

Contents

| | | |
|----------|--|----|
| | Preface | xi |
| 1 | Introduction | 1 |
| 2 | Conceptual Foundations of the MCF | 11 |
| | 2.1 The Excess Burden of Taxation | 13 |
| | 2.1.1 Measuring Excess Burden | 13 |
| | 2.1.2 Measuring the Gain from Tax Reform | 18 |
| | 2.2 Optimal Taxation and Public Expenditures | 22 |
| | 2.3 The MCF and the Gain from Tax Reform | 24 |
| | 2.4 Interpreting the MCF Using Demand and Supply Curves | 28 |
| | 2.5 The Relationship between the MCF and the MEB | 31 |
| | 2.6 Application: The MCF for a Tariff and the Gain from Free Trade | 33 |
| | 2.7 Incorporating Distributional Preferences in the MCF | 38 |
| | 2.8 Alternative Interpretations of the MCF | 42 |
| | Further Reading for Chapter 2 | 47 |
| | Appendix to Chapter 2 | 48 |
| | Exercises for Chapter 2 | 49 |
| 3 | The MCF for Commodity Taxes | 51 |
| | 3.1 The MCF and the Laffer Curve | 54 |
| | 3.2 The MCF with Multiple Tax Bases | 55 |
| | 3.3 Optimal Commodity Taxation | 58 |
| | 3.4 The MCF with Externalities | 63 |
| | 3.4.1 Environmental Externalities | 63 |
| | 3.4.2 Public Expenditure Externalities | 65 |
| | 3.5 The MCF with Imperfect Competition in Commodity Markets | 66 |
| | 3.5.1 The MCF under Monopoly | 67 |

| | | |
|----------|---|------------|
| 3.5.2 | Ad valorem versus Per Unit Taxes on a Monopolist's Product | 70 |
| 3.5.3 | The MCF under Oligopoly | 73 |
| 3.6 | Addiction/Self-control Problems | 75 |
| 3.7 | Smuggling | 77 |
| 3.8 | Studies of the Marginal Distortionary Cost of Taxing Commodities | 78 |
| | Further Reading for Chapter 3 | 78 |
| | Appendix to Chapter 3 | 82 |
| | Exercises for Chapter 3 | 83 |
| 4 | The MCFs for Excise Taxes in Thailand and the United Kingdom | 87 |
| 4.1 | The MCFs for Excise Taxes in Thailand | 88 |
| 4.1.1 | Parameter Values | 89 |
| 4.1.2 | Calculations of the MCFs | 98 |
| 4.1.3 | Calculations of the SMCFs | 102 |
| 4.1.4 | Summary and Extensions | 104 |
| 4.2 | The MCFs for Excise Taxes in the United Kingdom | 105 |
| 4.2.1 | Parameter Values | 106 |
| 4.2.2 | Computations of the MCFs | 111 |
| 5 | The MCF from Taxing Labor Income | 113 |
| 5.1 | The MCF for a Proportional Tax on Labor Income | 115 |
| 5.1.1 | Elasticity of Labor Supply | 116 |
| 5.1.2 | Elasticity of Demand for Labor | 119 |
| 5.2 | The SMCF for a Progressive Wage Tax | 121 |
| 5.3 | Incorporating Labor Force Participation Effects in the MCF | 126 |
| 5.4 | Using the Elasticity of Taxable Income to Calculate the MCF | 130 |
| 5.5 | The MCF in Models of Political Choice | 132 |
| 5.5.1 | Median Voter Model | 132 |
| 5.5.2 | Probabilistic Voting Model | 133 |
| 5.5.3 | Leviathan Model | 135 |
| 5.6 | Studies of the Marginal Distortionary Cost of Taxing Labor Income | 136 |
| | Further Reading for Chapter 5 | 136 |
| | Exercises for Chapter 5 | 136 |
| 6 | Applications of the MCF from Taxing Labor Income | 143 |
| 6.1 | Involuntary Unemployment and the MCF for a Payroll Tax | 144 |
| 6.2 | Cost-Benefit Analysis of the Taxpayer Survey in Thailand | 150 |

