Discussion - Optimal Redistribution: Rising Inequality vs. Rising Living Standards

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Summary of the paper

The main contribution

- Start with two simple stylized facts on the US between 1950 and 2010:
  1. large increase in inequality;
  2. but also a substantial improvement in living standards.

- Larger inequality calls for a stronger redistribution.

- In the standard model with homothetic preferences, rising living standards do not affect optimal redistribution.

- But how do these phenomena shape optimal redistribution in the context of non-homothetic preferences?

Non-homothetic preferences

Non-homothetic preferences (Comin et al. 2021; Alder et al. 2022) have some important properties:

1. allow to account for heterogeneous consumption patterns along the expenditure distribution, consistently with the micro evidence;
2. determine a heterogenoeus welfare impact of changes in relative commodity prices or changes in living standards;
3. under some conditions, imply DRRA (decreasing relative risk aversion) with respect to total expenditure.

Structure of the paper

Two different contributions

1. **Theoretical contribution**: Mirrlees setup with fully flexible non-linear taxes;

   $\Downarrow$

   Show how changes in living standards affect the equity-efficiency trade-off.

2. **Quantitative exercise**: Aiyagari-style model with parametric non-linear taxes.

   $\Downarrow$

   Higher living standards reduce the desired increase in redistribution due to rising inequality between 1950 and 2010 in the US.

Basic needs: static or dynamic?

Discussion (1/4)

- Non-homothetic preferences are used, especially in the development and structural transformation literature, to capture the concept of **basic needs**;
- Relative to Stone-Geary, non-homothetic preferences in the Comin et al. (2021) style have some desirable properties;
- However, how do they accommodate the idea that a luxury of yesterday may become a necessity today? (education, healthcare, housing)
- Example: since the 1950s, people live longer but not necessarily in healthier conditions. Health is part of Services, which are treated as luxuries.

Macro vs Micro evidence

Discussion (2/4)

Evidence from Heathcote, Perri & Violante (RED 2010):

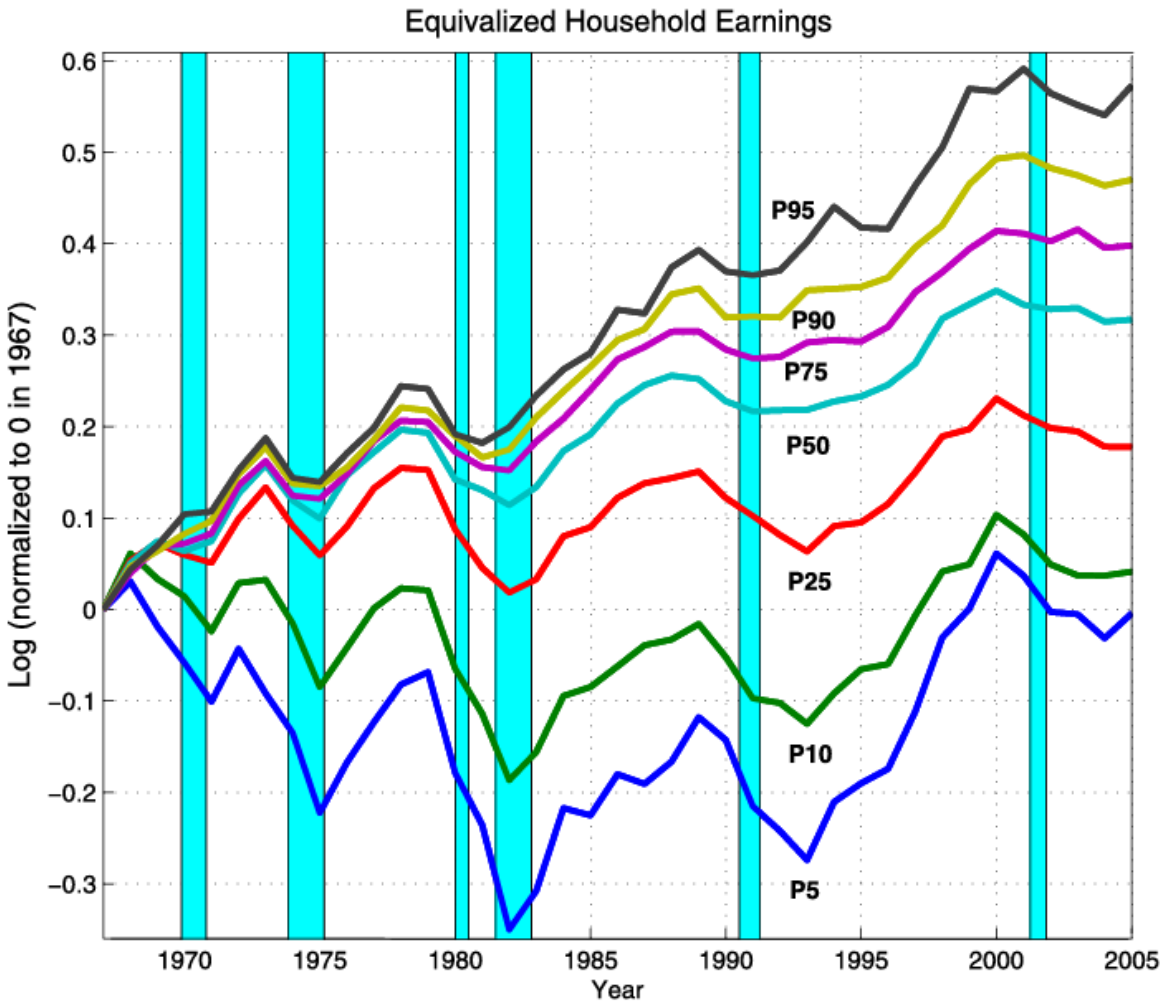

Fig. 9. Percentiles of the household earnings distribution (CPS). Shaded areas are NBER recessions.

Unifying theory + GE effects

Discussion (3/4)

- The quantification is in **partial** equilibrium;
- Rising living standards and inequality are treated as two **exogenous** and **independent** trends;
- The design of the tax system has **no effect** on living standards or growth;
- The quantitative model could be analyzed in a framework with endogenous growth and an endogenous wage premium (skill-biased technical change?).

Increasing inequality as a multi-faceted phenomenon

Discussion (4/4)

- In the quantitative model, rising inequality is captured by:
  1. an increase in the variance of idiosyncratic productivity;
  2. the fattening of the Pareto tail of the idiosyncratic labor productivity distribution;
  3. (a change in relative consumption goods' prices).

- The existing literature has identified as the main drivers:
  1. skill-biased technical change (Katz & Murphy 1992; Acemoglu 1998, 2002) and job polarization (Autor et al. 2003);
  2. trade and globalization (low-skilled labor competition) (Autor et al. 2013; Feenstra and Hanson 1996, 1999);
  3. falling tax progressivity (Saez, Piketty and Stantcheva 2014; Hubmer, Krusell and Smith 2020);
  4. wealth accumulation exceeding growth ($r > g$) (Piketty 2014);
  5. declining labor share (Autor, Levy and Murnane 2003; Karabarbounis & Neiman 2014; Autor et al. 2020; De