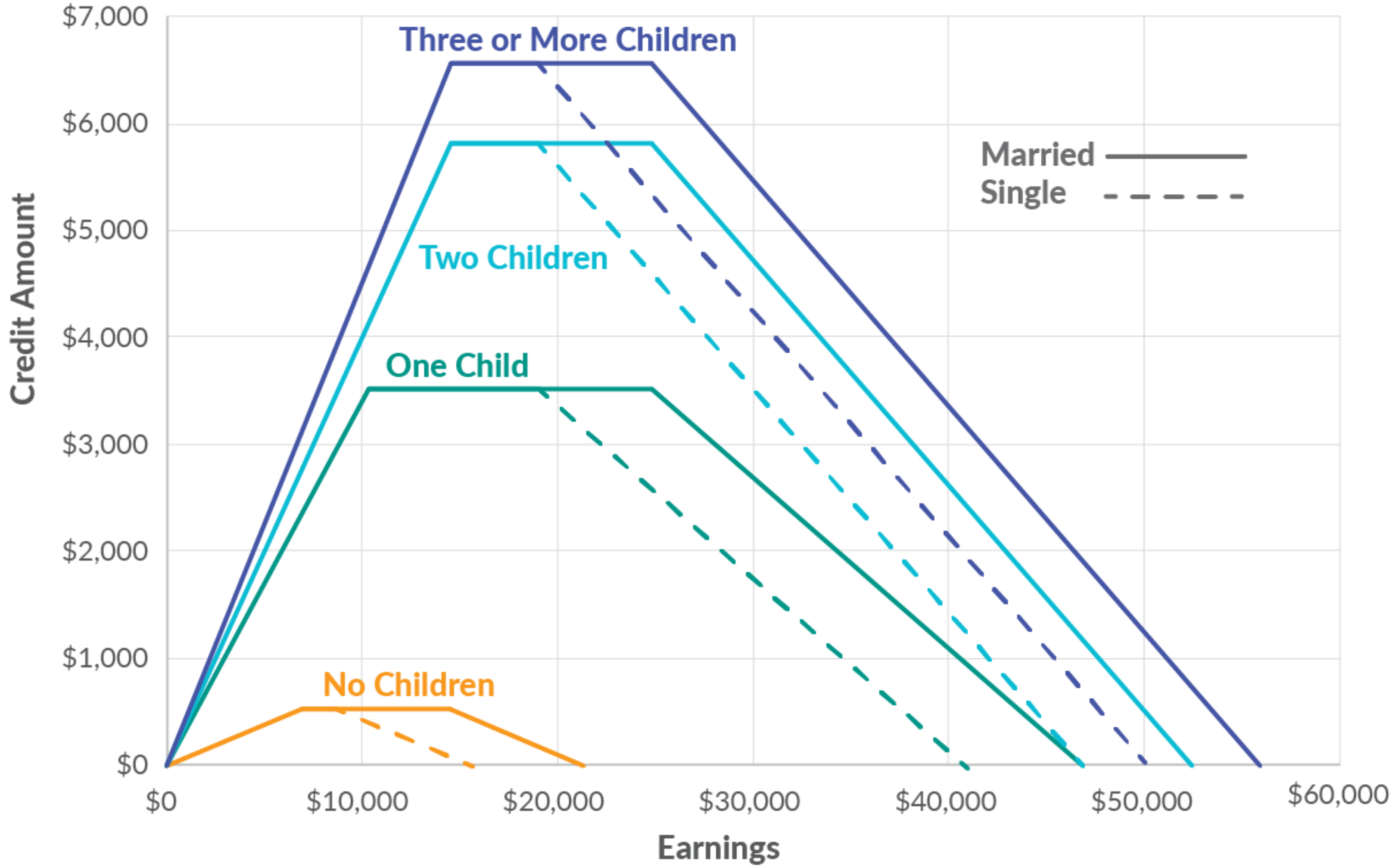
EITC Amount as a Function of Earnings



Source: Federal Govt

The Phase-In and Phaseout of the EITC

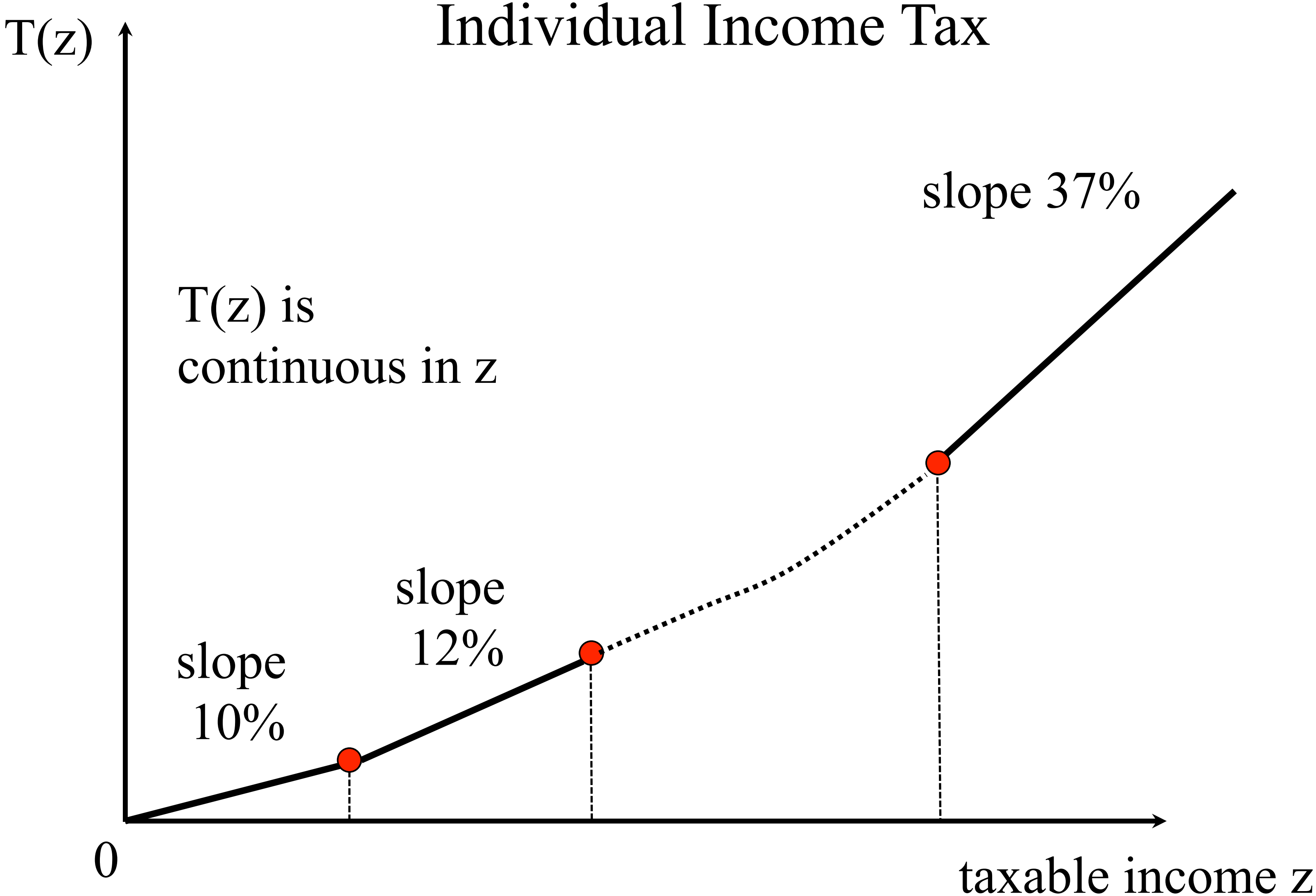
Credit Amount by Marital Status and Number of Children



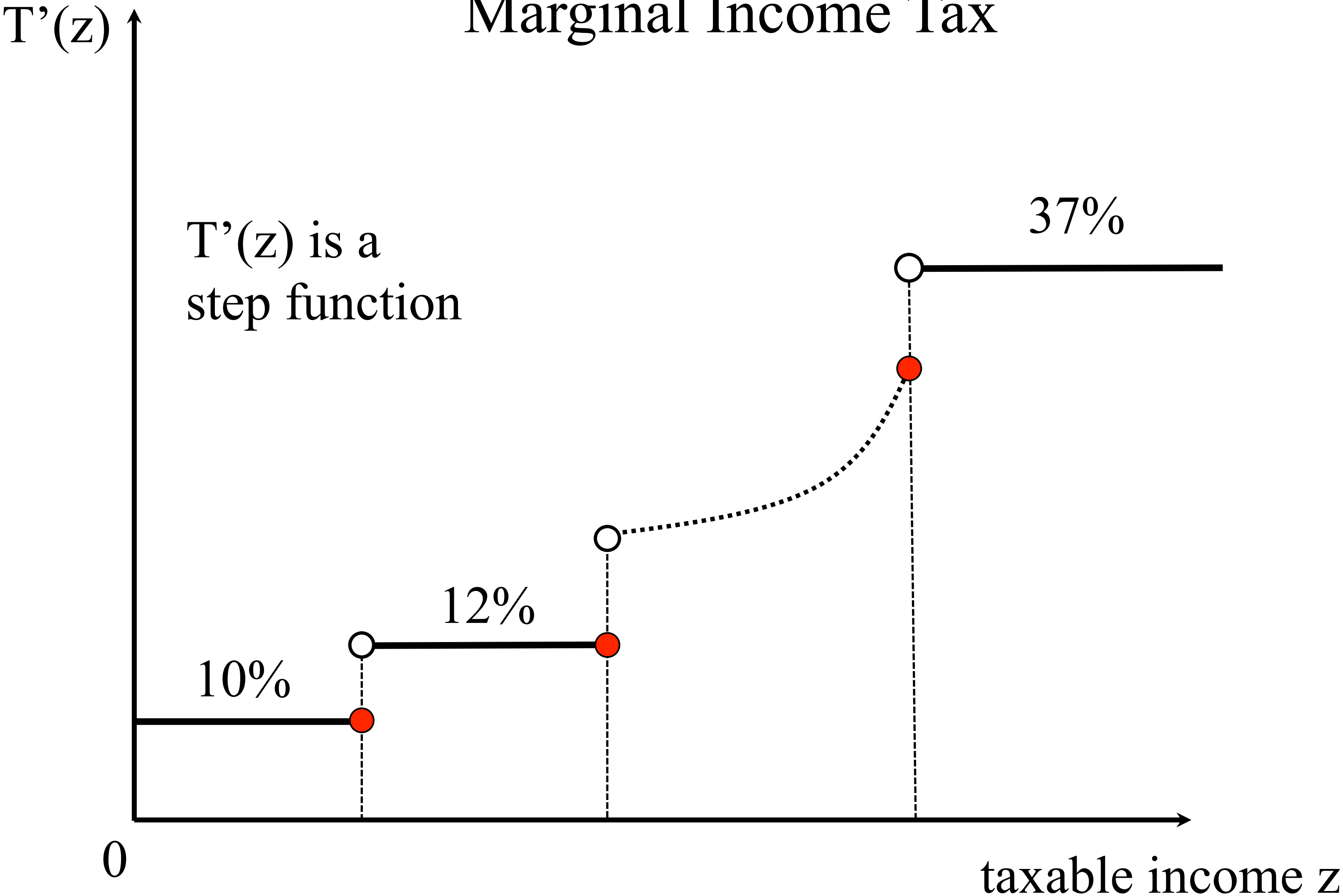
Source: Amir El-Sibaie, "2019 Tax Brackets," Tax Foundation, Nov. 28, 2018.

TAX FOUNDATION @TaxFoundation

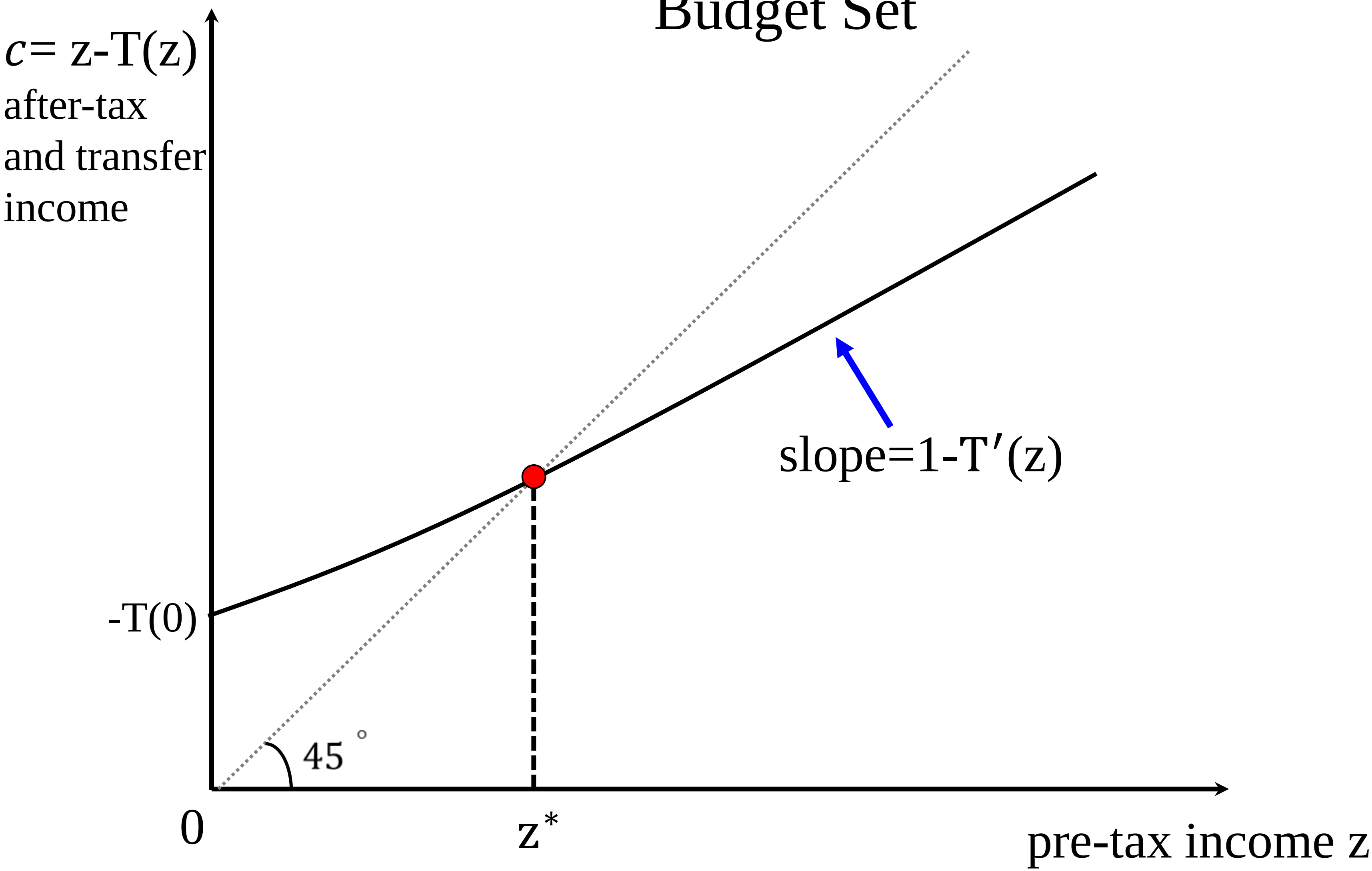
Individual Income Tax



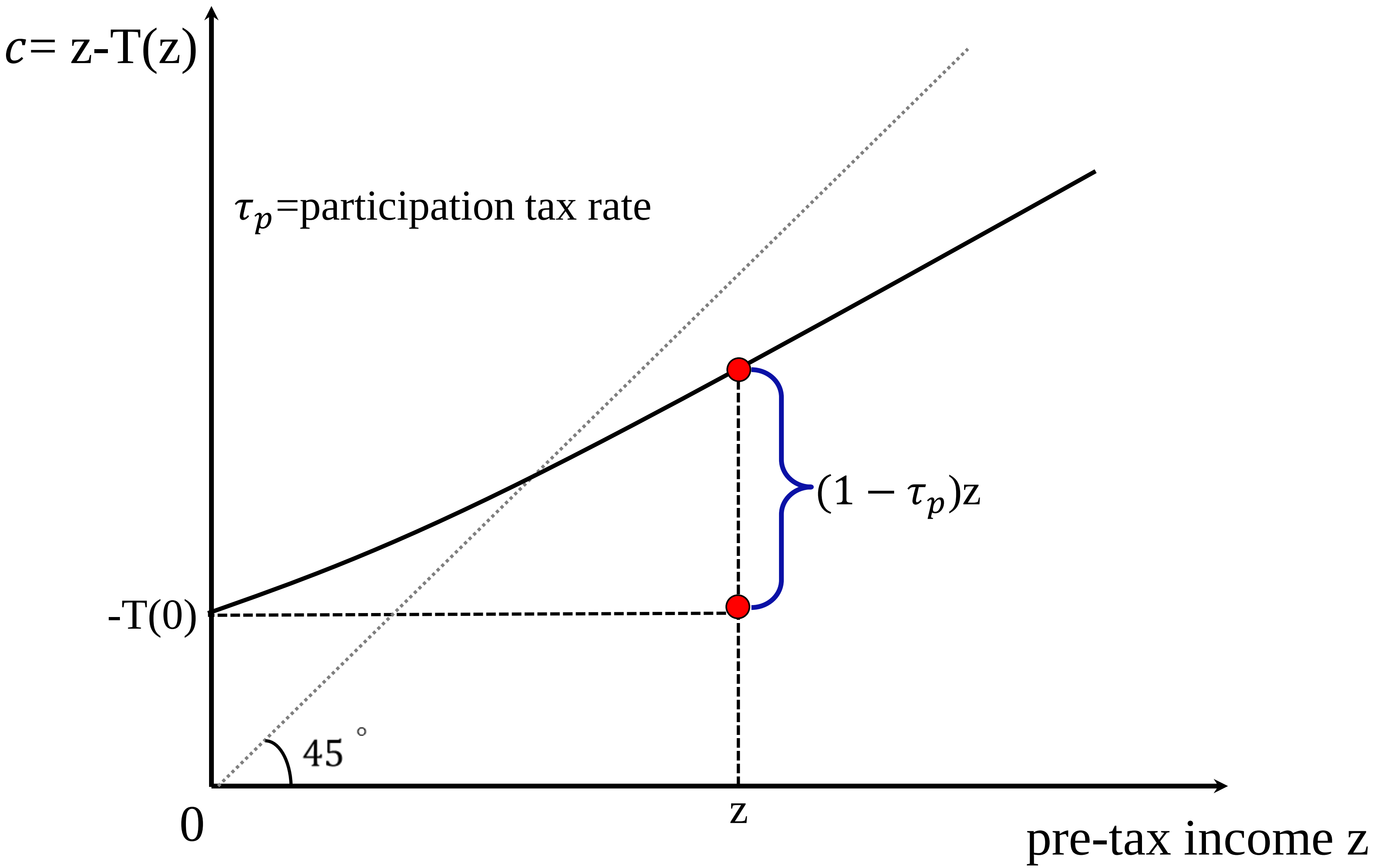
Marginal Income Tax



Budget Set



c= z-T(z)
after-tax
and transfer
income
slope=1-T′(z)
-T(0)
45 °
0
z*
pre-tax income z

