Inequality, Efficiency, and Taxation: Understanding Fiscal Policy Preferences

Andreu Arenas, Dirk Foremny, Pilar Sorribas-Navarro

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Introduction: fiscal policy responses to inequality

▶ **Rising inequality** is a persistent feature in many democracies.
▶ **Yet, redistributive fiscal policies** often fail to expand alongside it
  ▶ Is it a representation problem — institutions or special interests blocking action?
  ▶ Or do voters prioritize other goals — like economic growth or their own self-interest?
  ▶ Or perhaps voters actually don't care (or don't have information) about inequality?

Introduction: trade-offs in fiscal policy responses

- ▶ **Fiscal policy** shapes economic outcomes through a combination of features:
  - ▶ Overall tax burden
  - ▶ Tax progressivity
  - ▶ Spending priorities

- ▶ **Policy decisions** may involve balancing:
  - ▶ **Reducing inequality** vs. **Promoting economic growth**
  - ▶ **Political feasibility** as a constraint

- ▶ **This study** investigates voter preferences on:
  - ▶ **Progressivity/inequality**, **efficiency**, and **self-interest**
  - ▶ Based on a **survey experiment** in **Brazil**, **Spain**, and the **US**

Preference measurement challenges

- ▶ Traditional surveys:
  - ▶ Preferences unconstrained by costs
  - ▶ Social desirability bias

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  - ► Preferences unconstrained by costs
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- ► Conjoint experiments *aka* discrete choice experiments
  - ► Present pairs of alternatives to survey participants, who rate them and choose the most preferred
  - ► Preferences inferred from those ratings and choices between hypothetical alternatives
    - ► Choices have costs
  - ► Can't recover preferences from a single choice
    - ► All alternatives are good in some dimension

  - ► Uncover hidden preferences by forcing trade-offs, simulating real-world decision-making better than traditional surveys
    - ► Allows to measure *willingness to pay* for fiscal policy features
    - ► Allows us to understand *electable* fiscal policy bundles

This paper: a conjoint experiment on fiscal policy preferences

► Present pairs of hypothetical fiscal policy proposals featuring:

1. Income tax reform: marginal tax rates across income brackets

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   ▶ Increase/reduce spending, keeping composition constant

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4. Expected effect on economic growth within 5 years

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   4 Expected effect on economic growth within 5 years

▶ Policy proposals' features are randomly assigned
- ▶ Constraint: only proportional or progressive income tax schedules

▶ Each participant rates 8 pairs of proposals and makes a choice for each pair

▶ We quantify trade-offs based on those ratings/choices

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Preview of results

1. Trade-offs Between Inequality and Efficiency Shift with Tax Levels

▶ Reducing inequality often implies a higher tax burden — both overall and individually.
▶ **Baseline preferences:**
   ▶ **Spain, US:** Weak unconditional preference for reducing inequality.
   ▶ **Brazil:** Stronger unconditional preference for reducing inequality.

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2. Tax Burden Shapes Preferences

- ▶ **Conditional preferences:** When controlling for overall tax burden:
    - ▶ Strong preference for redistribution in all countries.
    - ▶ Would trade 1pp economic growth for 1pp Gini reduction
- ▶ **Individual self-interest matters:**
    - ▶ Willing to pay 3-4pp of income for 1pp growth increase.
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3. Purpose Shapes Acceptance of Tax Burdens

- ▶ **Brazil, Spain:** Prefer taxes for education and cash transfers.
- ▶ **US:** Prefer taxes for reducing consumption taxes or debt.

Contribution

▶ Related literature:
  ▶ Conjoints tax preferences: Ballard-Rosa et. al (JoP 2016), Bansak et al. (APSR 2021)
  ▶ Conjoints institutions and public goods: Adserà et al. (PNAS 24)
  ▶ Conjoints spending types: Barnes et al. (AJPS 2022)
  ▶ Survey experiments on preferences: Stantcheva (QJE 2021)

Contribution

Tax Policy Preferences:

▶ Redistributive preferences: Meltzer & Richard (1981). How inequality shapes demand for redistribution.

▶ Behavioral responses to taxes: Slemrod (2010). Do voters focus on efficiency costs or self-interest?

Public Finance Effects:

▶ Tax rates & growth: Barro (1990). Balancing growth with tax burden.
▶ Fiscal policy & inequality: Piketty (2014). Taxation as a lever against inequality.