| | | |
|----------|---|------------|
| 6.2.1 | A Framework for Evaluating a Tax Enforcement Program | 151 |
| 6.2.2 | Key Components of the Analysis | 154 |
| 6.2.3 | Net Social Gain and the SMCF for the Taxpayer Survey | 158 |
| 6.3 | Optimal Flat Tax | 159 |
| 6.3.1 | Deriving the Conditions for the Optimal Flat Tax | 160 |
| 6.3.2 | Computing the Optimal Flat Tax | 167 |
| 7 | The MCF from Taxing the Return to Capital | 171 |
| 7.1 | The MCF from Taxing the Return to Savings in a Small Open Economy | 174 |
| 7.1.1 | Optimal Tax Rate on Savings | 176 |
| 7.1.2 | Application: Gain from Switching to a Consumption Tax | 181 |
| 7.2 | The MCF from Taxing the Return to Capital in a Small Open Economy | 184 |
| 7.3 | The MCF for the Corporate Income Tax in a Small Open Economy | 190 |
| 7.3.1 | The MCF for the CIT under Alternative Foreign Income Tax Systems | 190 |
| 7.3.2 | Application: The Optimal CIT and Wage Tax Rates | 198 |
| 7.4 | Studies of the Marginal Distortionary Cost from Taxing the Return on Capital | 199 |
| | Further Reading for Chapter 7 | 199 |
| | Exercises for Chapter 7 | 202 |
| 8 | The MCF from Public Sector Borrowing | 205 |
| 8.1 | Postwar Debates on the Burden of the Public Debt | 206 |
| 8.2 | The MCF from Public Debt in an Overlapping Generations Model | 209 |
| 8.3 | The MCF from Debt Financed by Distortionary Taxation | 214 |
| 8.4 | Tax Smoothing and Optimal Debt Financing of Public Expenditures | 217 |
| 8.5 | The MCF from Public Sector Borrowing in an Endogenous Growth Model | 221 |
| 8.5.1 | A Simple Endogenous Growth Model with Public Debt | 221 |
| 8.5.2 | The MCF in an Endogenous Growth Model | 226 |
| 8.5.3 | Effect of the Public Debt on Optimal Public Expenditures | 229 |
| 8.5.4 | Application: The MCF from Public Sector Borrowing in Canada and the United States | 233 |

| | | |
|-----------|---|-----|
| | Further Readings for Chapter 8 | 237 |
| | Exercises for Chapter 8 | 238 |
| 9 | The MCF in a Federal System of Government | 241 |
| 9.1 | Fiscal Externalities and Fiscal Imbalances | 242 |
| 9.1.1 | Conventional Definition of Vertical Fiscal Imbalance | 243 |
| 9.1.2 | Alternative Definition of Vertical Fiscal Imbalance | 245 |
| 9.1.3 | Horizontal Fiscal Imbalances in a Federation | 247 |
| 9.2 | Horizontal Fiscal Externalities and the MCF of a Subnational Government | 248 |
| 9.3 | Intergovernmental Grants and Subnational Governments' MCF | 253 |
| 9.3.1 | Correcting Horizontal Expenditure Externalities | 253 |
| 9.3.2 | Correcting Horizontal Tax Externalities | 254 |
| 9.3.3 | Optimal Equalization Grants | 255 |
| 9.4 | Vertical Fiscal Externalities in a Federation | 257 |
| 9.5 | Vertical Fiscal Imbalances in a Federation | 263 |
| 9.5.1 | The MCF for a State Government | 265 |
| 9.5.2 | Simulation Model of Vertical Fiscal Imbalance | 268 |
| | Appendix to Chapter 9 | 273 |
| | Exercises for Chapter 9 | 274 |
| 10 | Applications of the MCF in Federations | 275 |
| 10.1 | Evaluating the Canadian Provinces' Tax Incentives for R&D | 276 |
| 10.2 | Incentive Effects of the Australian Equalization Grant System | 282 |
| 10.3 | Equalization Grants and Vertical and Horizontal Fiscal Imbalances | 289 |
| 10.3.1 | A Unitary State | 293 |
| 10.3.2 | Federation without Intergovernmental Transfers | 294 |
| 10.3.3 | Federation with a Net Equalization Grant System | 295 |
| 10.3.4 | Federation with a Gross Equalization Grant System | 296 |
| 10.3.5 | Simulation Model of the Effects of Equalization Grants | 297 |
| | Notes | 303 |
| | References | 311 |
| | Index | 325 |