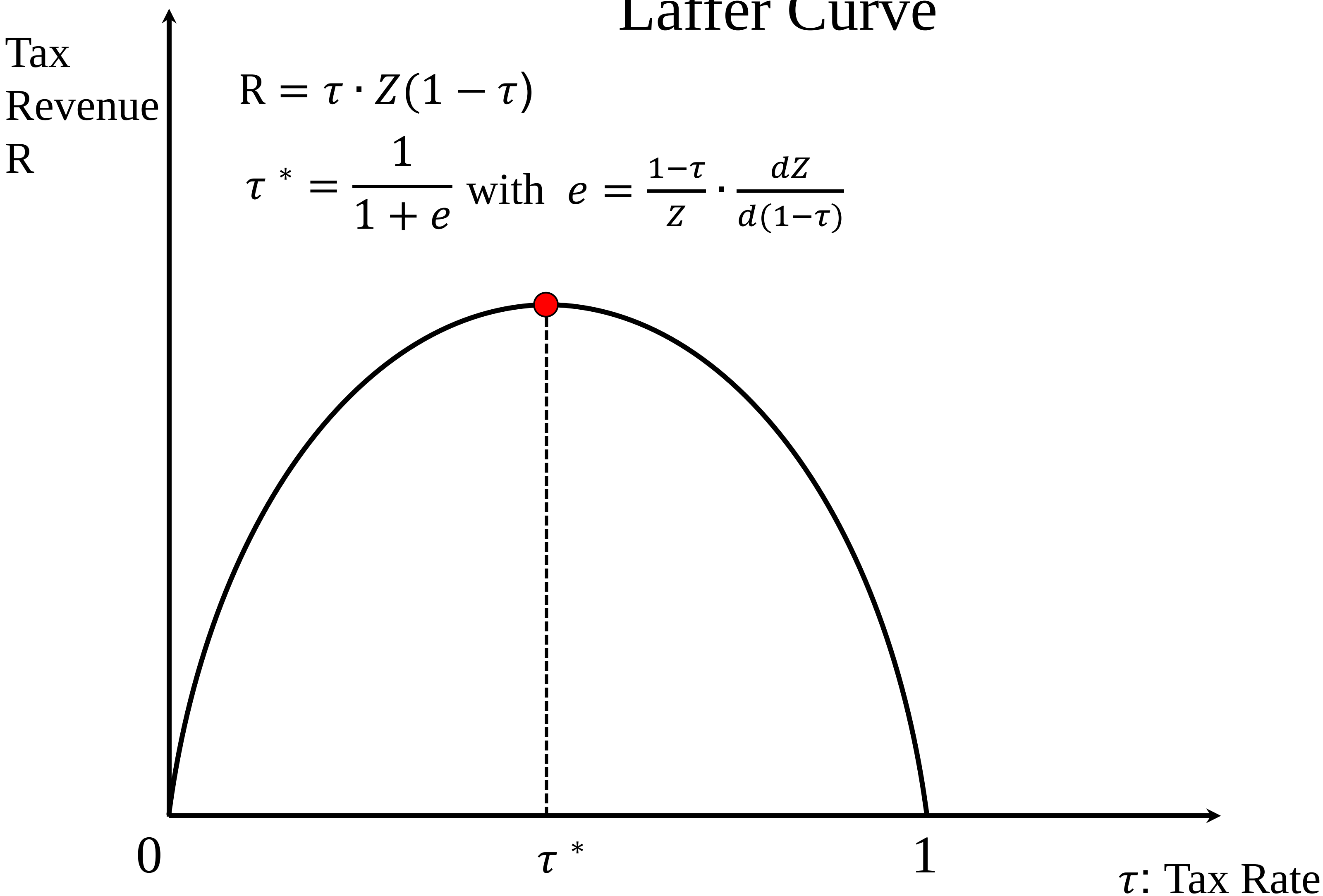


c= z-T(z)
τ_p=participation tax rate
$(1-\tau_p)$z
-T(0)
45 °
0
z
pre-tax income z

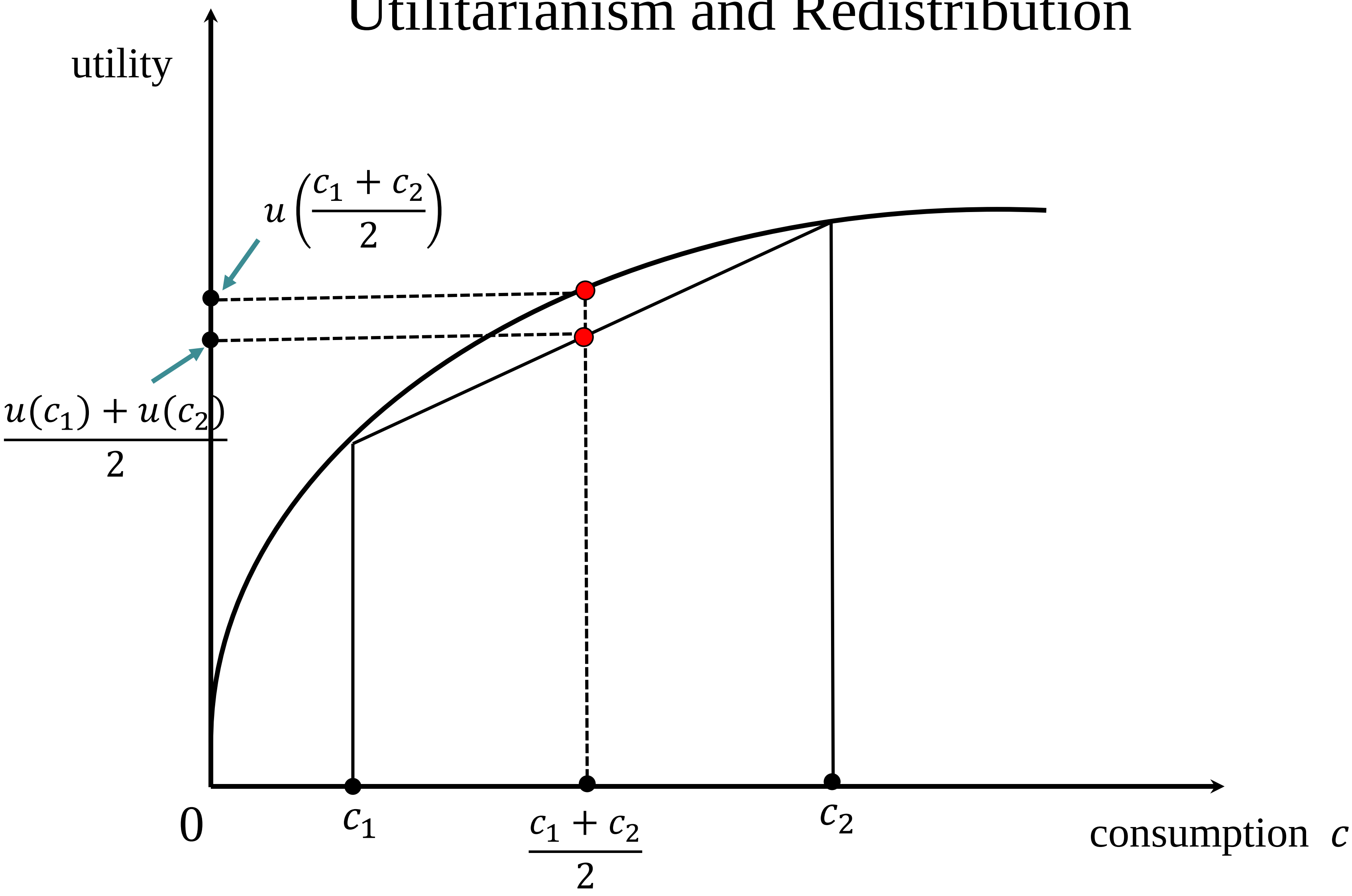
Laffer Curve

$$R = \tau \cdot Z(1-\tau)$$

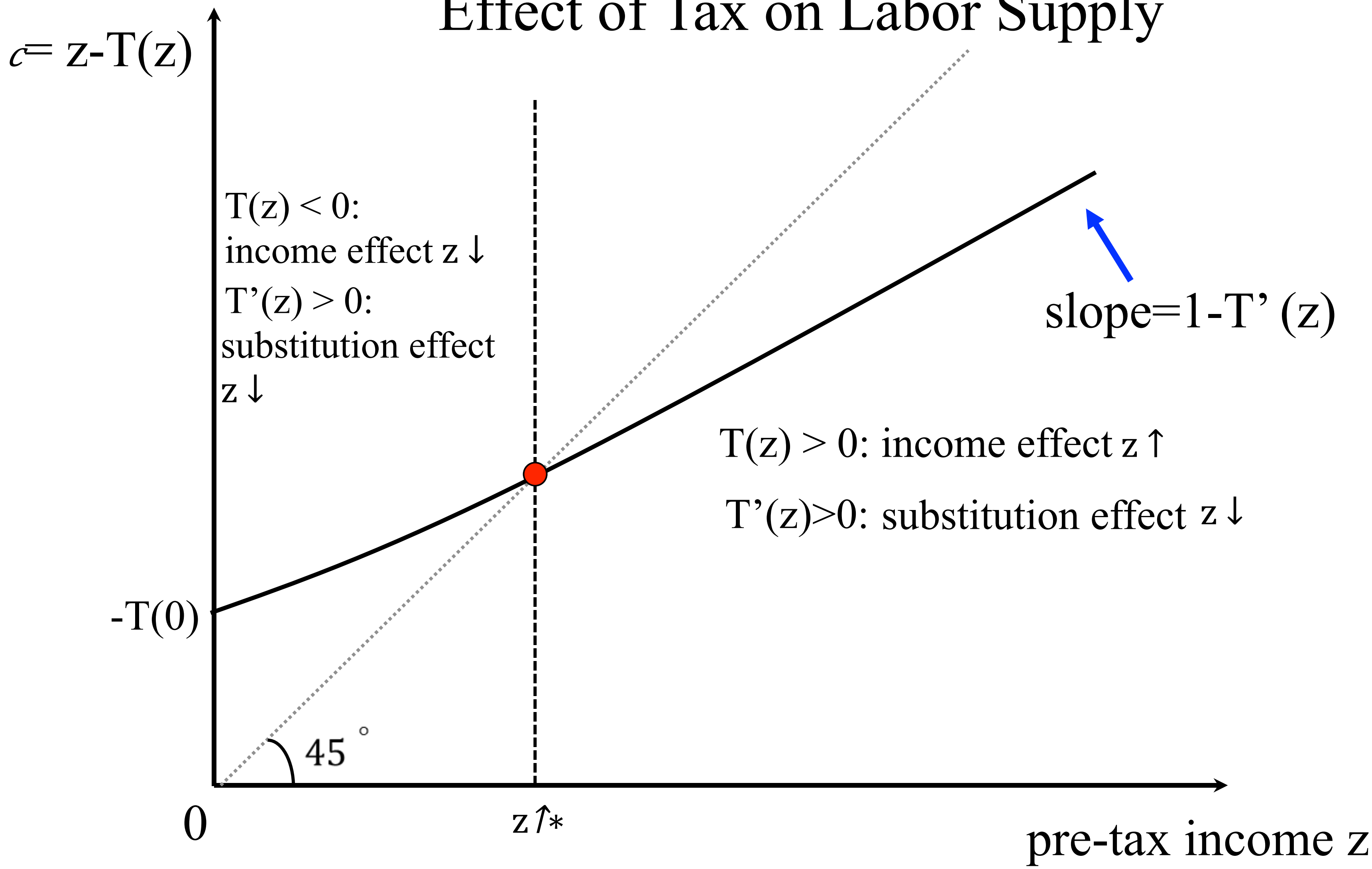
$$\tau^* = \frac{1}{1+e} \text{ with } e = \frac{1-\tau}{Z} \cdot \frac{dZ}{d(1-\tau)}$$