Experiment design

- ▶ 2000 participants per country, with quotas for key demographics
  - ▶ Ask broad range of demographic and attitudinal questions, beyond the conjoint
- ▶ Marginal Tax Rates
  - ▶ 6 Income Tax Brackets: income percentiles: [0-20], [20-50],[50-70], [70-90], [90-99],[99+]
  - ▶ Range of Marginal Rates: 0 to 55
    - ▶ 1st Bracket Mg rate: 7.85 on average
    - ▶ 2nd Bracket Mg rate: 15.7 on average
    - ▶ 3rd Bracket Mg rate: 23.5 on average
    - ▶ 4th Bracket Mg rate: 31.4 on average
    - ▶ 5th Bracket Mg rate: 39.2 on average
    - ▶ 6th Bracket Mg rate: 47 on average
    - ▶ Constraint: progressive or proportional schedules
    - ▶ We use these rates and gross income data to compute the post-tax Gini

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        - ► We use these rates and gross income data to compute the post-tax Gini
- ► Estimated tax revenue effort: initially distributed, re median raises effects (i.e., between +9 and +10%)
- ► Expected economic growth in 5 years from now
    - ► From -2% to 7%. Uniformly distributed

Experiment design

- ▶ We also use information on participants' (self-reported) gross income to compute their tax bill under each possible tax schedule
    - ▶ From 0 to 55% of gross income
    - ▶ Mean 15%, median 14%
    - ▶ Log-normally distributed

Please indicate your preferred personal income tax proposal:

	A	B
• Tax rates		
Annual income brackets	Marginal tax rates %	Marginal tax rates %
< $ 12.000	5	35
$ 12.001 - $ 50.000	10	35
$ 50.001 - $ 89.000	15	35
$ 89.001 - $ 179.000	50	35
$ 179.001 - $ 640.000	50	35
> $ 640.000	55	35
• Tax revenue effect	increase (between 9% and 10%)	increase (between 30% and 35%)
• Public budget **composition**	A decrease in public debt	More spending on education
• Annual **economic growth** rate in five years' time	4%	-1%
Rating:	⌄	⌄

⚙ Variables

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Empirical strategy

▶ One observation per alternative j and individual i
  ▶ Each individual makes 8 choices and rates rates $8 \times 2 = 16$ alternatives
▶ We estimate a regression of the rating/choice on alternatives' pair fixed effects ($\alpha_{p(ij)}$) and
  1 **Inequality:** the resulting Gini Index from the tax proposal (alternatively: how much the marginal tax rate increases across brackets for a given alternative)
  2 **Efficiency:** the expected economic growth under the alternative

$$y_{ij} = \alpha_{p(ij)} + \beta_1 \text{Inequality}_j + \beta_2 \text{Economic Growth}_j + \gamma X_j + \epsilon_{ij}$$

Measuring self-interest and willingness to pay

- ▶ Reducing inequality often comes along with high taxes across the board
- ▶ Preferences for a more (or less) progressive tax system may be driven by individual instrumental considerations
- ▶ Compare estimates of the previous regression with estimates controlling for the overall and the individual tax burden
    - ▶ **Income Tax Revenues:** the measure of the expected change in income revenues in the alternative
    - ▶ **Individual tax burden:** obtained by applying the tax schedule of the alternative j to the gross individual income of i

$$y_{ij} = \alpha_{p(ij)} + \beta_1 \text{Inequality}_j + \beta_2 \text{Economic Growth}_j$$
$$+ \beta_3 \text{Income Tax Revenues}_{ij} + \beta_4 \text{Individual Fiscal Burden}_j + \gamma X_j + \epsilon_{ij}$$

Inequality-growth trade-off

| | (1) | (2) | (3) |
	Brazil	Spain	US
Economic Growth (1pp increase)	0.0485***	0.0669***	0.0666***
	(0.00714)	(0.00703)	(0.00867)
Inequality (1pp Gini increase)	-0.0283***	-0.0227*	-0.0181
	(0.00876)	(0.0132)	(0.0127)
N	32112	32816	32208
Measure of preference	Rating	Rating	Rating

Standard errors clustered by individual in parenthesis. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

▶ Stronger preference for policies that increase growth than for policies that reduce inequality

▶ Not willing to give up much growth to reduce inequality

Inequality-growth and tax burden trade-off

	Brazil (1)	Brazil (2)	Spain (3)	Spain (4)	US (5)	US (6)
Economic Growth (1pp increase)	0.0485***	0.0487***	0.0669***	0.0670***	0.0666***	0.0487***
	(0.00714)	(0.00715)	(0.00703)	(0.00699)	(0.00867)	(0.00715)
Inequality (1pp Gini increase)	-0.0283***	-0.0497***	-0.0227*	-0.0854***	-0.0181	-0.0497***
	(0.00876)	(0.00935)	(0.0132)	(0.0132)	(0.0127)	(0.00935)
Tax Revenues (10% increase)		-0.0405***		-0.0591***		-0.0405***
		(0.00828)		(0.00630)		(0.00828)
N	32112	32112	32816	32816	32208	32112
Measure of preference	Rating	Rating	Rating	Rating	Rating	Rating

Standard errors clustered by individual in parenthesis. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

▶ Weak preference for inequality-reducing plans is because they involve high taxes overall, which is seen negatively

  ▶ Conditional on tax burden, could give up 10pp of growth to reduce gini 10pp
  ▶ Conditional on tax burden, could give up 10pp of Gini to increase growth by 10pp

