Political competition and Mirrleesian income taxation: A second and third pass

by

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Abstract

We study a model of political competition in which the policy domain consists of non-linear income tax schedules and voters have private information about their productive abilities. We restrict attention to environments with preferences that are quasi-linear in consumption.

We first look at political competition á la Downs (1954), i.e. politicians act as vote-share maximizers and citizens have no ideological feelings.
We show that equilibrium tax policies are first-best, i.e. they do not involve tax distortions. In the normative framework due Mirrless (1971), redistributive and distortionary taxation is desirable. Our result implies that such a policy cannot arise under Downsian competition.

The Downsian approach is of conceptual interest, but too stylized to derive meaningful empirical implications. We therefore also look at a probabilistic voting model in which citizens have ideological biases. Moreover, we allow for the possibility that the distribution of ideology is different among, say, rich and poor citizens. Under these assumptions we can derive empirically testable hypothesis on the discrepancy between tax rates that are ideal and tax rates that are politically sustainable.