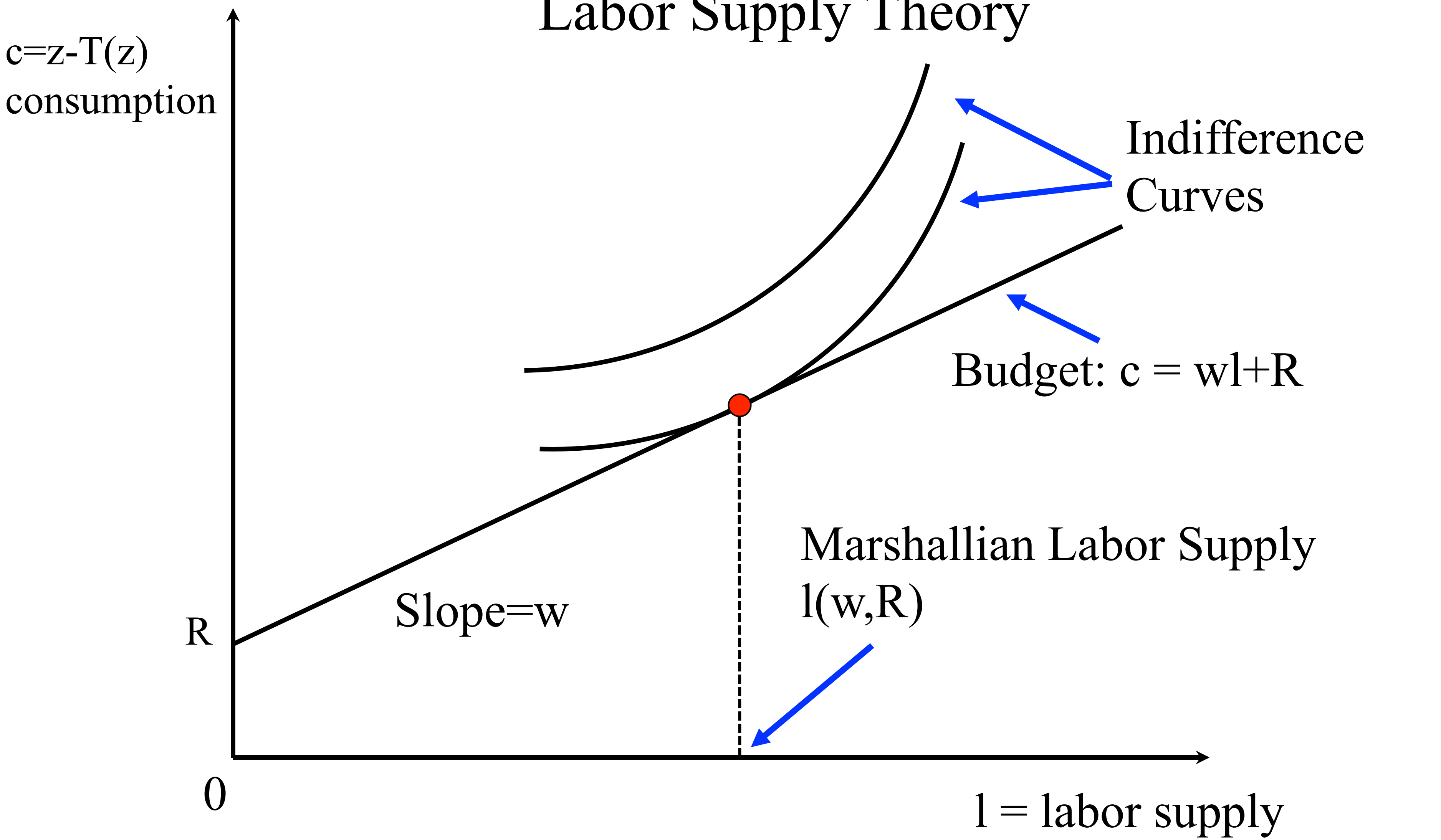
Utilitarianism and Redistribution



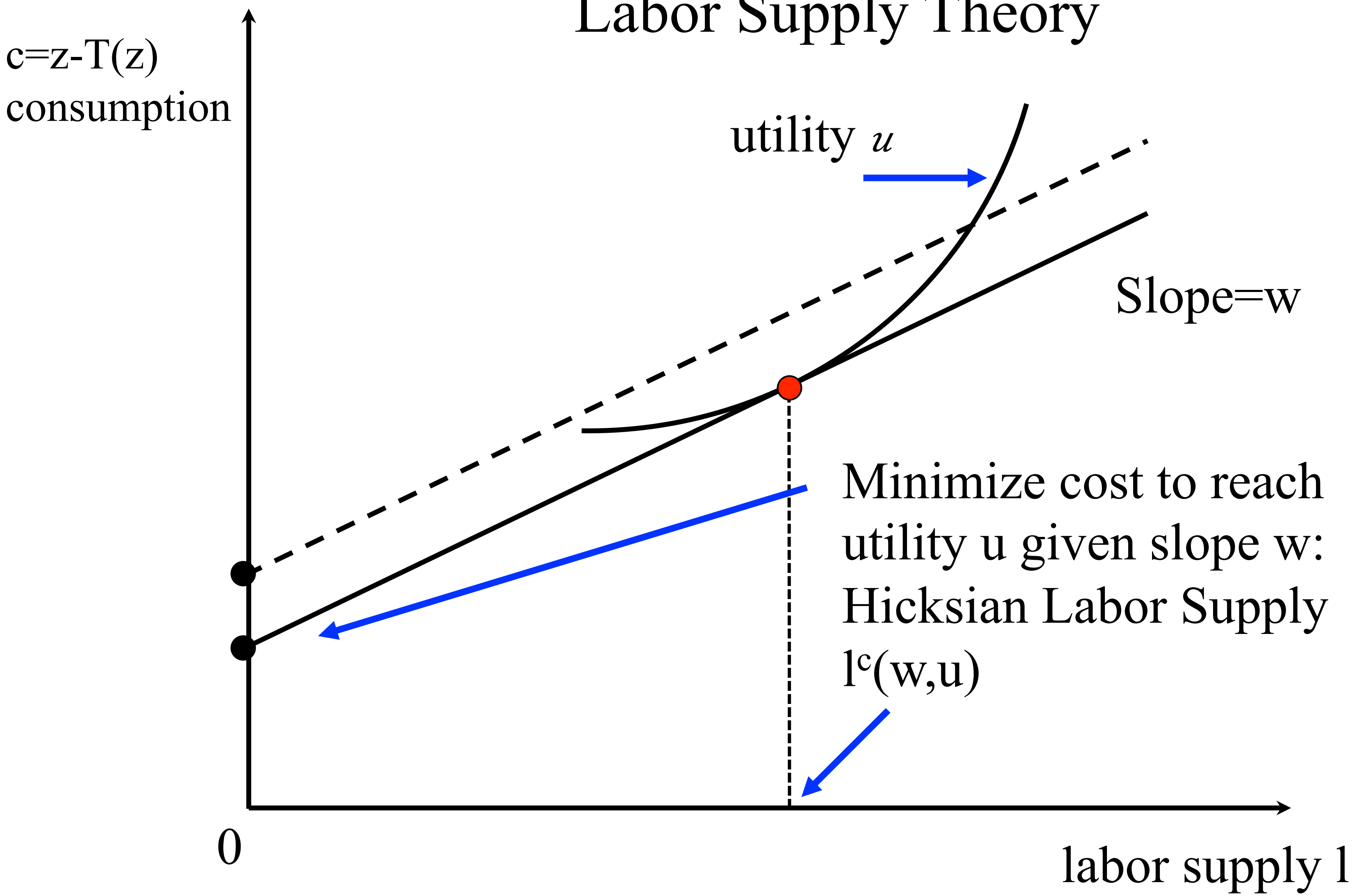
Effect of Tax on Labor Supply



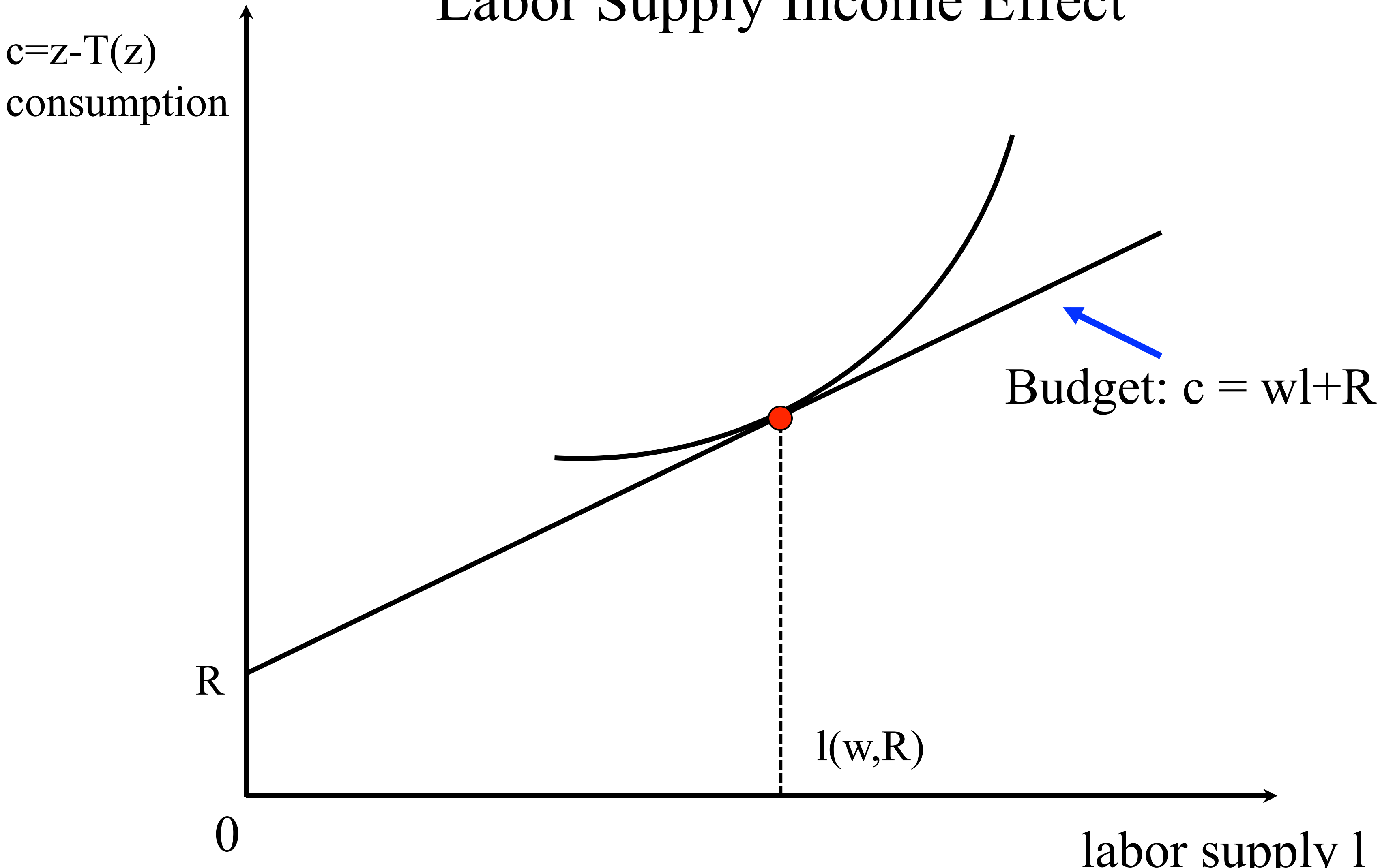
Labor Supply Theory



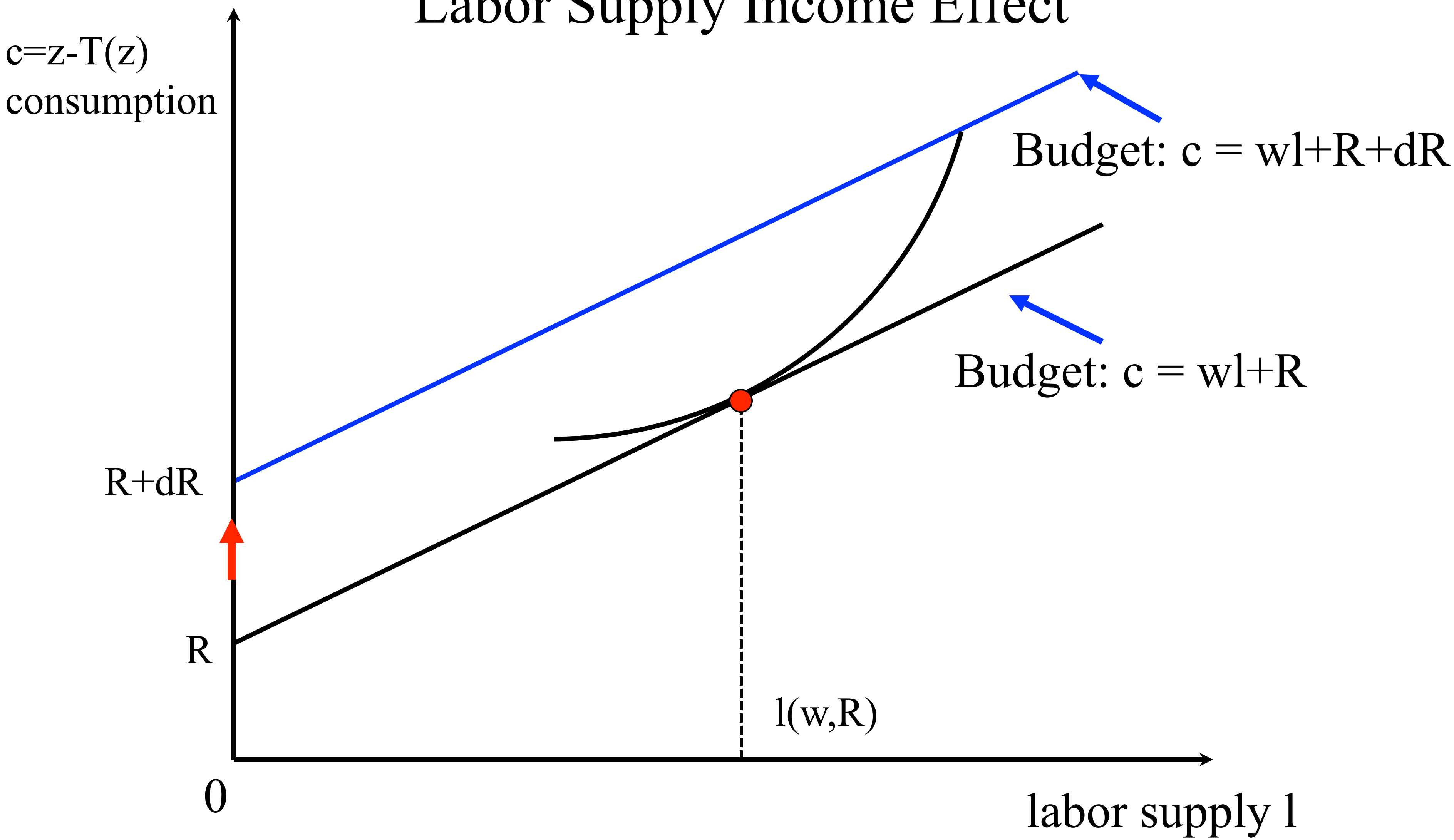
Labor Supply Theory



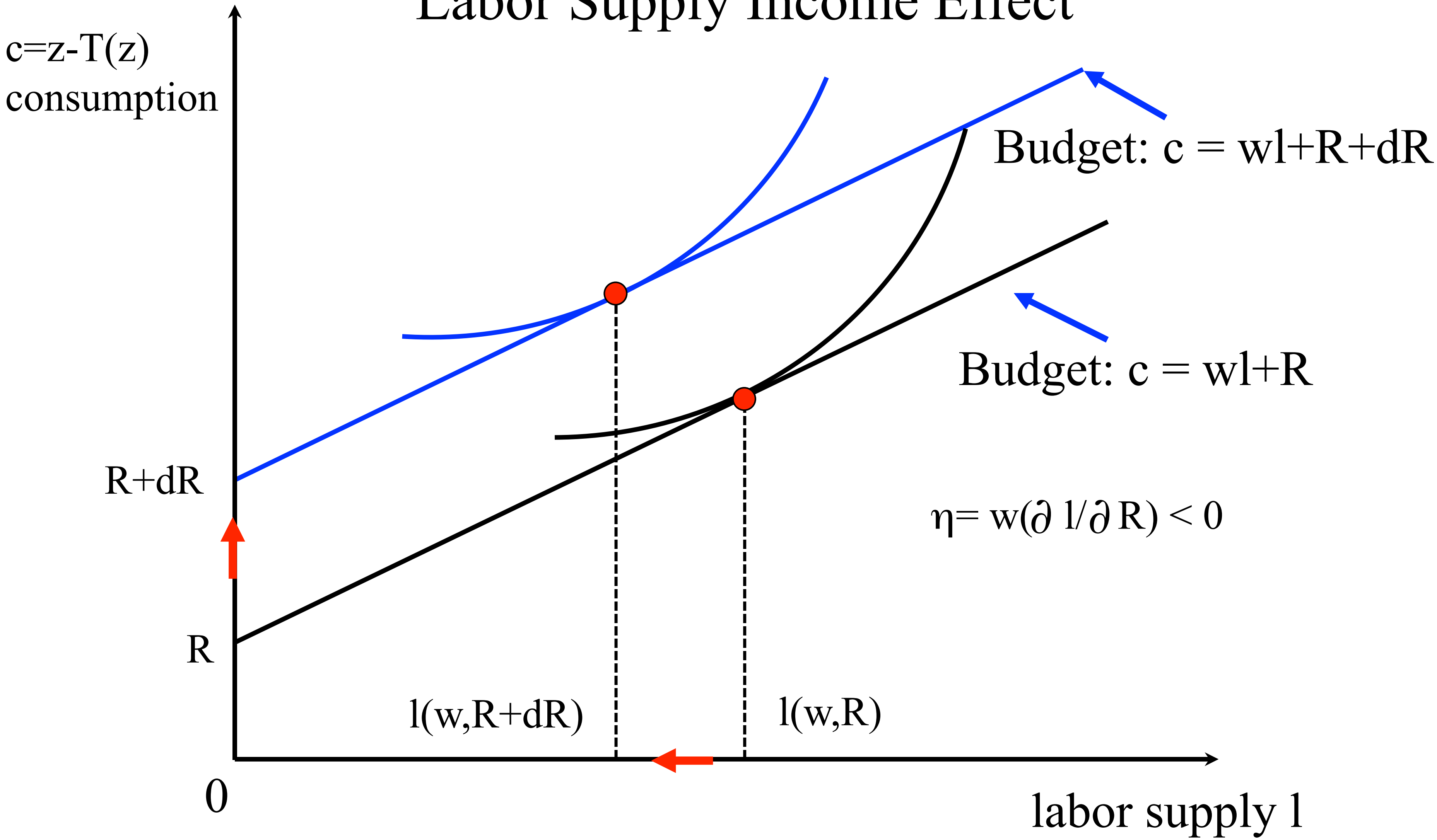
Labor Supply Income Effect



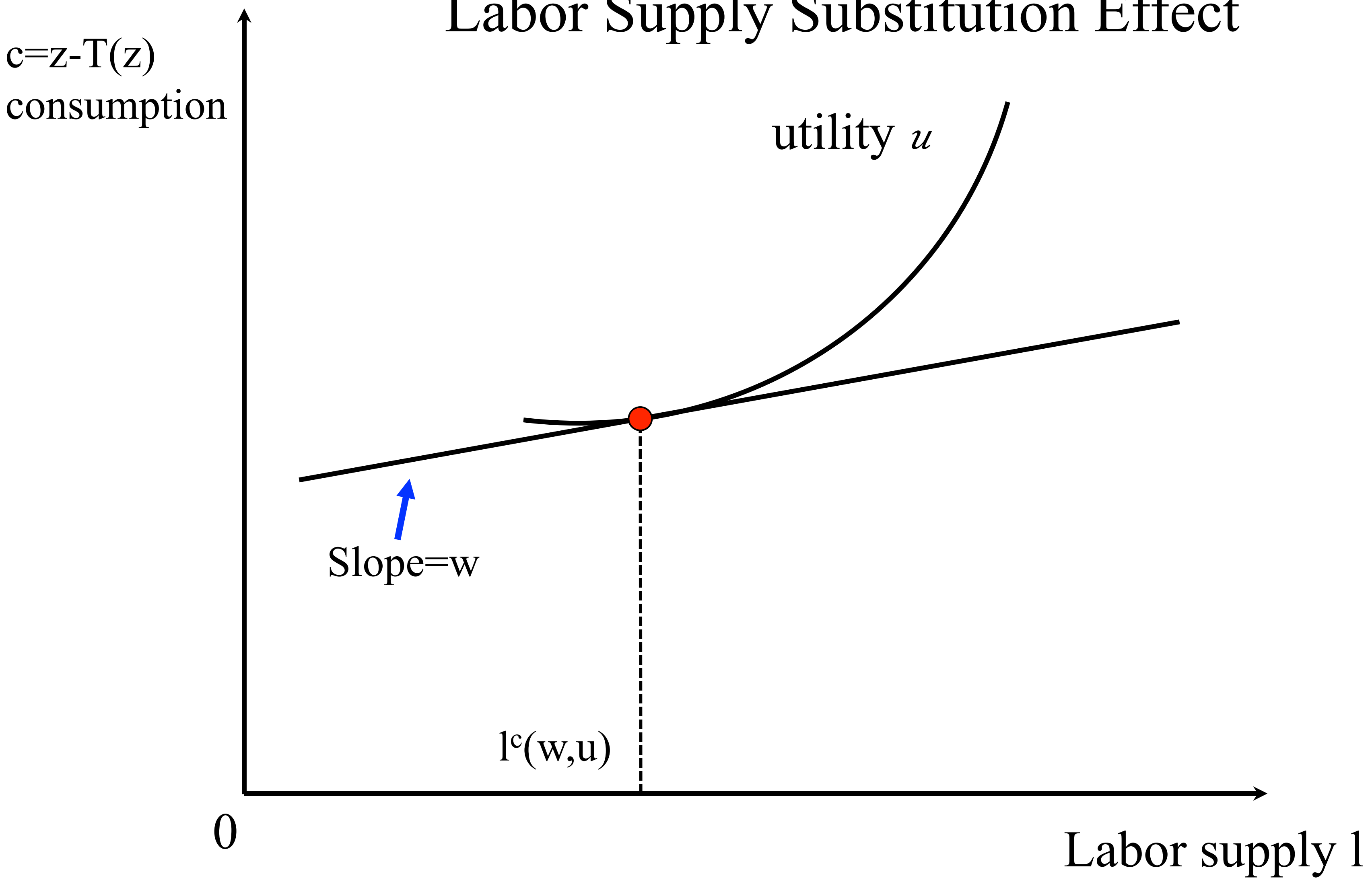