Inequality-growth and individual tax burden trade-off

	Brazil (1)	Brazil (2)	Spain (3)	Spain (4)	US (5)	US (6)
Economic Growth (1pp increase)	0.0485***	0.0488***	0.0669***	0.0673***	0.0666***	0.0488***
	(0.00714)	(0.00715)	(0.00703)	(0.00699)	(0.00867)	(0.00715)
Inequality (1pp Gini increase)	-0.0283***	-0.0268***	-0.0227*	-0.0346***	-0.0181	-0.0268***
	(0.00876)	(0.00877)	(0.0132)	(0.0129)	(0.0127)	(0.00877)
Individual tax bill (% of income)		-0.0112***		-0.0273***		-0.0112***
		(0.00236)		(0.00272)		(0.00236)
N	32112	32112	32816	32816	32208	32112
Measure of preference	Rating	Rating	Rating	Rating	Rating	Rating

Standard errors clustered by individual in parenthesis. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

▶ Conditional on individual tax burden, inequality matters slightly more

    ▶ Would pay 3-4pp more taxes for a 1pp growth increase

    ▶ Would pay 1.25-2pp more taxes for a 1pp gini decrease

Inequality-growth and individual tax burden trade-off

	Brazil (1)	Brazil (2)	Brazil (3)	Spain (4)	Spain (5)	Spain (6)	US (7)	US (8)	US (9)
Economic Growth (1pp increase)	0.0485*** (0.00714)	0.0487*** (0.00715)	0.0487*** (0.00715)	0.0669*** (0.00703)	0.0670*** (0.00699)	0.0674*** (0.00698)	0.0666*** (0.00867)	0.0487*** (0.00715)	0.0663*** (0.00865)
Inequality (1pp Gini increase)	-0.0283*** (0.00876)	-0.0497*** (0.00935)	-0.0430*** (0.0134)	-0.0227* (0.0132)	-0.0854*** (0.0132)	-0.0223 (0.0192)	-0.0181 (0.0127)	-0.0497*** (0.00935)	-0.0335* (0.0183)
Tax Revenues (10% increase)		-0.0405*** (0.00828)	-0.0288* (0.0174)		-0.0591*** (0.00630)	0.0139 (0.0159)		-0.0405*** (0.00828)	-0.0130 (0.0182)
Individual tax bill (% of income)			-0.00366 (0.00497)			-0.0329*** (0.00692)			-0.0138*** (0.00534)
N	32112	32112	32112	32816	32816	32816	32208	32112	32208
Measure of preference	Rating	Rating	Rating	Rating	Rating	Rating	Rating	Rating	Rating

Standard errors clustered by individual in parenthesis. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

▶ Distaste for alternatives with high taxes can be explained by an aversion to (individually) paying higher taxes

Regression trees

▶ A decision tree recursively divides the feature (predictor) space into two in a way that reduces the pre-specified loss function the most.

▶ For any candidate split variable x, we define the **split point** for partitions R_m in a way that minimises the sum of the two sub-partition RSS:
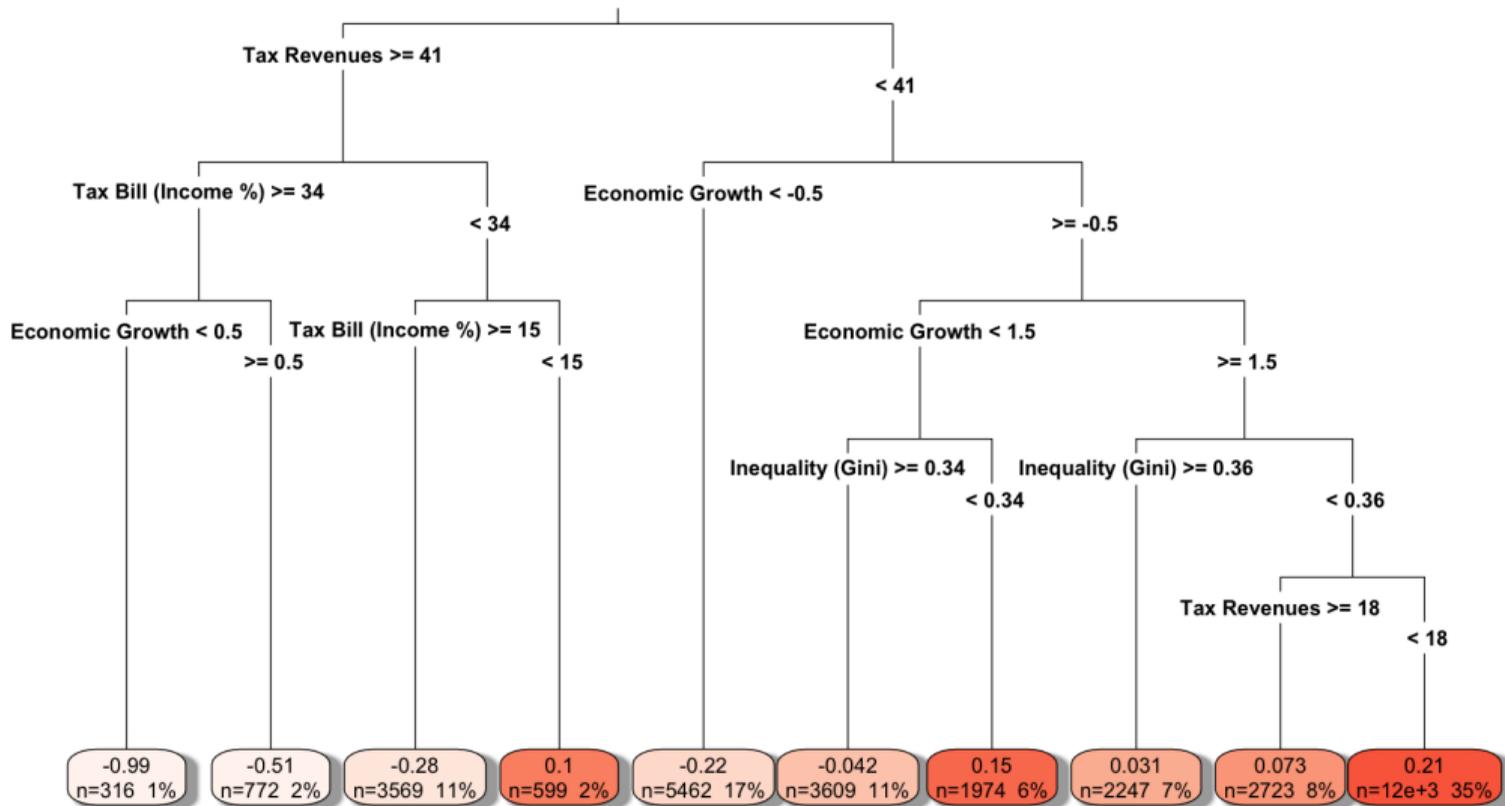
$$\sum_{x_i \in R_A} (y_i - \hat{y}_{R_A})^2 + \sum_{x_i \in R_B} (y_i - \hat{y}_{R_B})^2$$

