
Discussion of “Redistributive Taxation and Bankruptcy in US States”

by Charles Grant and Winfried Koeniger

Justin Wolfers

The Wharton School – University of Pennsylvania,
NBER and IZA

<http://bpp.wharton.upenn.edu/jwolfers>

IZA Workshop on Labor Market Institutions, December 3 2004.

Research Question

- ◆ Is fiscal redistribution a substitute for generous bankruptcy laws?
(Equivalently: Are generous bankruptcy laws a substitute for fiscal redistribution?)

$$Is \frac{d \left[\frac{dU}{dX} \right]}{d\tau} > 0?$$

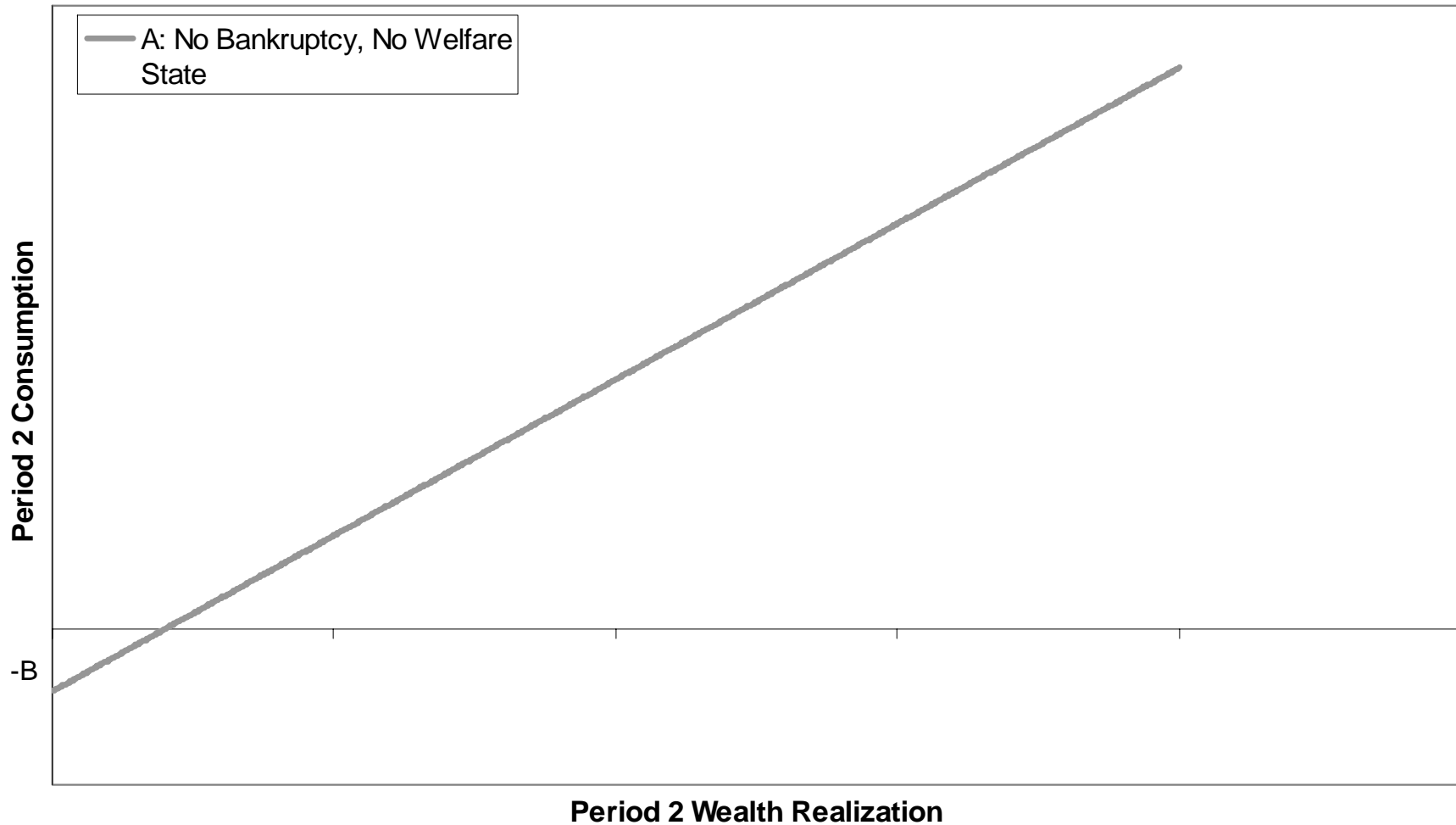
- ◆ Broader literatures:
 - Trade-off between redistribution through fiscal transfers, and mandating private transfers through regulation.
 - Positive political economy: Endogenizing the welfare state