Labor Supply Income Effect



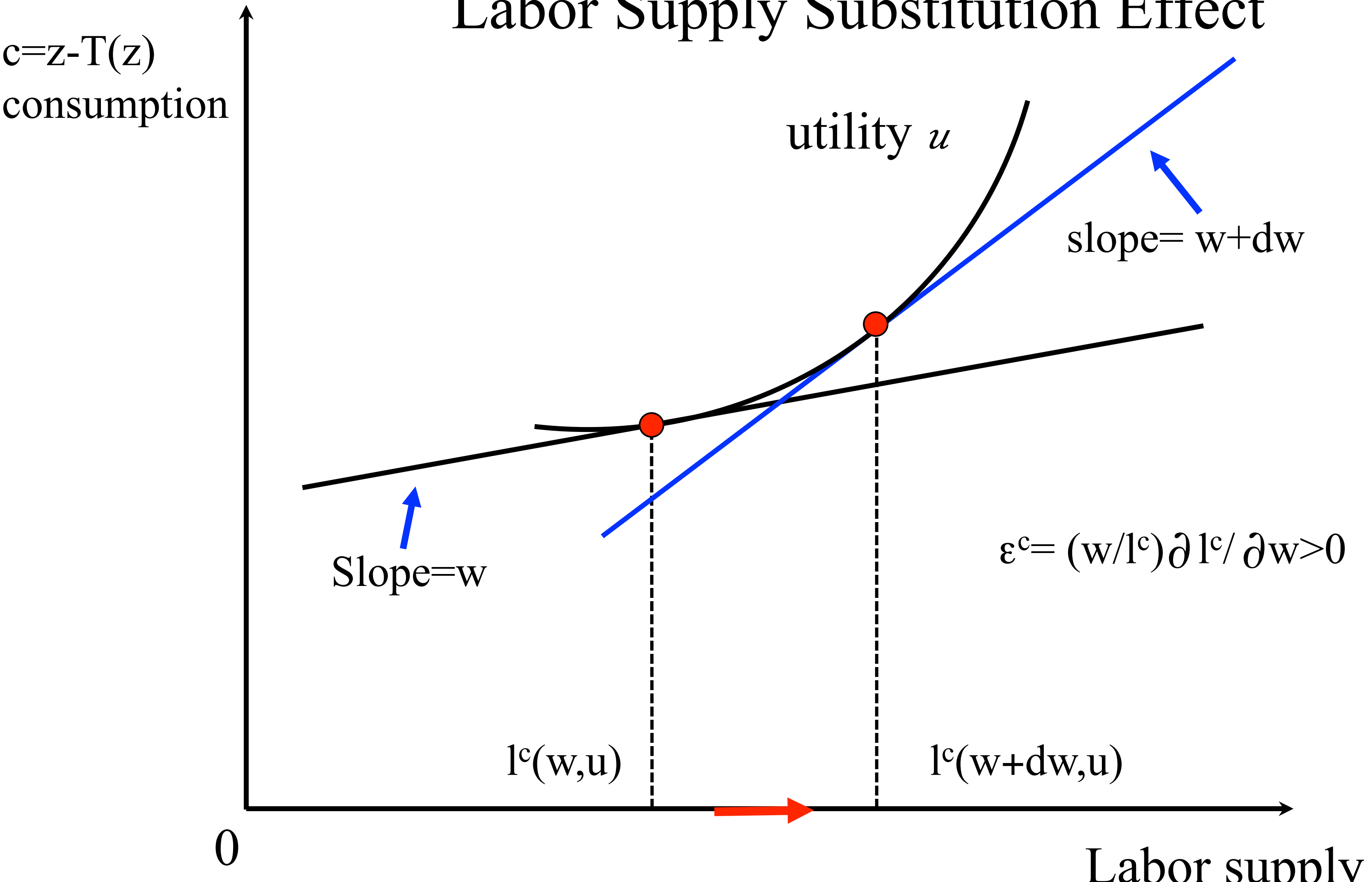
Labor Supply Income Effect



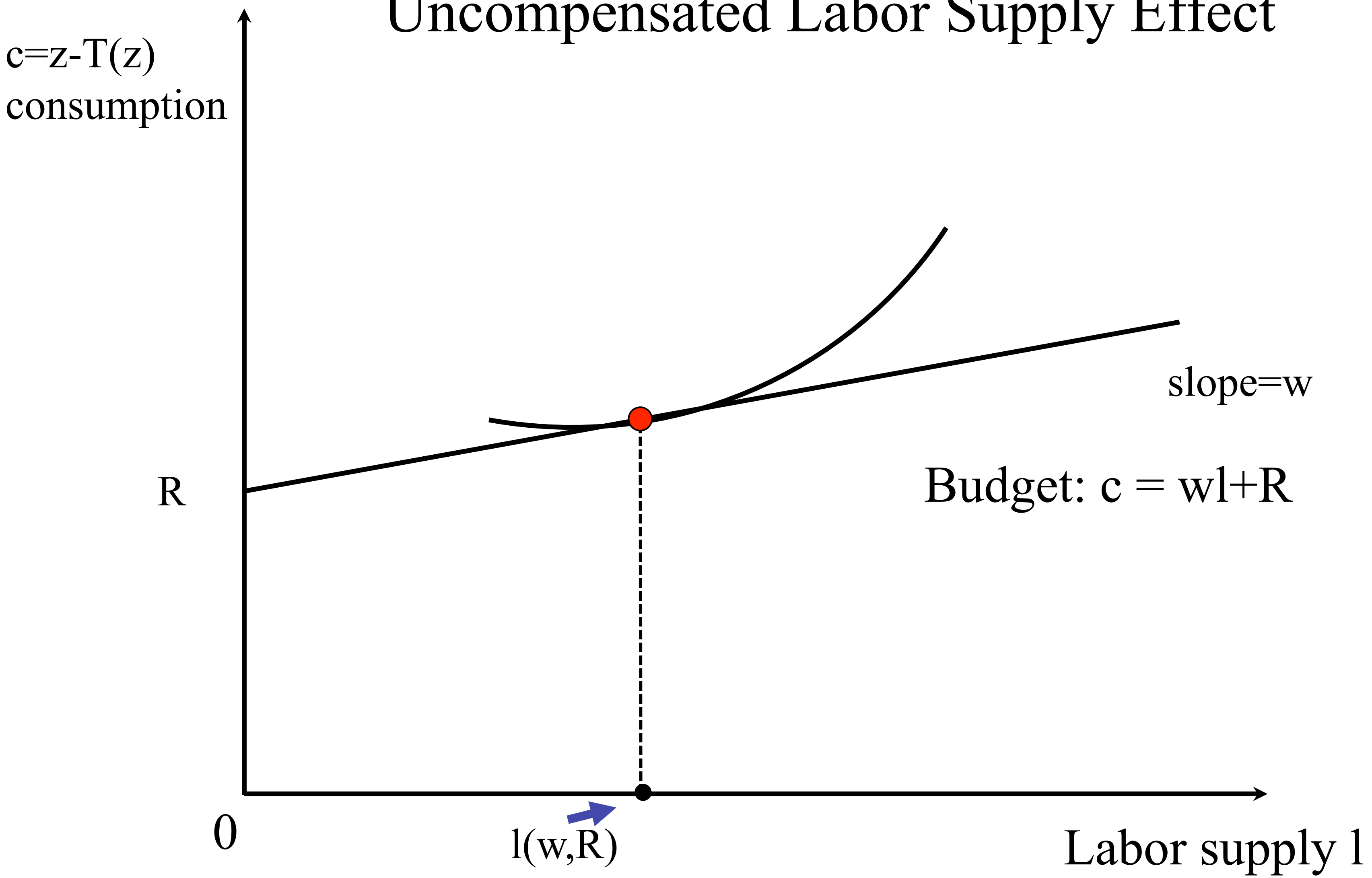
Labor Supply Substitution Effect



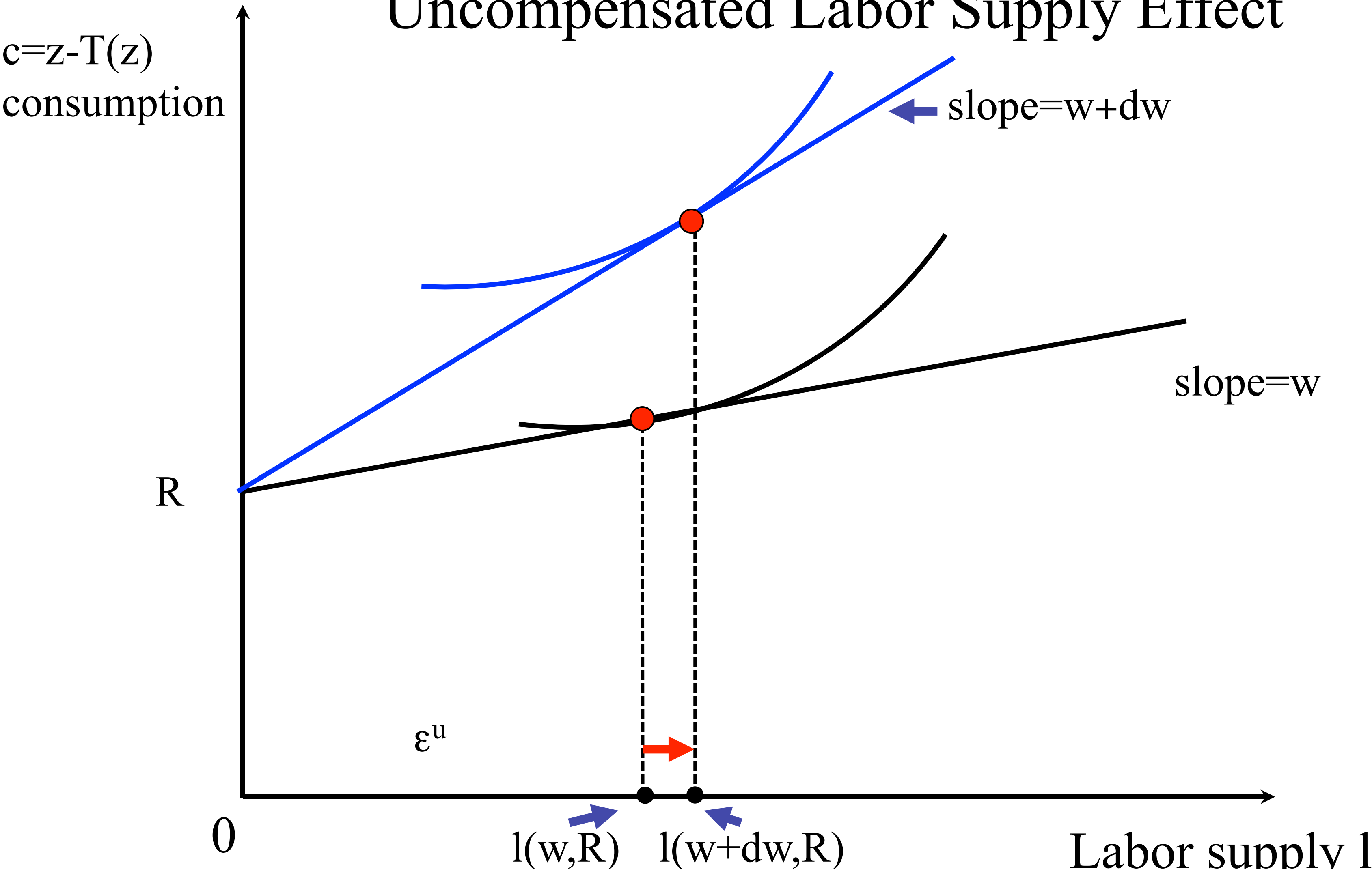
Labor Supply Substitution Effect



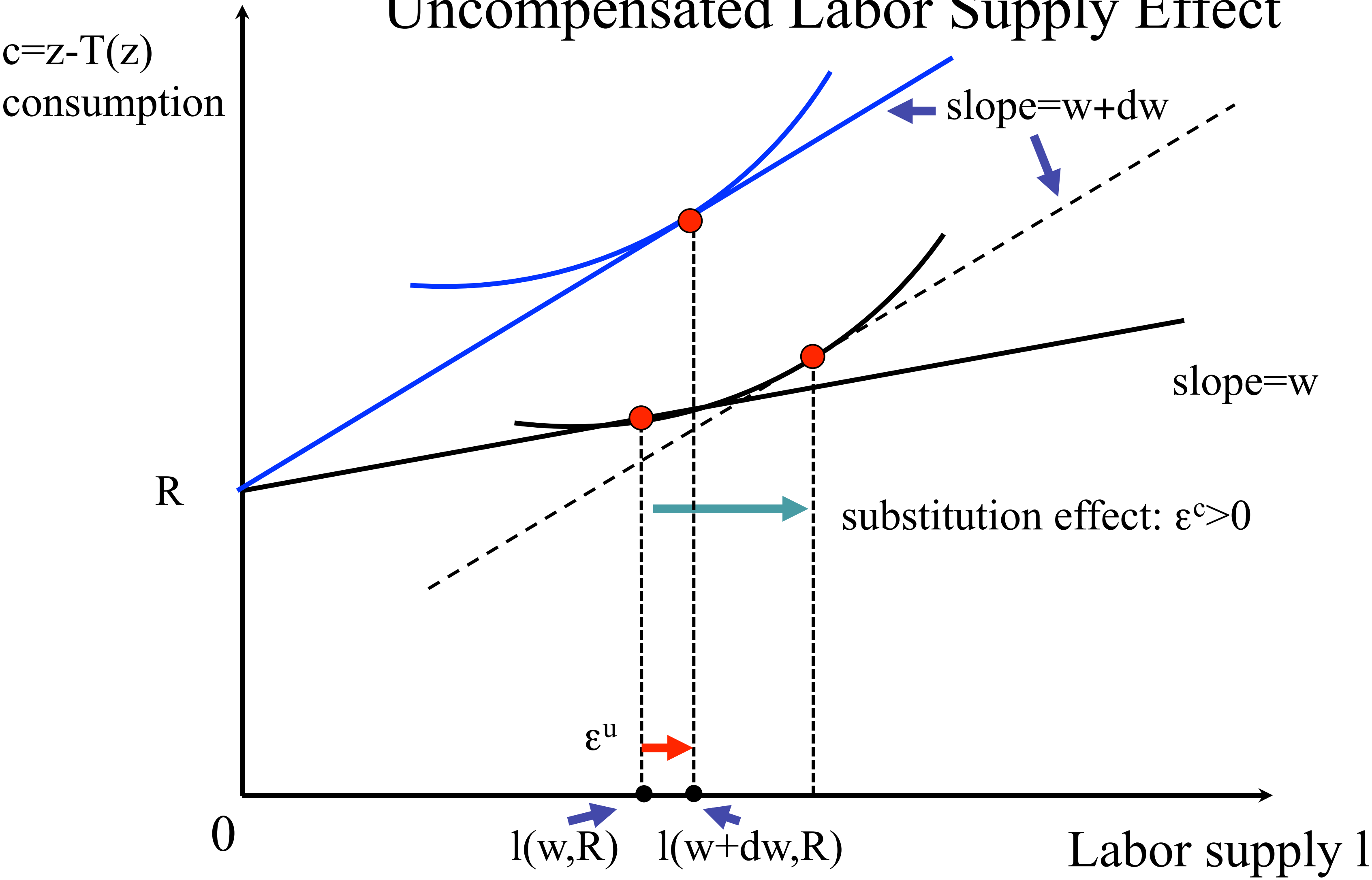
Uncompensated Labor Supply Effect



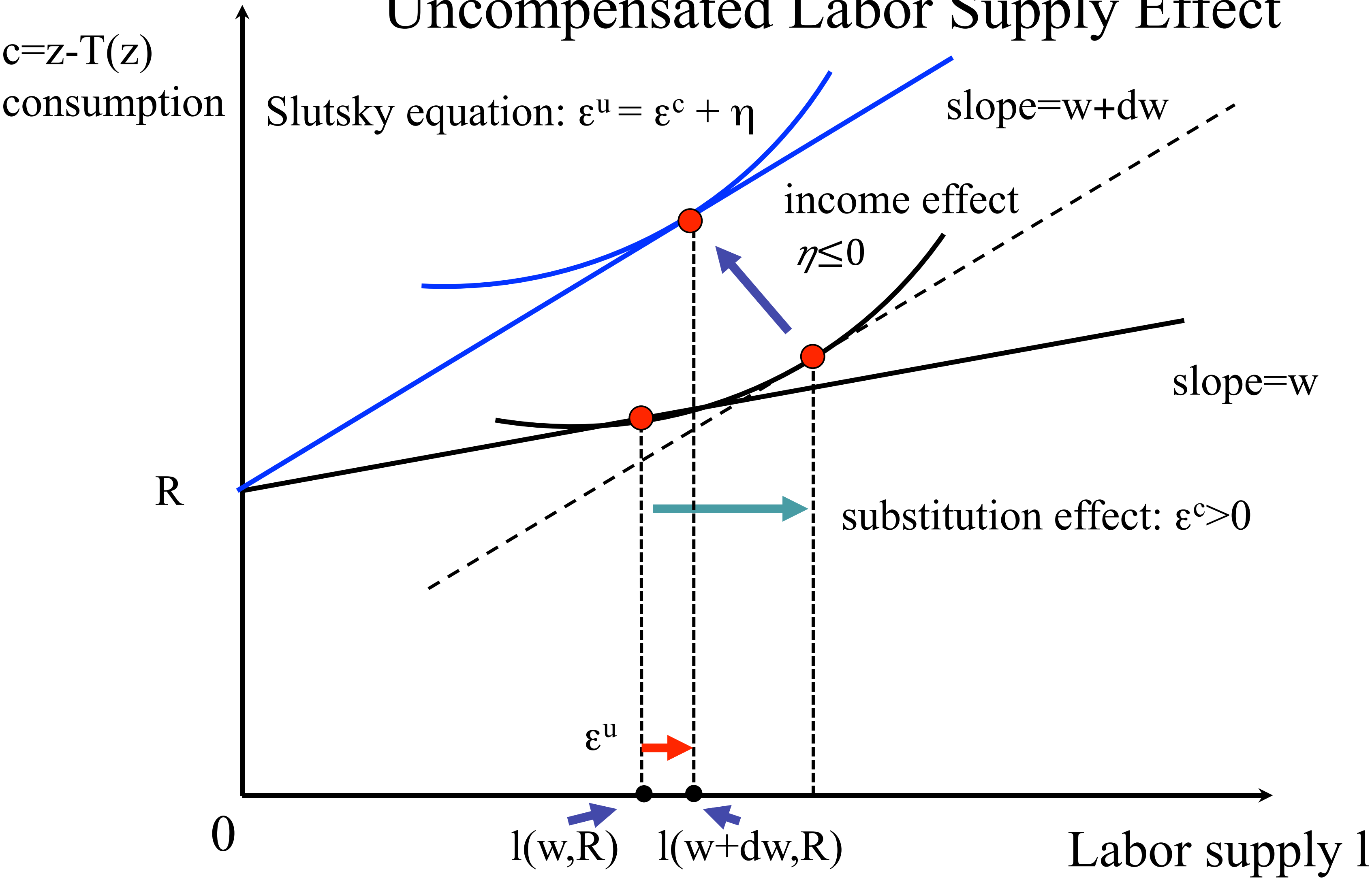