▶ We *prune* the tree using cross-validation, and only keep the leaves that are good predictors (based on MSE reduction in testing samples). Otherwise the tree could be infinite

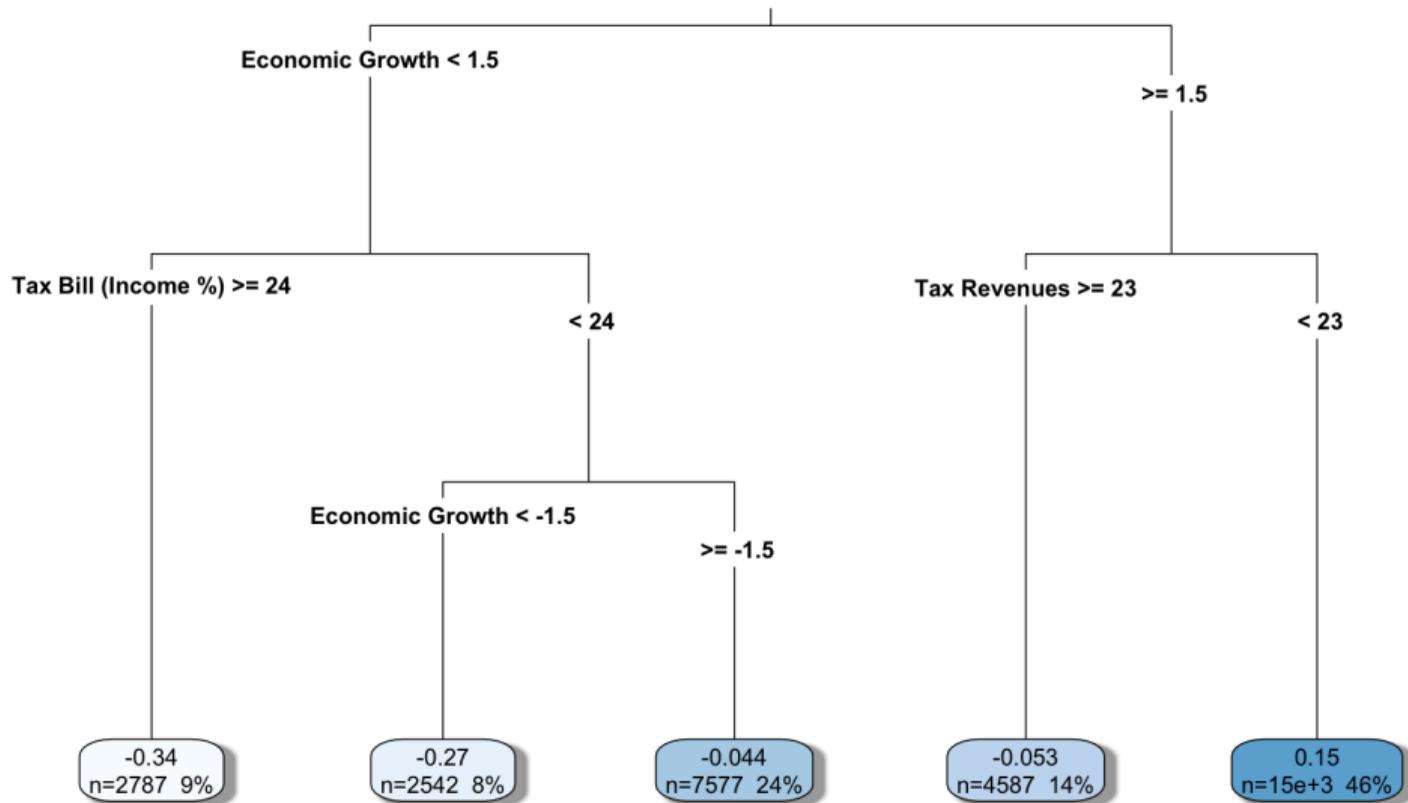▶ Useful to model the thought process when evaluating hypothetical policies
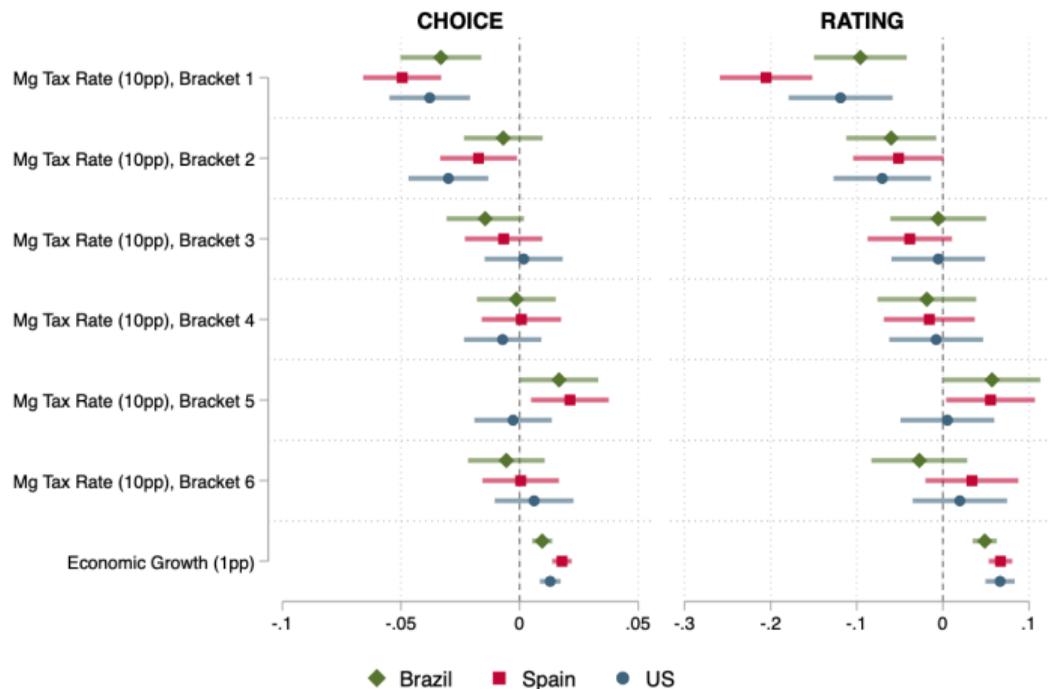
Prunned Regression Tree, Brasil
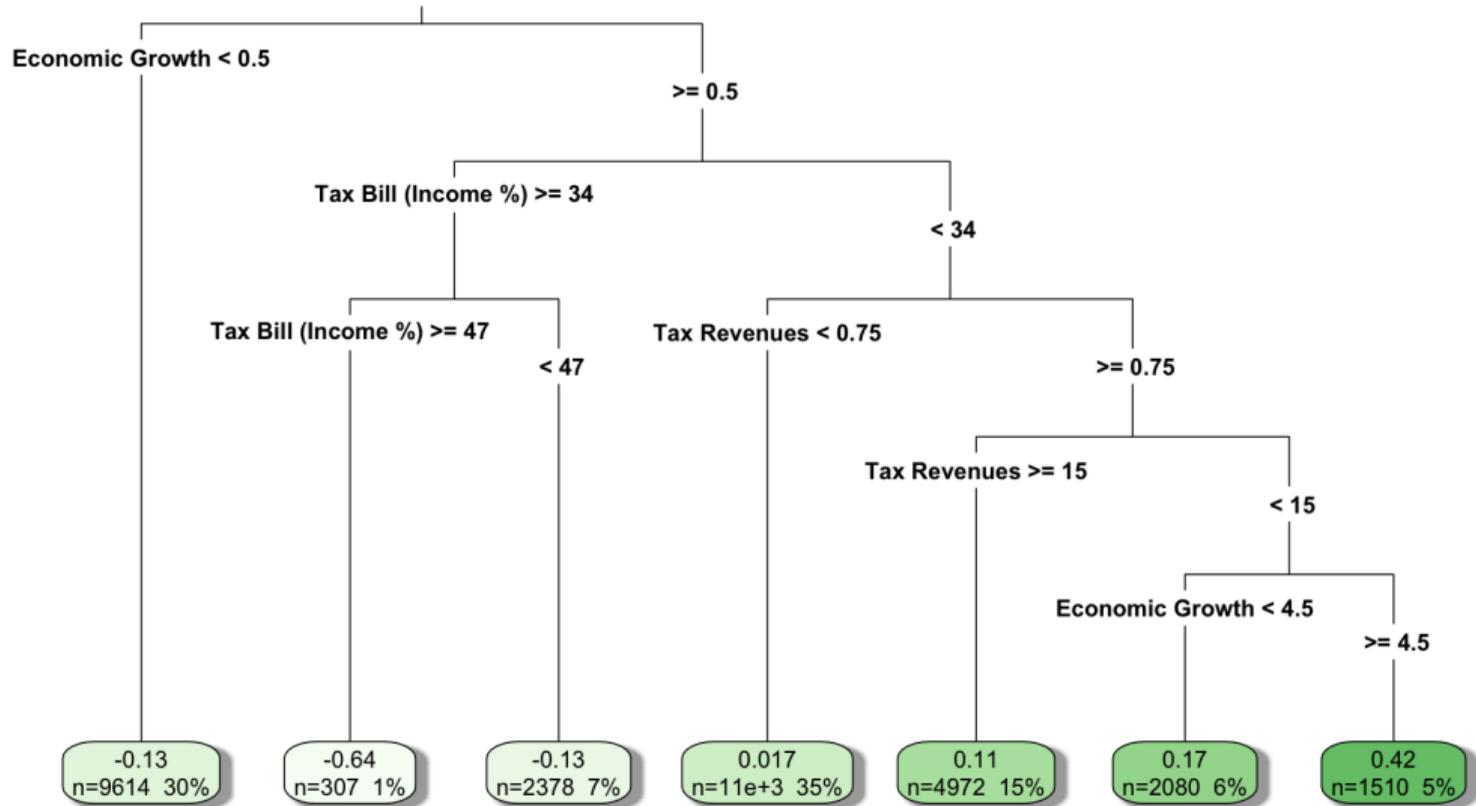
Prunned Regression Tree, Spain
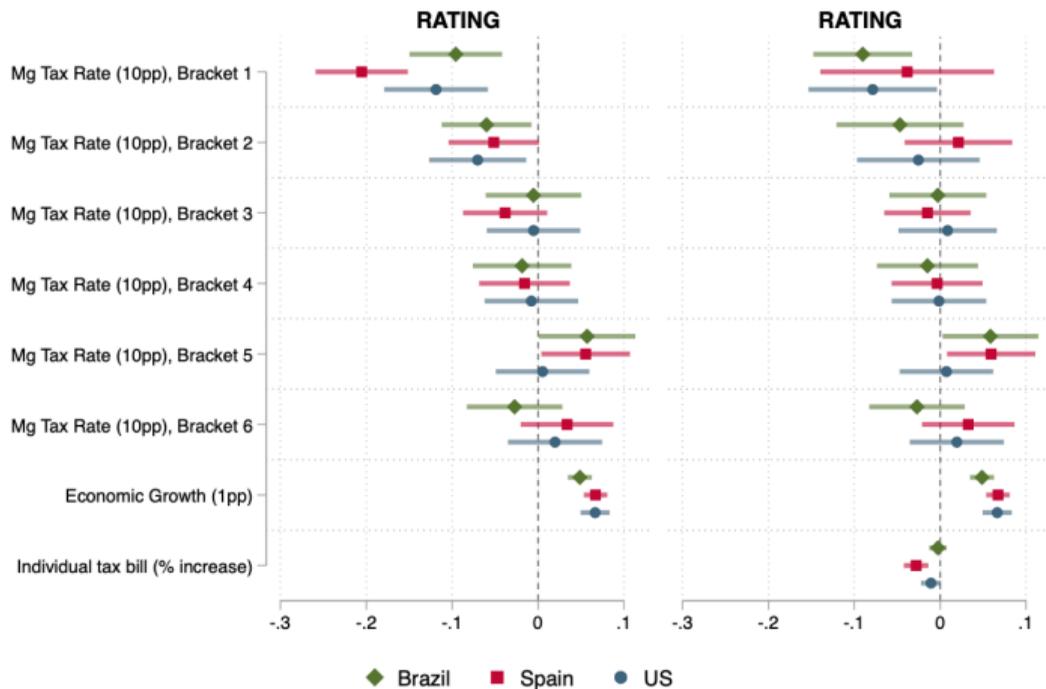
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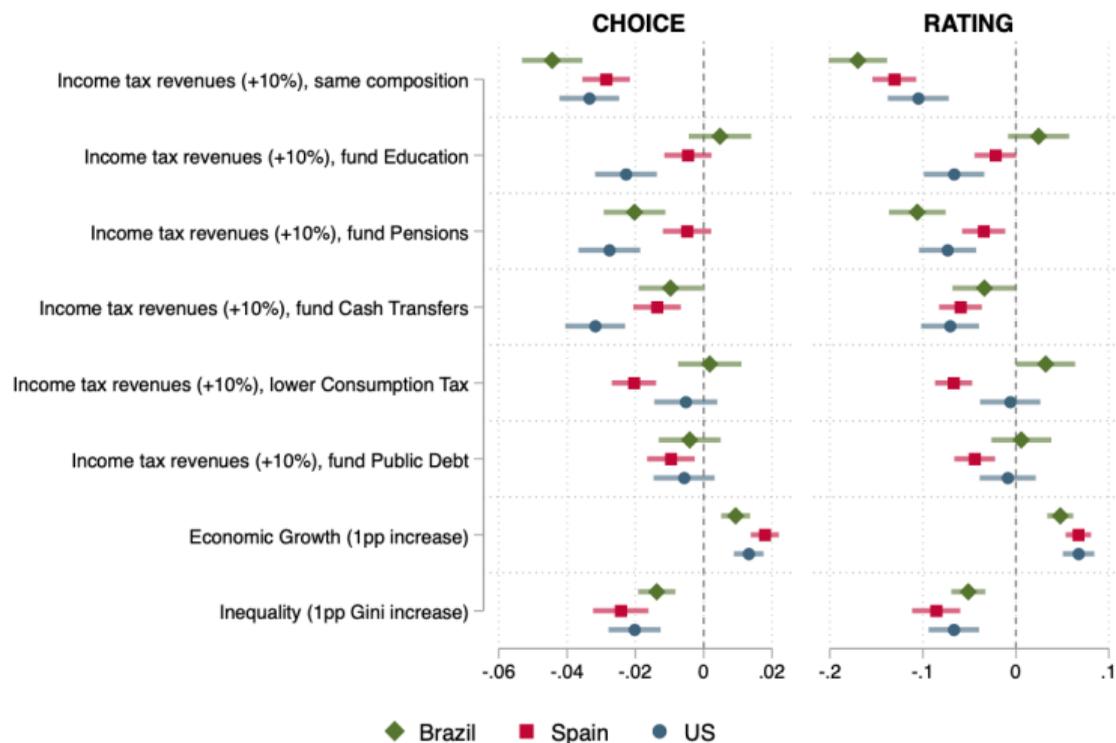
Zooming in: AMCEs for each bracket's rates