Uncompensated Labor Supply Effect



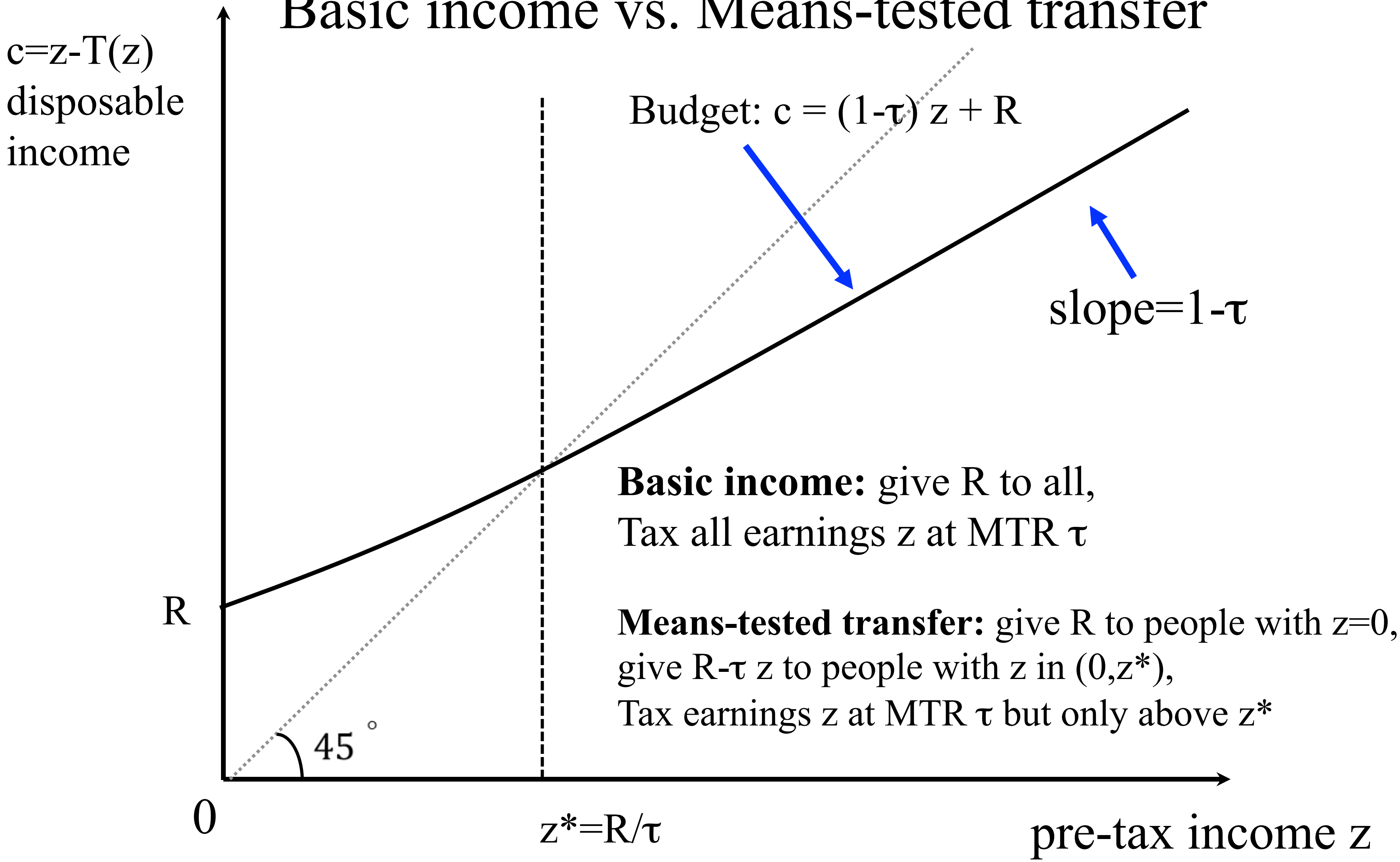
Uncompensated Labor Supply Effect



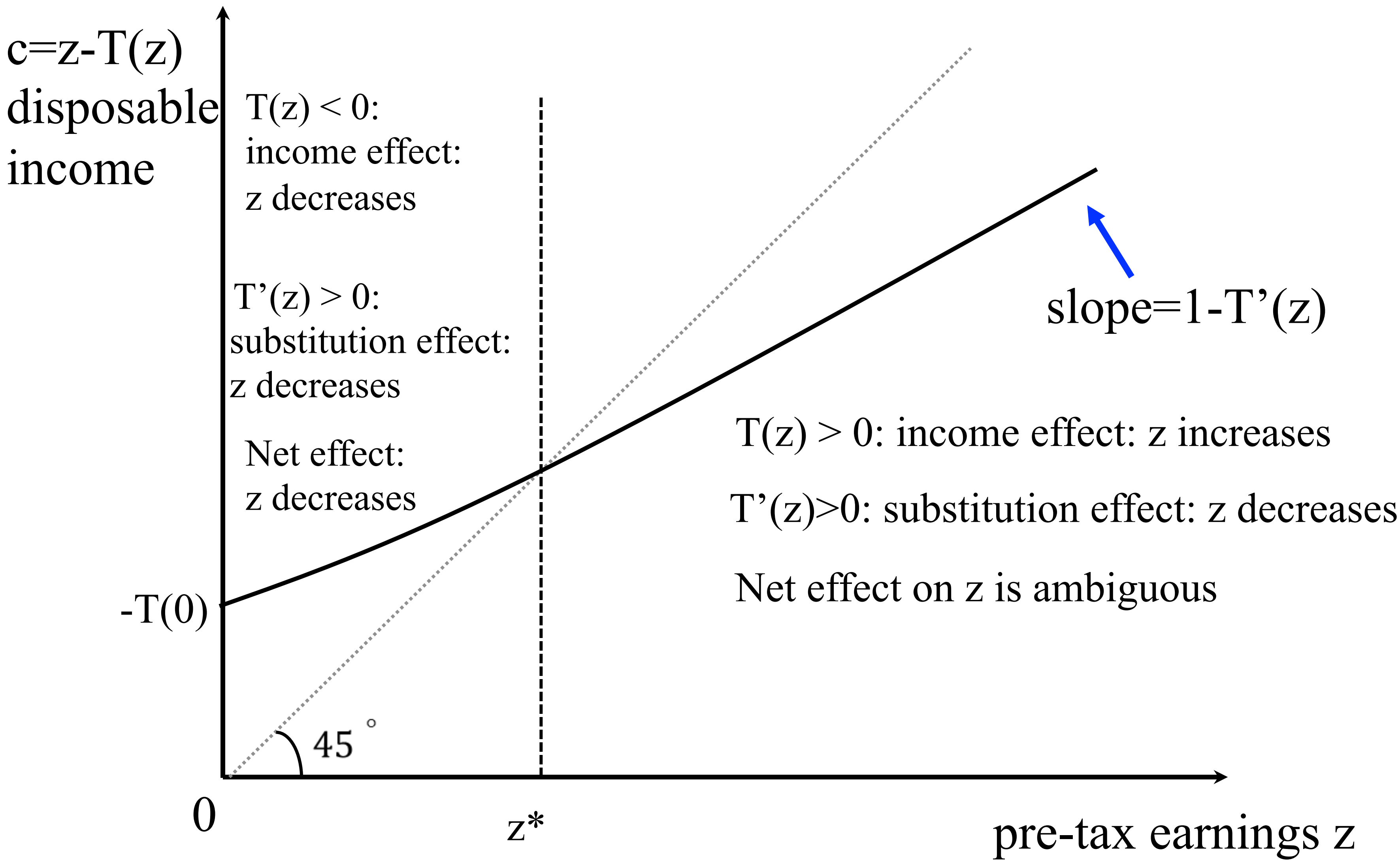
Uncompensated Labor Supply Effect



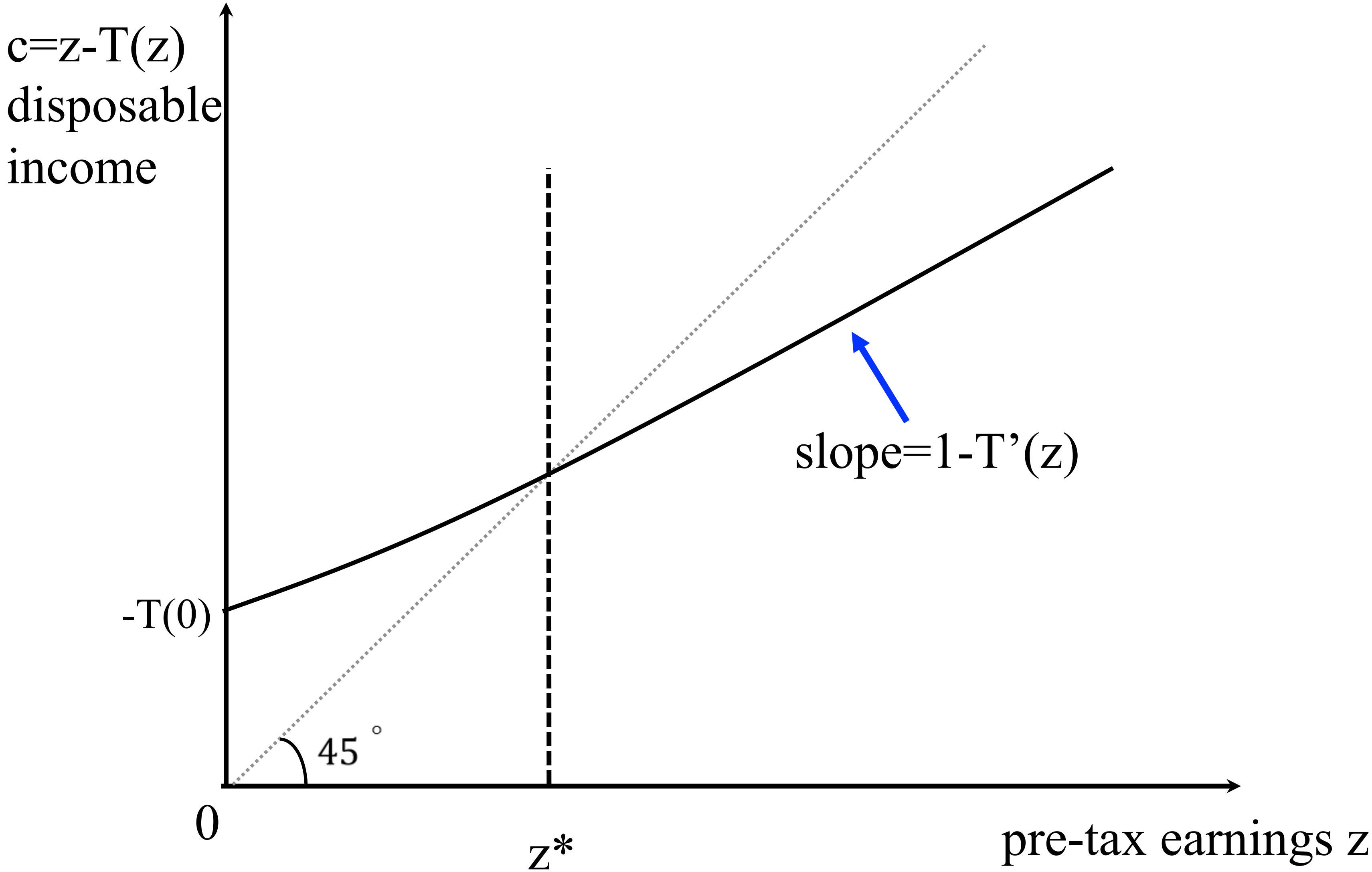
Basic income vs. Means-tested transfer



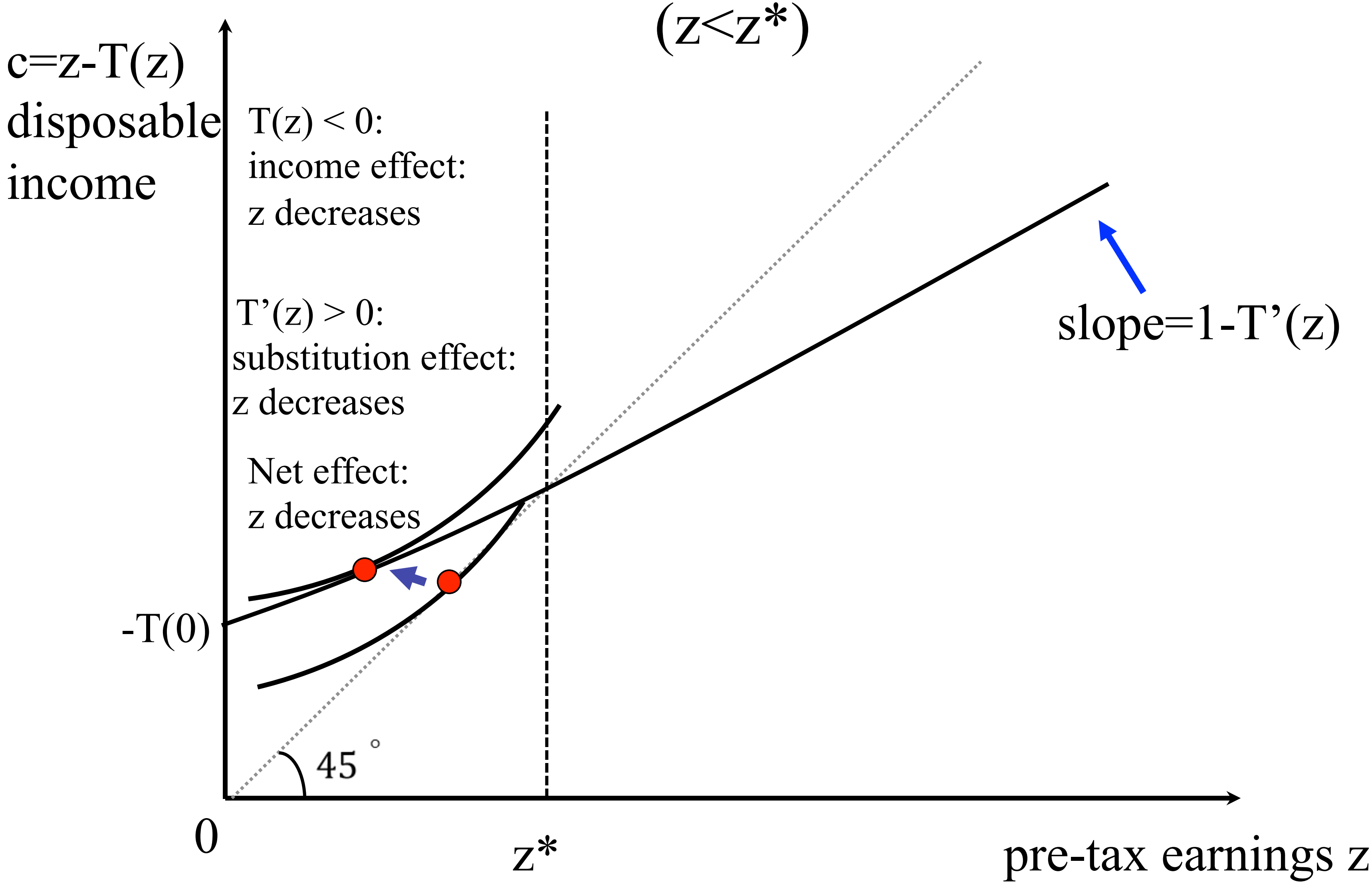
Effect of Taxes/Transfers on Labor Supply



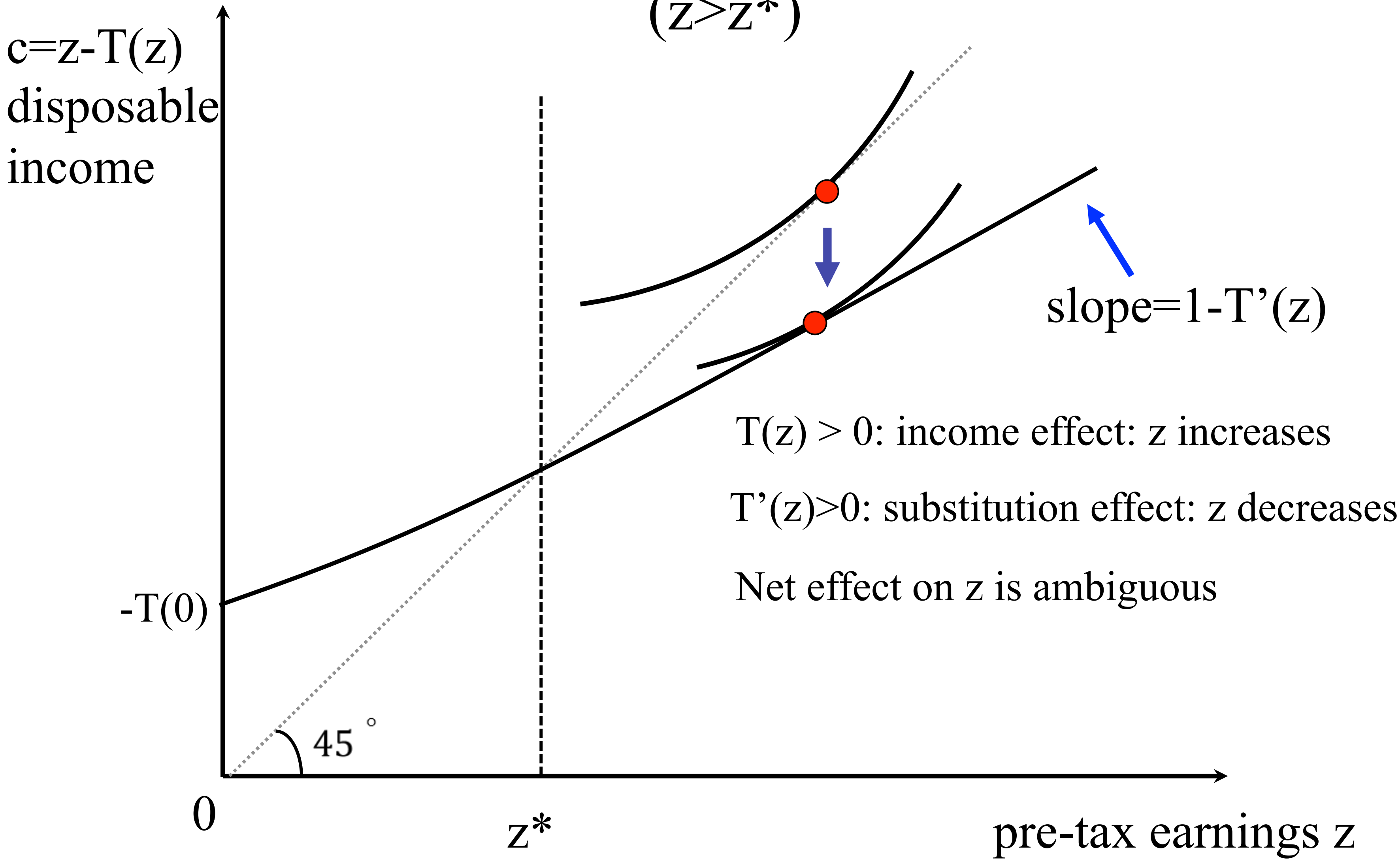
Effect of Taxes/Transfers on Labor Supply



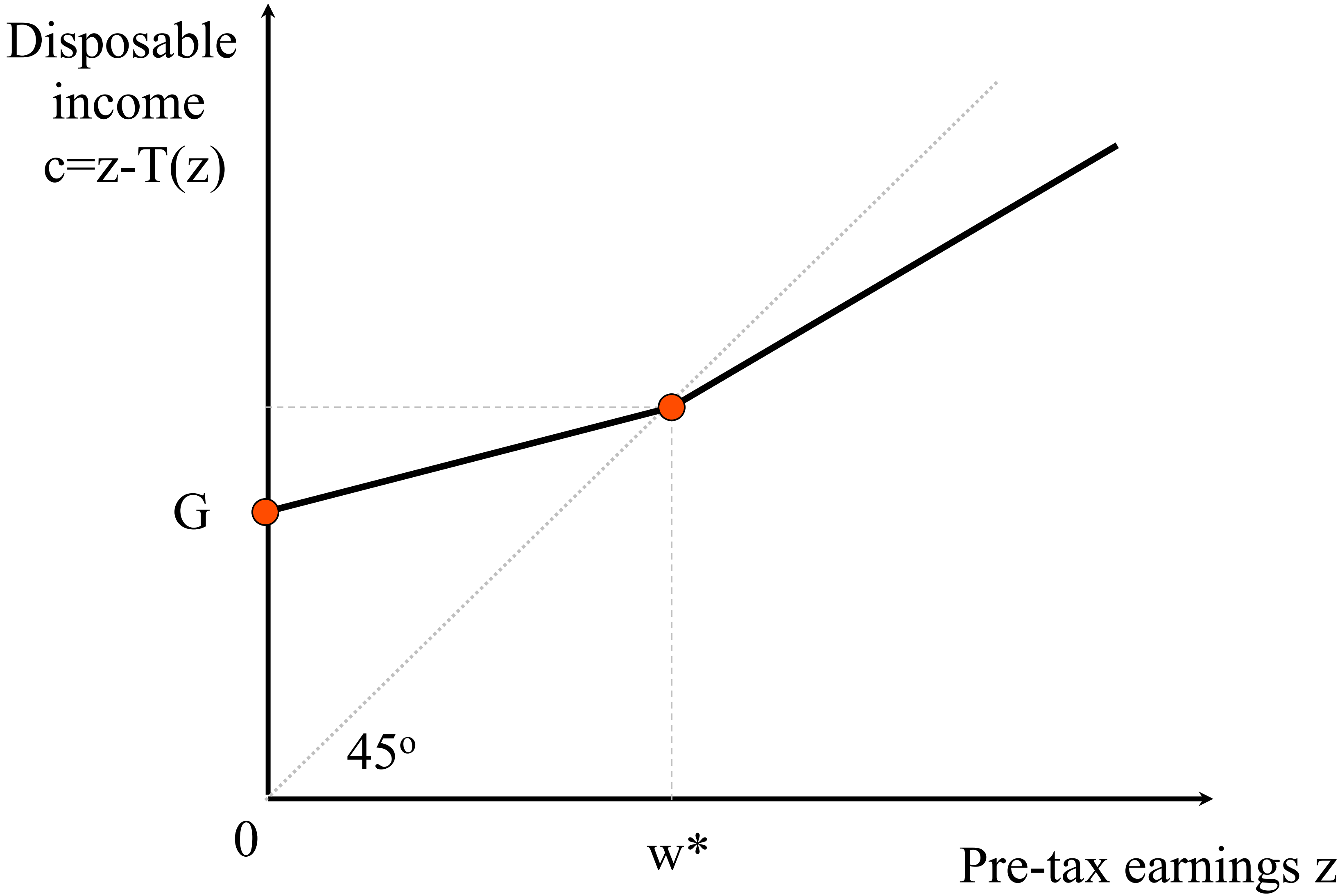
Effect of Taxes/Transfers on Labor Supply (z<z*)



Effect of Taxes/Transfers on Labor Supply
(z>z*)



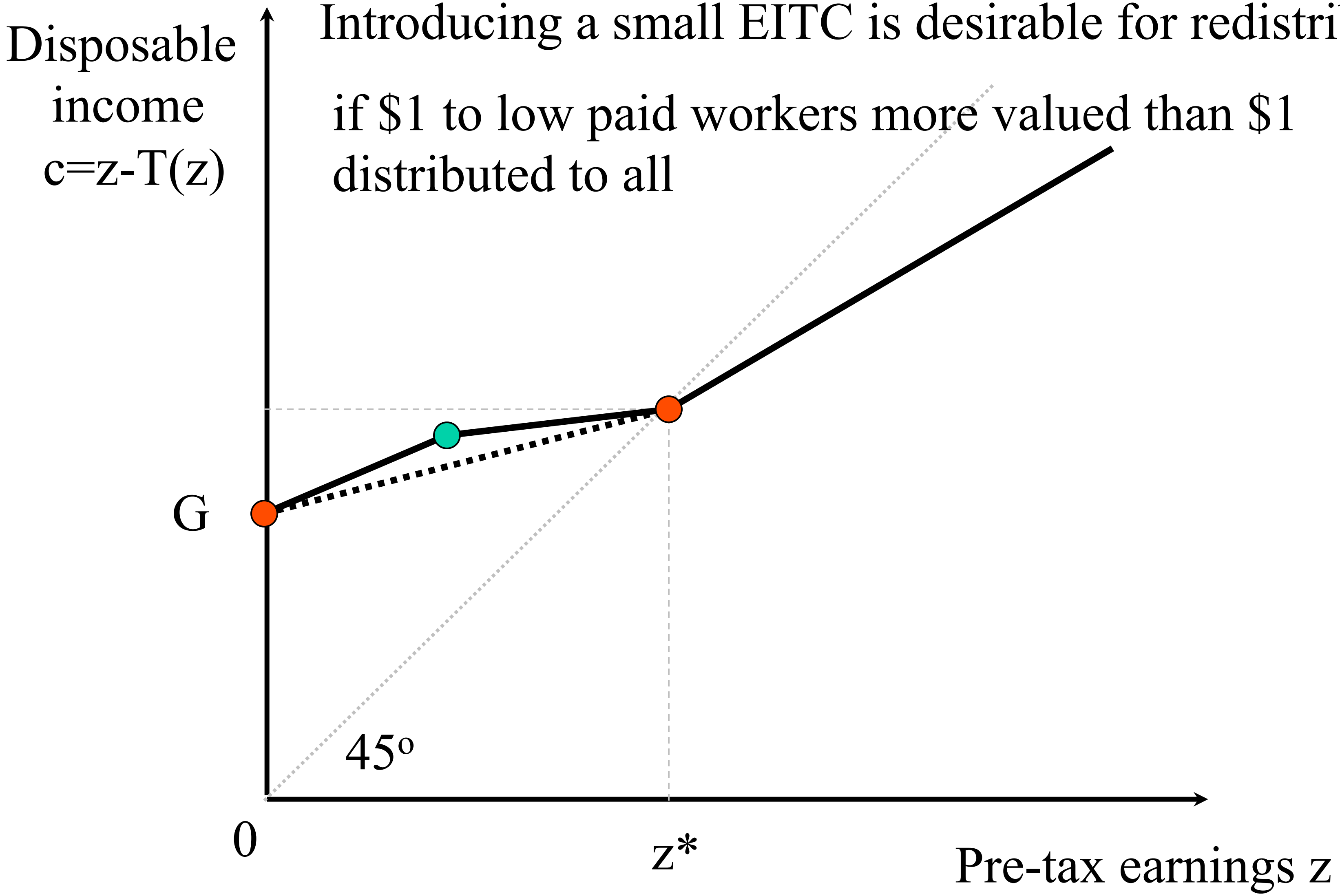
Starting from a Means-Tested Program



Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

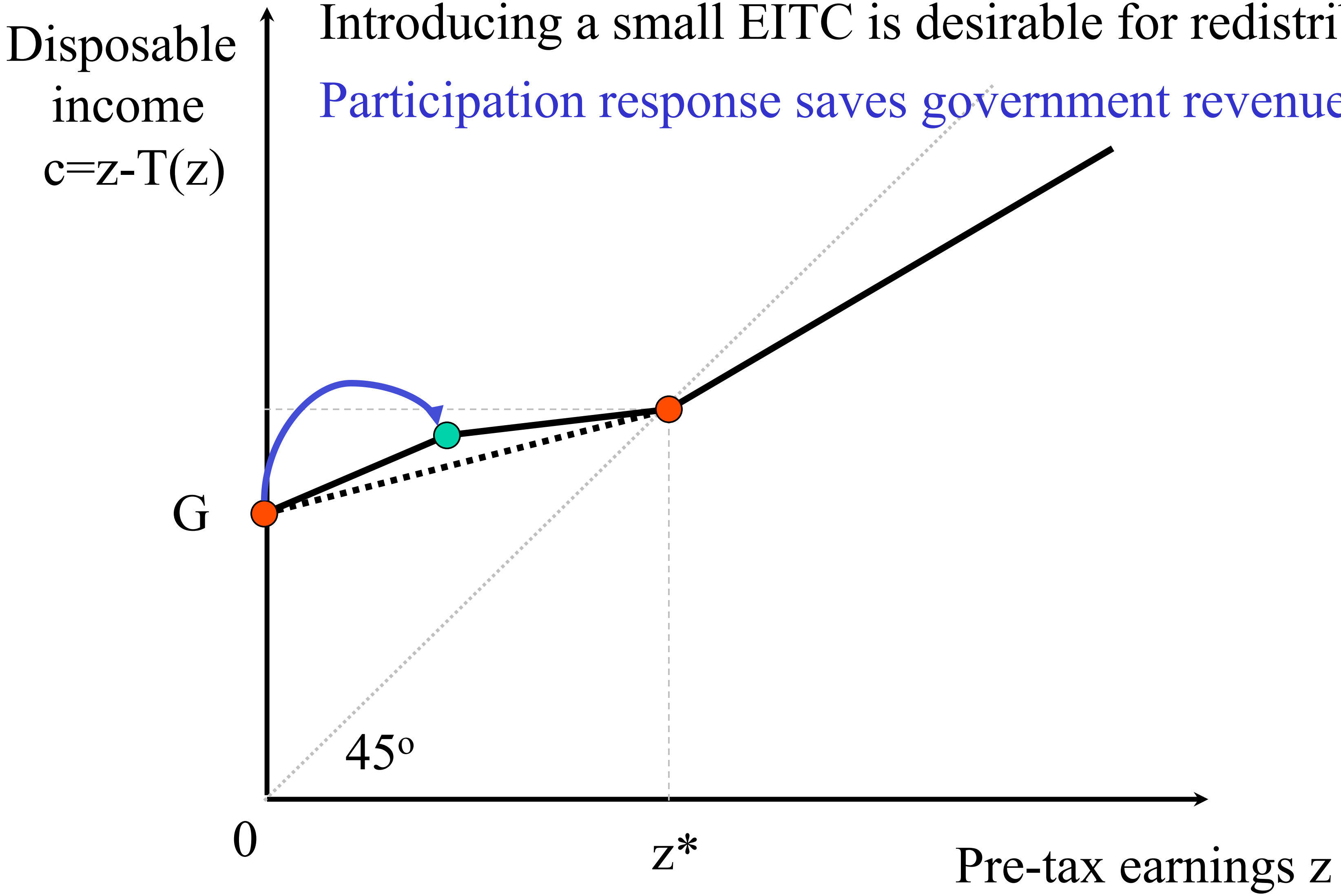
if $1 to low paid workers more valued than $1 distributed to all



Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

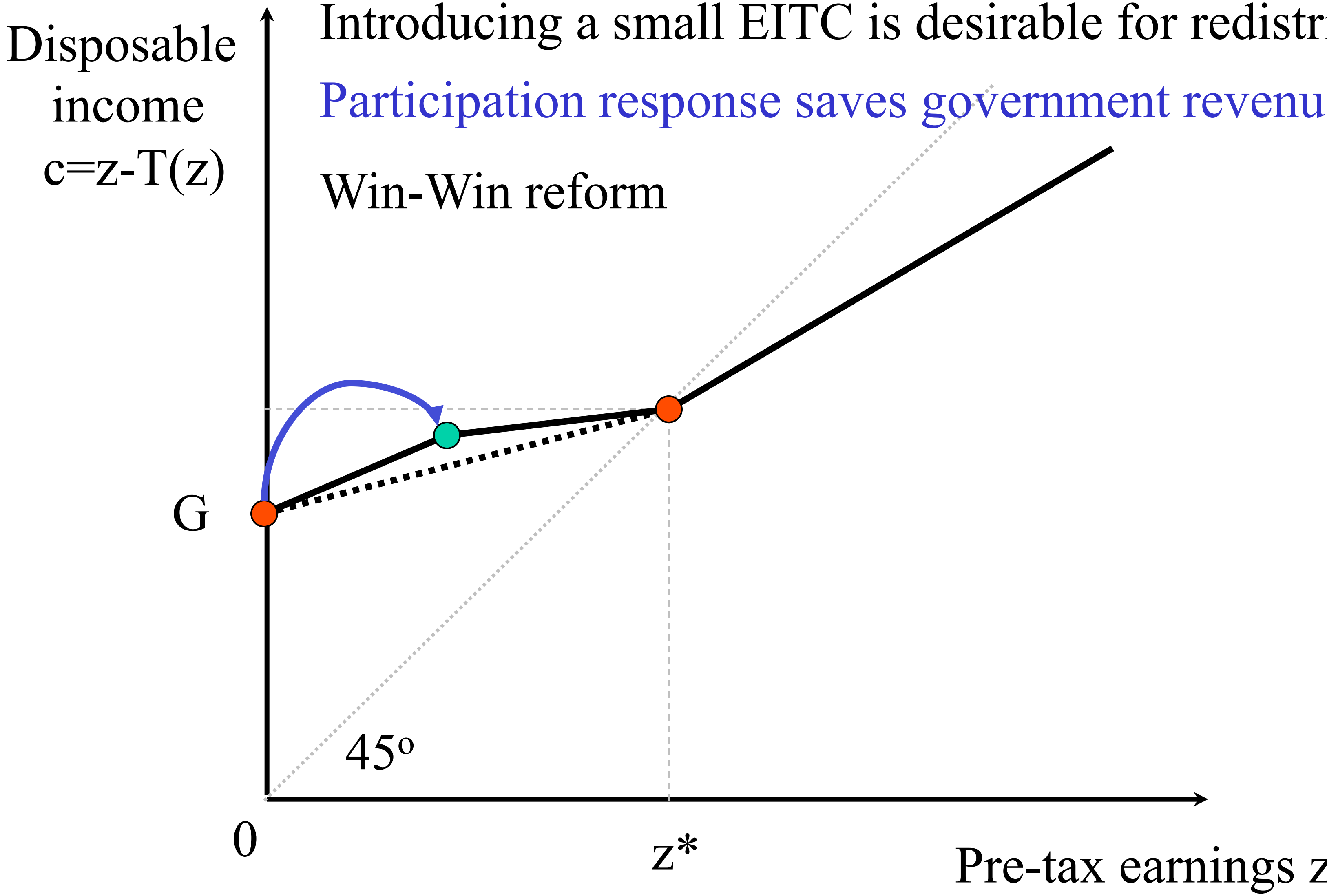


Starting from a Means-Tested Program

Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

Win-Win reform

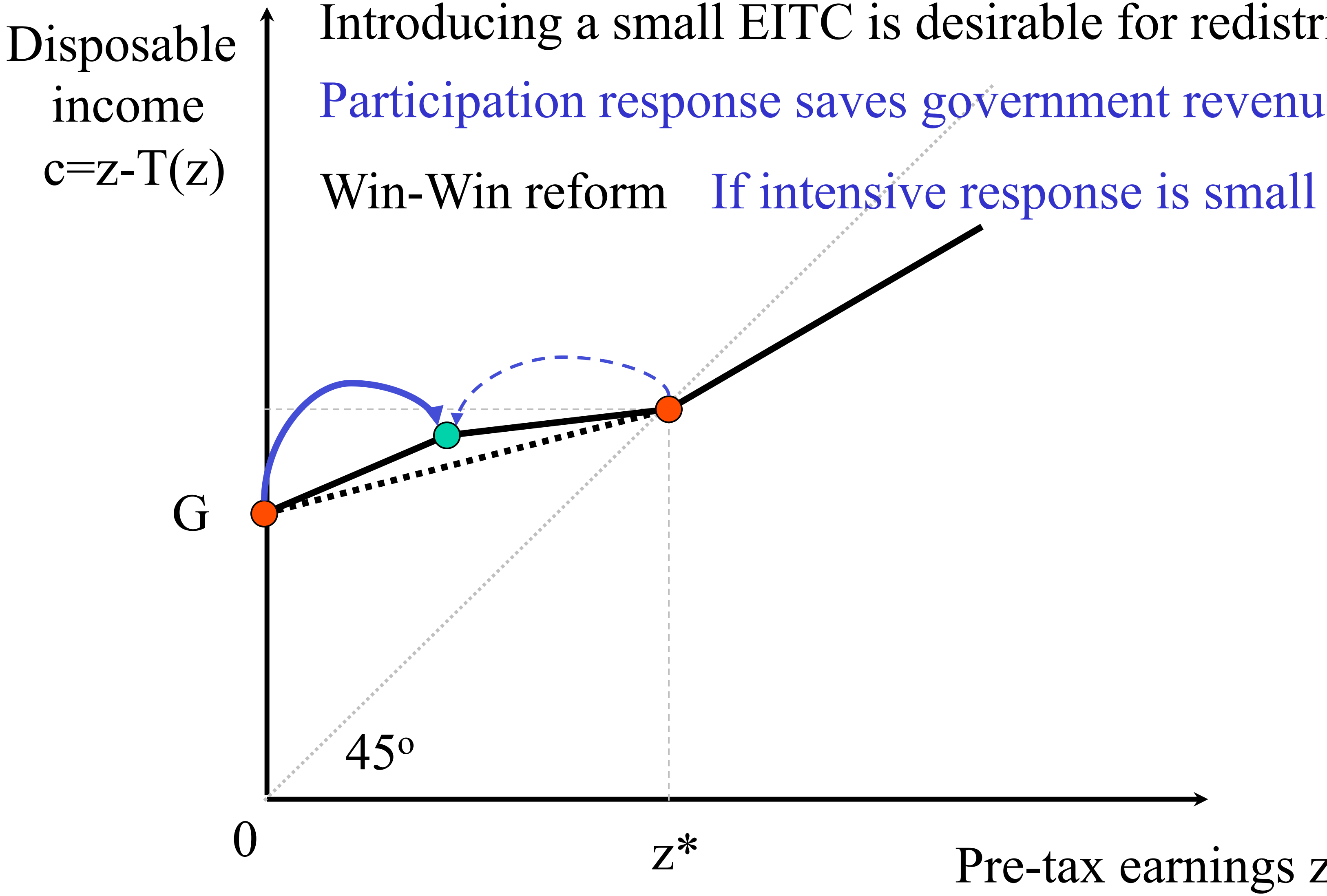


Starting from a Means-Tested Program

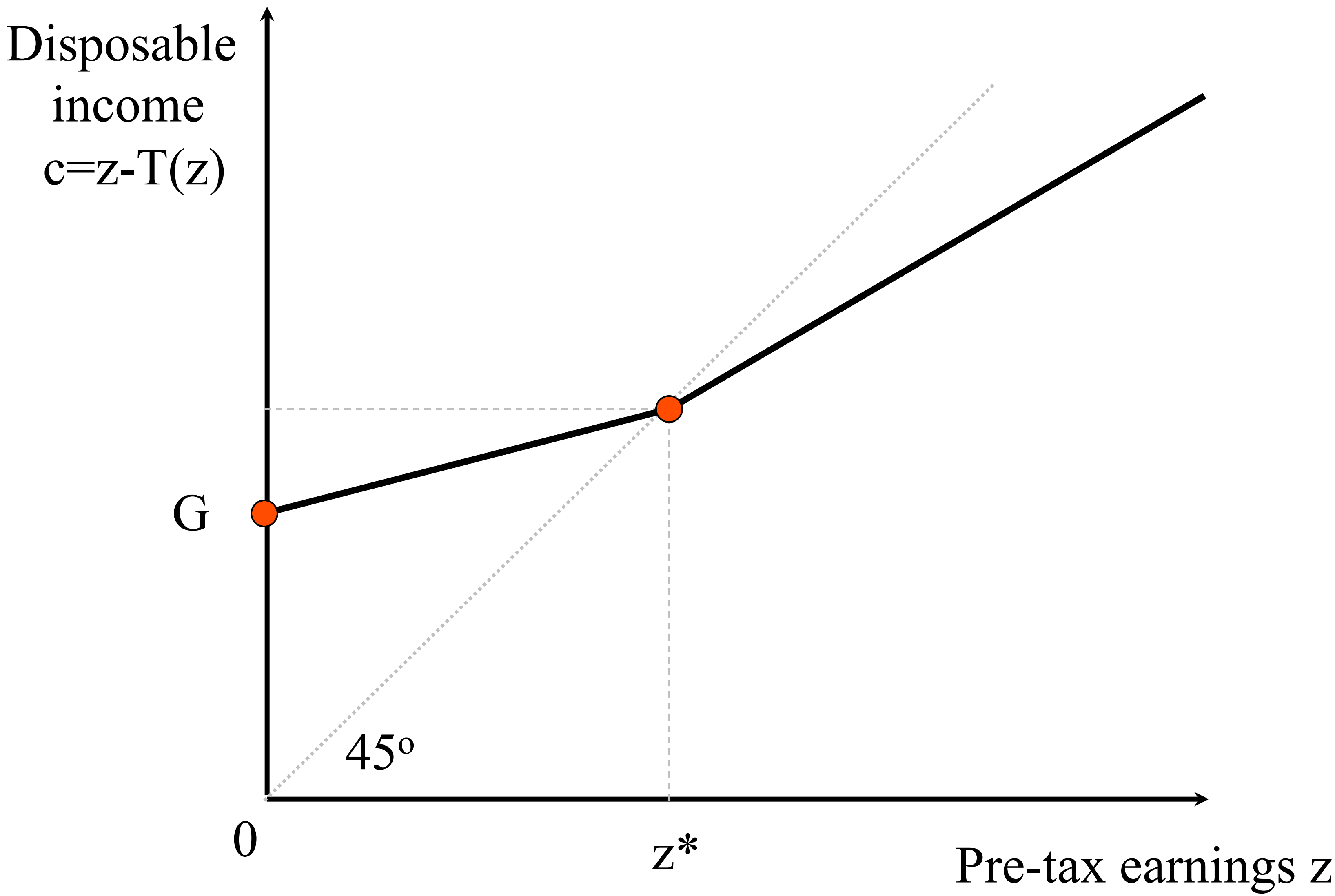
Introducing a small EITC is desirable for redistribution

Participation response saves government revenue

Win-Win reform   If intensive response is small



Starting from a means-tested program

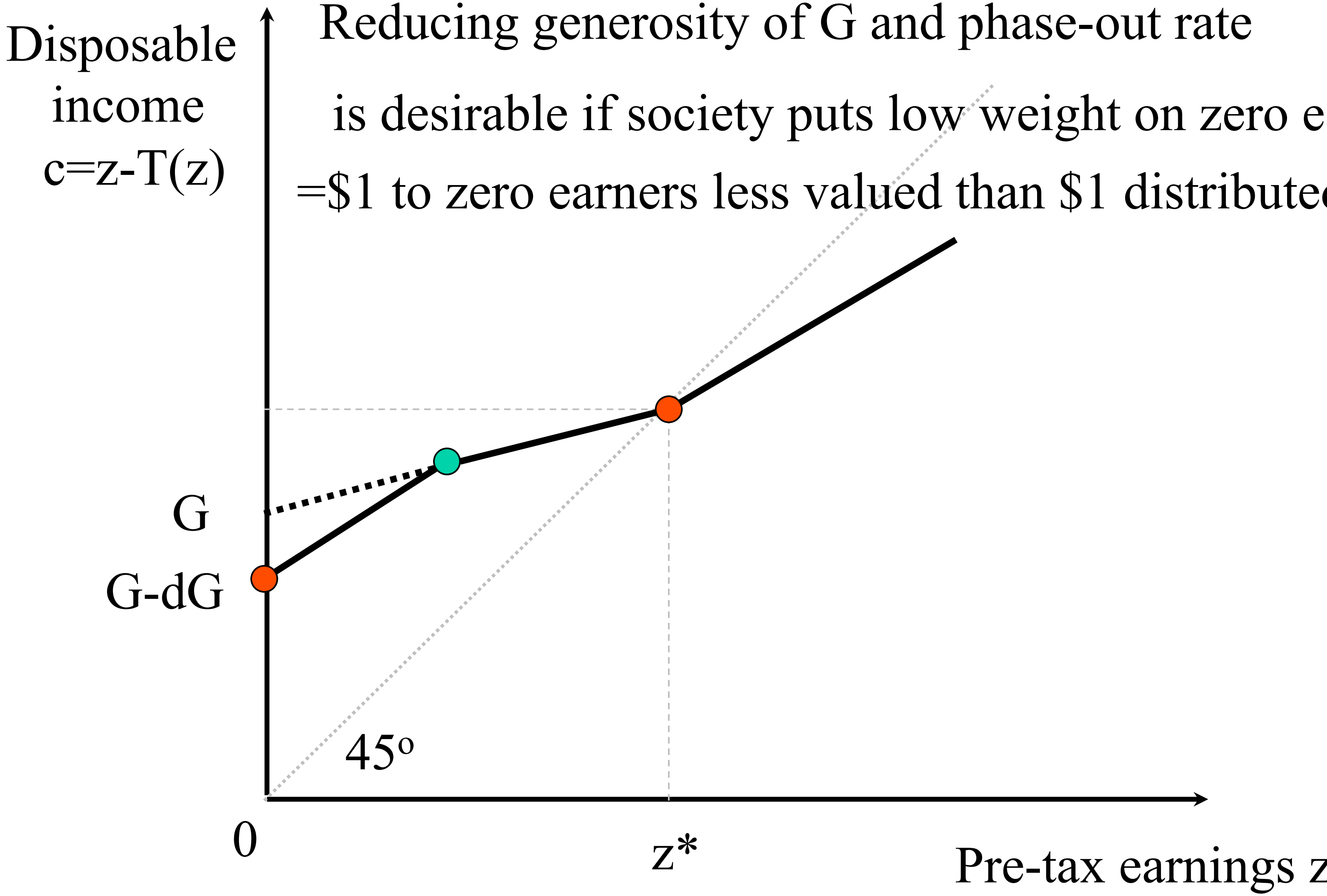


Starting from a means-tested program

Reducing generosity of G and phase-out rate

is desirable if society puts low weight on zero earners

=$1 to zero earners less valued than $1 distributed to all



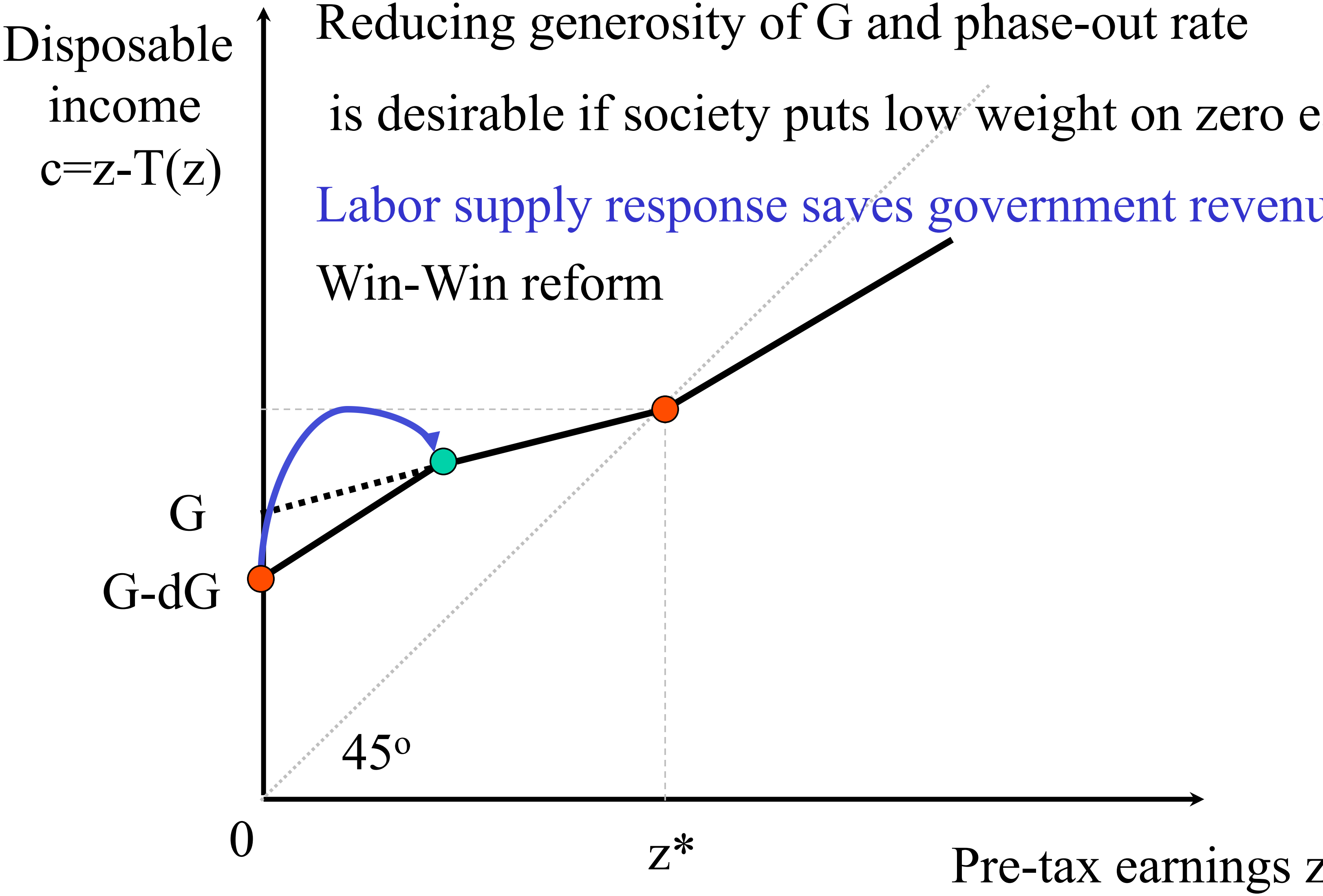
Starting from a means-tested program

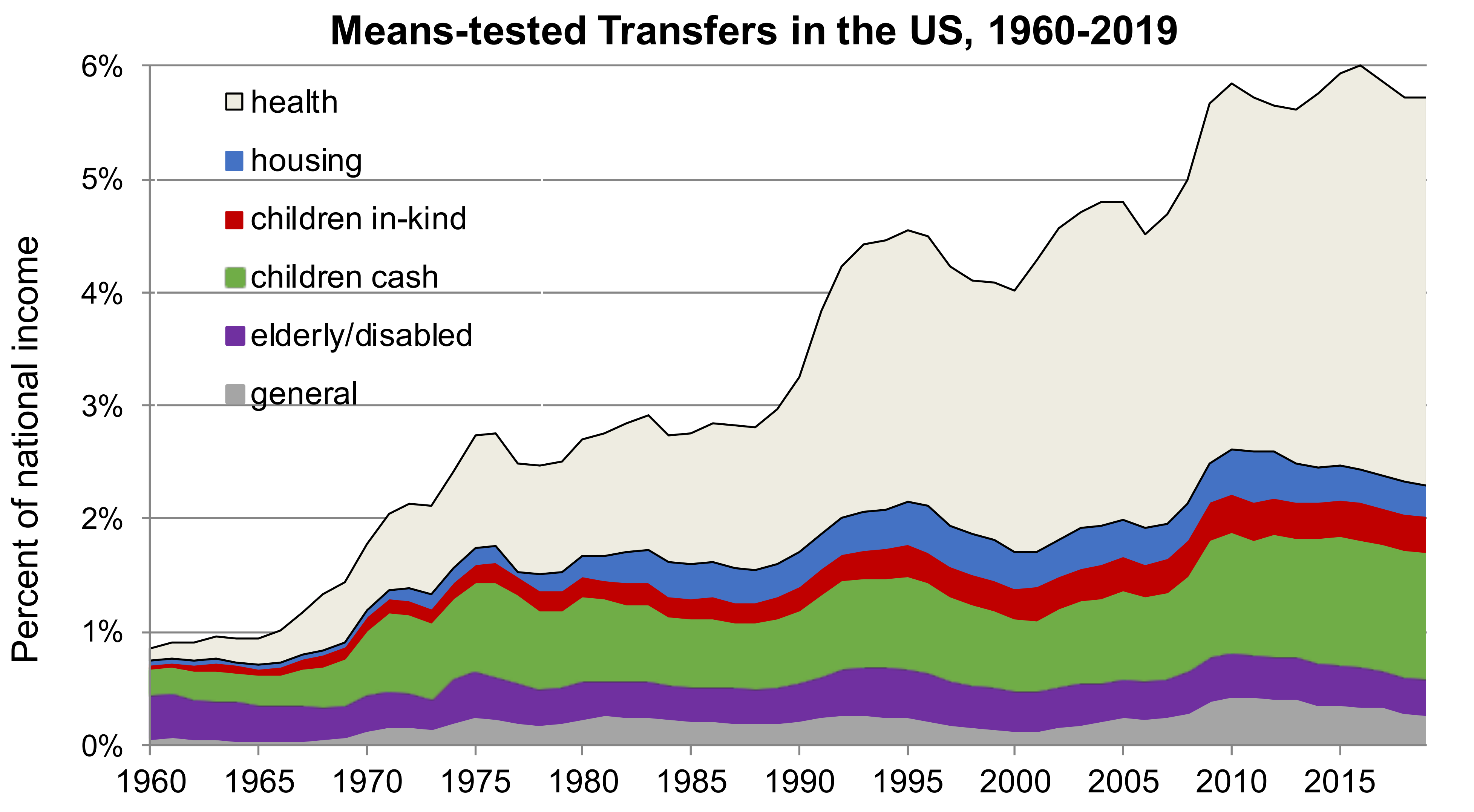
Reducing generosity of G and phase-out rate