▶ Inequality aversion comes from preferences for low Mg Rates for the lowest incomes

# Zooming in: AMCEs for each bracket's rate

► Inequality aversion comes from preferences for low Mg Rates for the lowest incomes.
► Accounting for self-interest slightly reduces those preferences

Zooming in: government size and composition

	CHOICE	RATING

Income tax revenues (+10%), same composition

Income tax revenues (+10%), fund Education

Income tax revenues (+10%), fund Pensions

Income tax revenues (+10%), fund Cash Transfers

Income tax revenues (+10%), lower Consumption Tax

Income tax revenues (+10%), fund Public Debt

Economic Growth (1pp increase)

Inequality (1pp Gini increase)

◆ Brazil ■ Spain ● US

▶ Across the board, dislike increase in taxes without compositional changes
▶ In Brazil and Spain, they are fine if tax increases fund Education or Cash Transfers
▶ In the US, want lower taxes except if they are used to lower consumption tax or reduce public debt

Zooming in: government size and composition

- Brazil
- Spain
- US
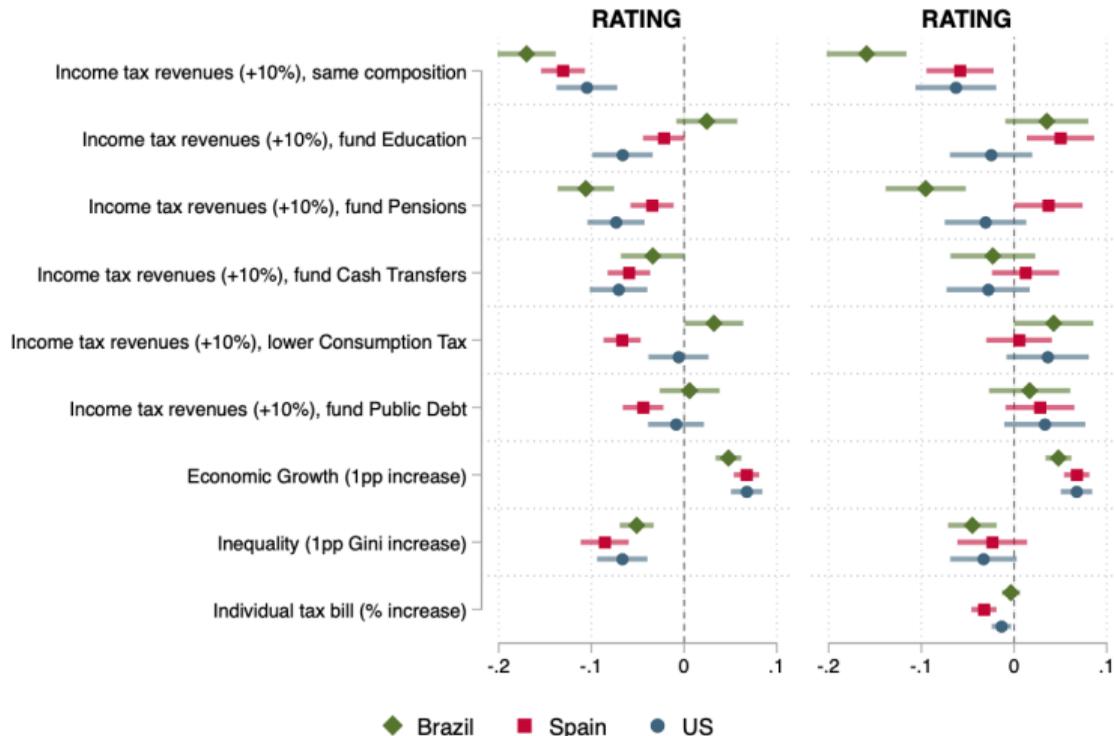
► Accounting for individual taxes slightly increases the acceptance for spending in almost all categories, similar broad pattern

Next Steps

► Use macro estimates to understand the trade-offs around the empirically most likely quantities

► Understand the role of beliefs about economic mechanisms and sources of success

Coalitions

- ▶ Do voters tend to agree in two particular dimensions?
- ▶ Estimate IMCEs, study correlations between them

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  ▶ Those who (ceteris paribus) like larger government tend to favor progressive tax systems

Coalitions

- ▶ Do voters tend to agree in two particular dimensions?
- ▶ Estimate IMCEs, study correlations between them
  - ▶ Those who (ceteris paribus) care less about paying taxes themselves tend to favor progressive tax systems
  - ▶ Those who (ceteris paribus) like larger government tend to favor progressive tax systems
  - ▶ No relationship between economic growth preferences and progressive taxation preferences
  - ▶ Suggests the trade-offs is not only within-person, but that different groups of voters are responding differently to the trade-offs, and this matters for aggregate support

Correlation between preferences for attributes

	Progressivity Preference		