is desirable if society puts low weight on zero earners

Labor supply response saves government revenue

Win-Win reform



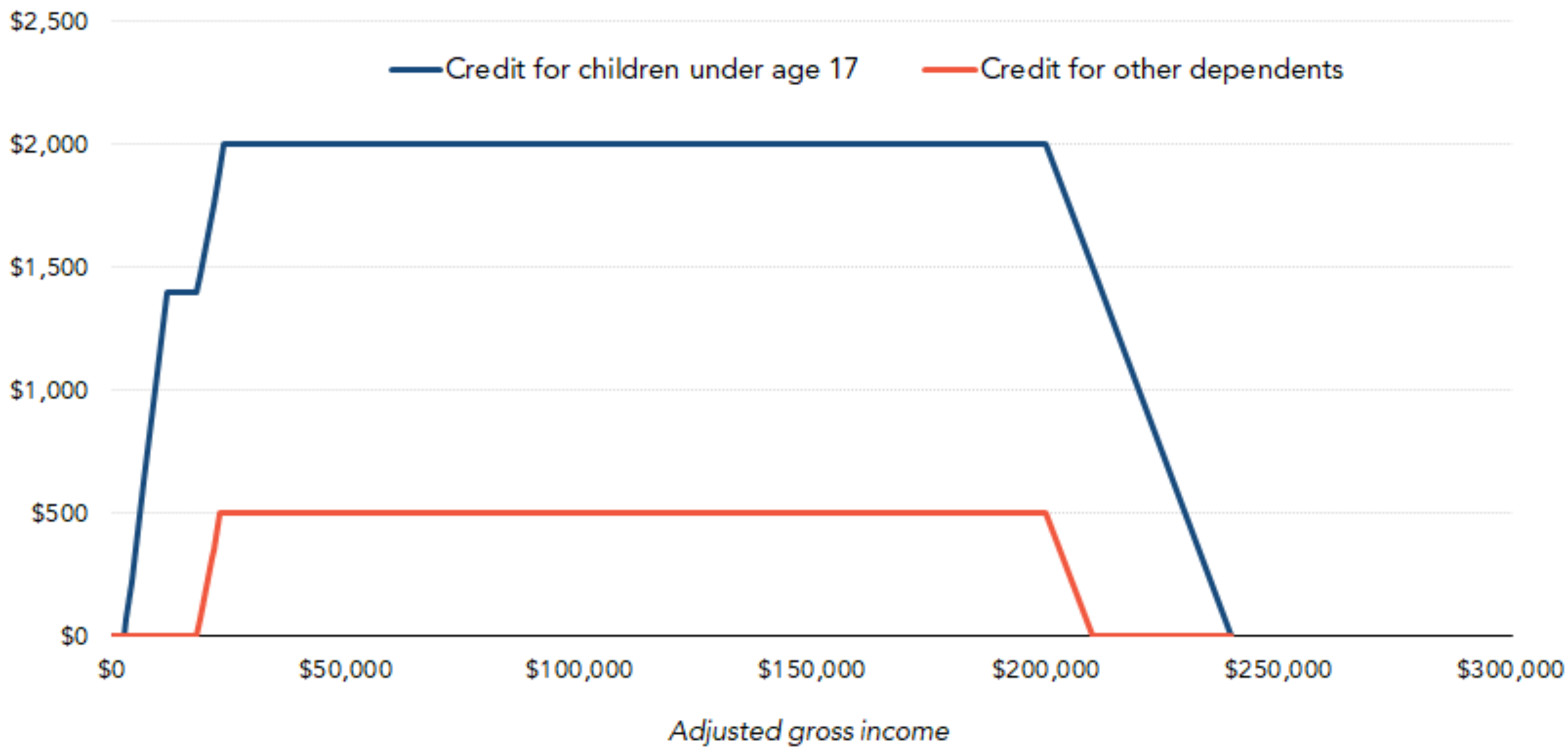


Source. National Accounts. Includes all individualized and means-tested transfers. General is untargetted (SNAP and general assistance for adults). Children cash includes refundable tax credits (EITC+CTC), TANF, and SNAP for children. Health is mostly Medicaid.

FIGURE 1

Child Tax Credit, Single Parent

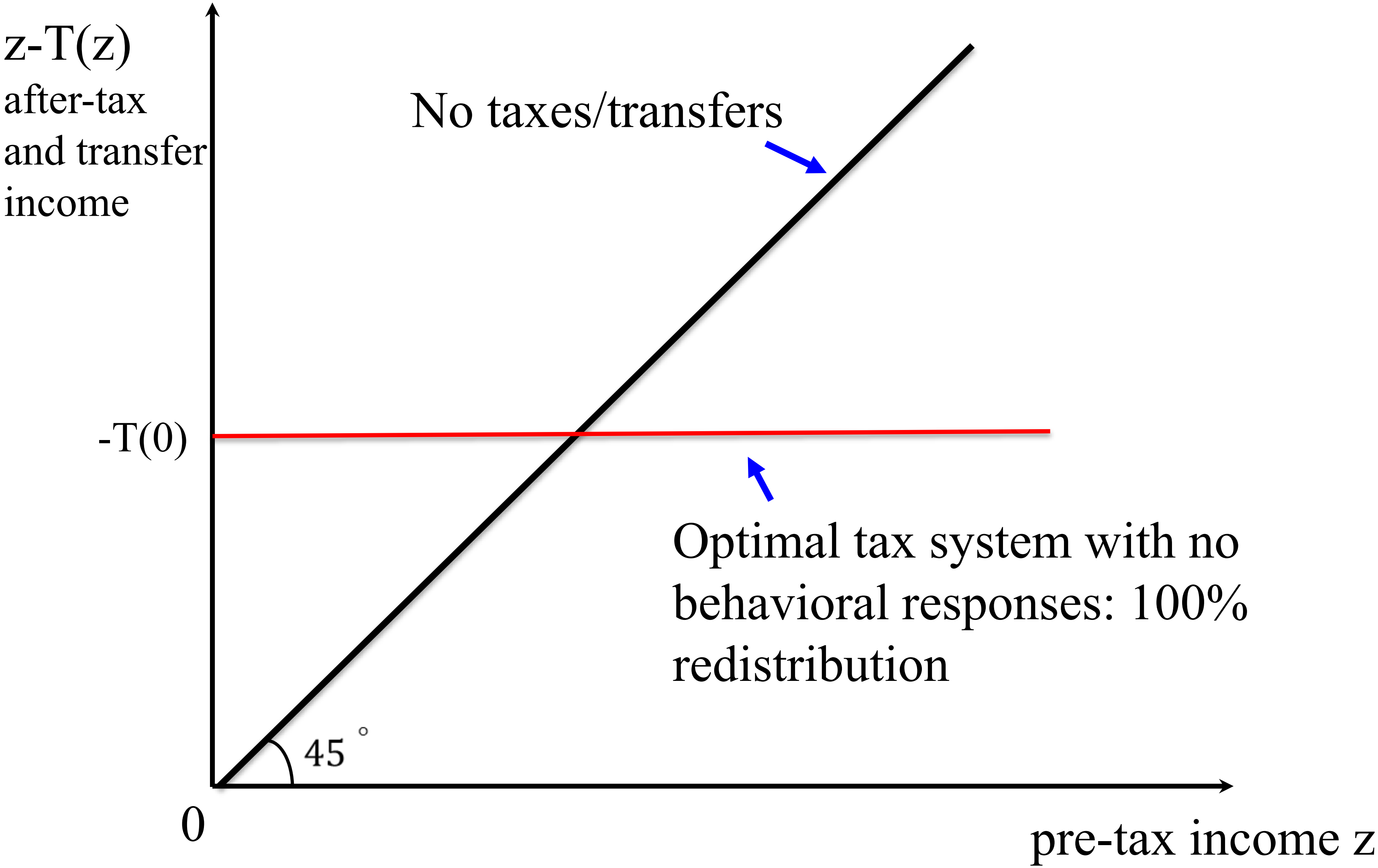
For one child, tax year 2020



Source: Urban-Brookings Tax Policy Center calculations.

Notes: Assumes all income comes from earnings, and child meets all tests to be a CTC-qualifying dependent. Credit for married parents begins to phase out at $400,000 of income. Only citizen children qualify for the $2,000 CTC for children under 17. Noncitizens under age 17 who meet the dependency tests of eligibility can qualify for the credit for dependents over age 17.

Optimal Tax/Transfer Systems



Optimal Tax/Transfer Systems

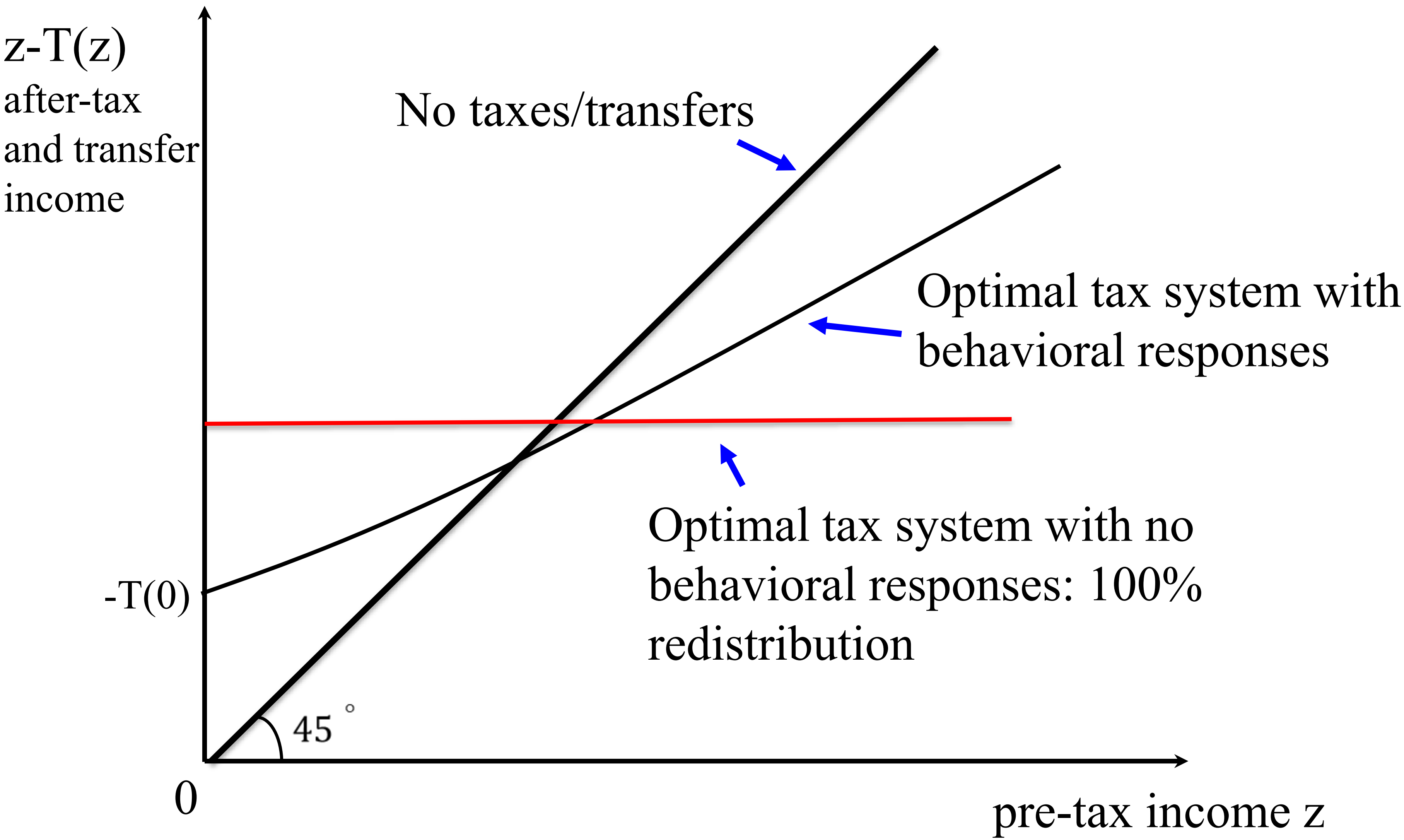
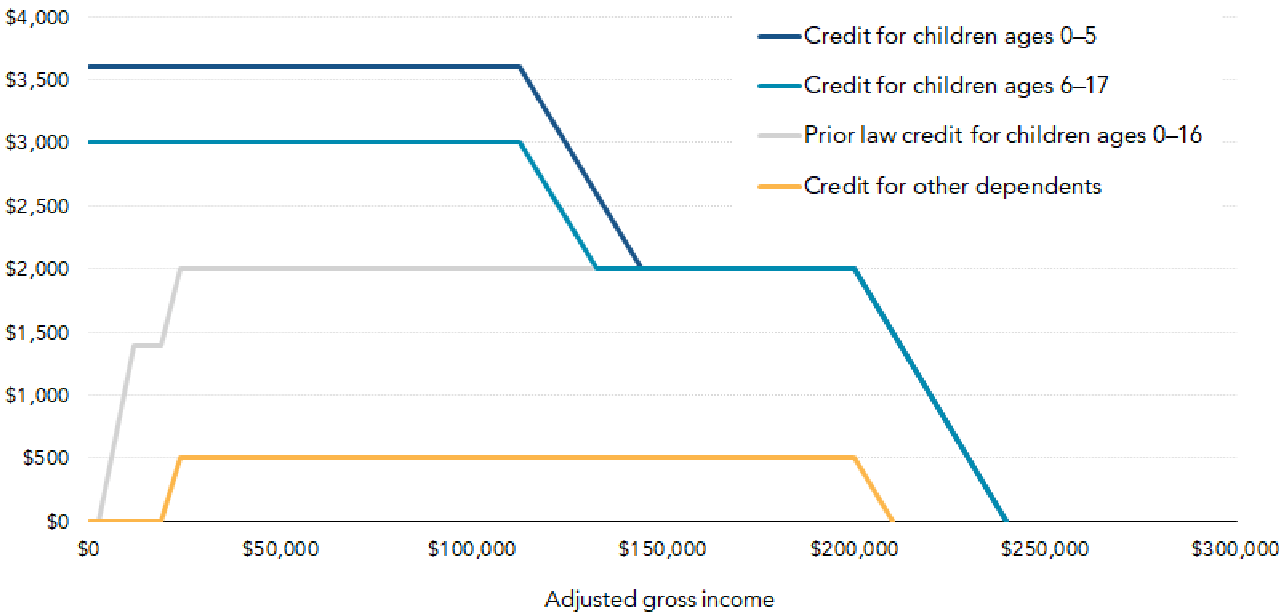


FIGURE 1

Child Tax Credit, Single Parent
For one child, tax year 2021



Source: Urban-Brookings Tax Policy Center calculations.
Notes: Assumes all income comes from earnings, and child meets all tests to be a CTC-qualifying dependent. $3,000 and $3,600 credits are fully refundable; prior law limited refunds to $1,400 out of the maximum $2,000 credit. Credit for married parents first phases out at $150,000 of income until credit reaches pre-2021 level; begins second phase out at $400,000 of income. Only citizen children qualify for the $3,000 and $3,600 credits for children under 18. Noncitizens under age 18 who meet the dependency tests of eligibility can qualify other dependent credit.