	(1)	(2)	(3)
Economic Growth Preference	0.0443	0.00849	0.0643
	(0.118)	(0.0949)	(0.0832)
Tax level preference	1.408***	1.250***	1.083***
	(0.155)	(0.116)	(0.102)
Aversion to pay higher taxes	-2.870***	-0.550*	-0.932**
	(0.642)	(0.296)	(0.456)
N	2007	2051	2013
Measure of preference	Choice	Choice	Choice
Country			

Regression coefficients between IMCEs. Robust standard errors in parenthesis.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Correlation between preferences for attributes

	Progressivity Preference		
	(1)	(2)	(3)
Economic Growth Preference	0.177	0.0562	-0.00751
	(0.157)	(0.134)	(0.108)
Tax level preference	1.282***	1.121***	0.923***
	(0.143)	(0.143)	(0.111)
Aversion to pay higher taxes	-2.227***	-0.292	-0.503
	(0.539)	(0.364)	(0.418)
N	2007	2051	2013
Measure of preference	Rating	Rating	Rating
Country			

Regression coefficients between IMCEs. Robust standard errors in parenthesis.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Conclusion: Insights on Fiscal Policy Preferences

▶ **Trade-offs are multidimensional:**
  ▶ Voters trade **1 percentage point (pp)** of economic growth for **1pp** reduction in the Gini index, **conditional on the overall tax burden.**
  ▶ Is more redistribution without higher taxes more or less distortive/feasible?

▶ **Self-interest matters but people can be persuaded:**
  ▶ Willing to pay **3-4pp** of income in taxes for **1pp** growth increase.
  ▶ Willing to pay **1.25-2pp** of income in taxes for **1pp** Gini reduction

▶ **Purpose shapes taxation acceptance:**
  ▶ **Brazil, Spain:** Support taxes to fund **education** and **cash transfers**.
  ▶ **US:** Prefer taxes aimed at **cutting consumption taxes** or **reducing debt**.
  ▶ Should measure the progressivity/regressivity of those for a more accurate evaluation

Conclusion: Insights on Fiscal Policy Preferences

▶ **Why didn't redistribution increase more to counteract inequality?** Our results suggest voters' concerns about related dimensions (growth and tax burden) - often in conflict with reducing inequality

▶ **No one-size-fits-all solution:** Voter preferences shift with national context, tax structures, and individual costs

▶ **Tax progressivity alone isn't the end of the story:** Support increases when revenues fund **valued spending** — education and transfers (Brazil, Spain), or **tax relief** (US).