Model Structure

- ◆ Three equations:
 - Individual borrowing/lending decisions (b):
How much should I borrow?
(Understanding insurance provided by bankruptcy)
 - Individual bankruptcy decision:
Given my period 2 draw (ω_2), should I choose to:
 - » Repay and consume $\omega_2 - b(1+r)$, or
 - » Declare bankruptcy and consume $\min(\omega_2, x)$?
 - Bank interest rate (r)
 - » Pinned down by zero profit condition

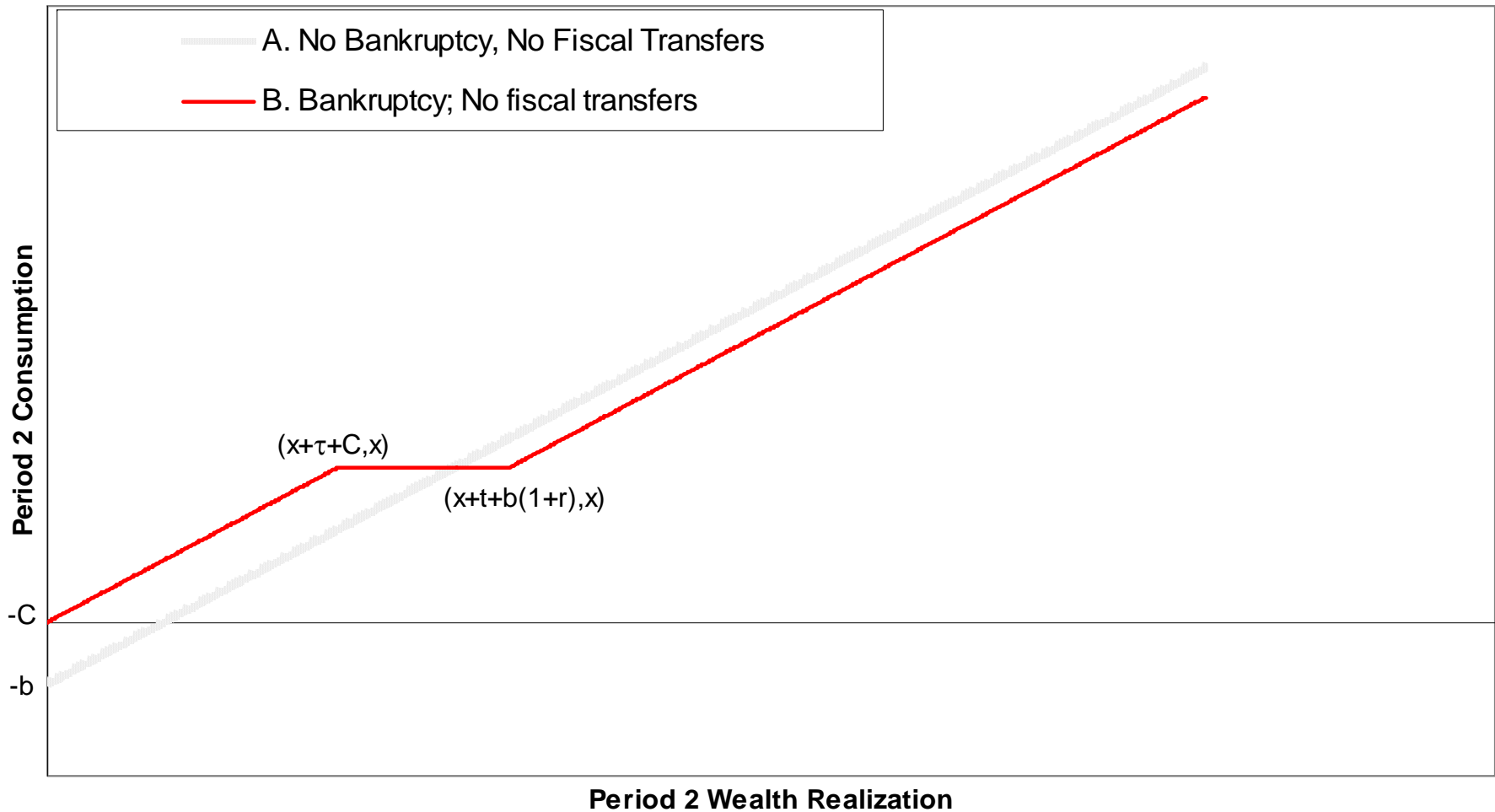
Model: Graphical Interpretation

Bankruptcy as Social Insurance



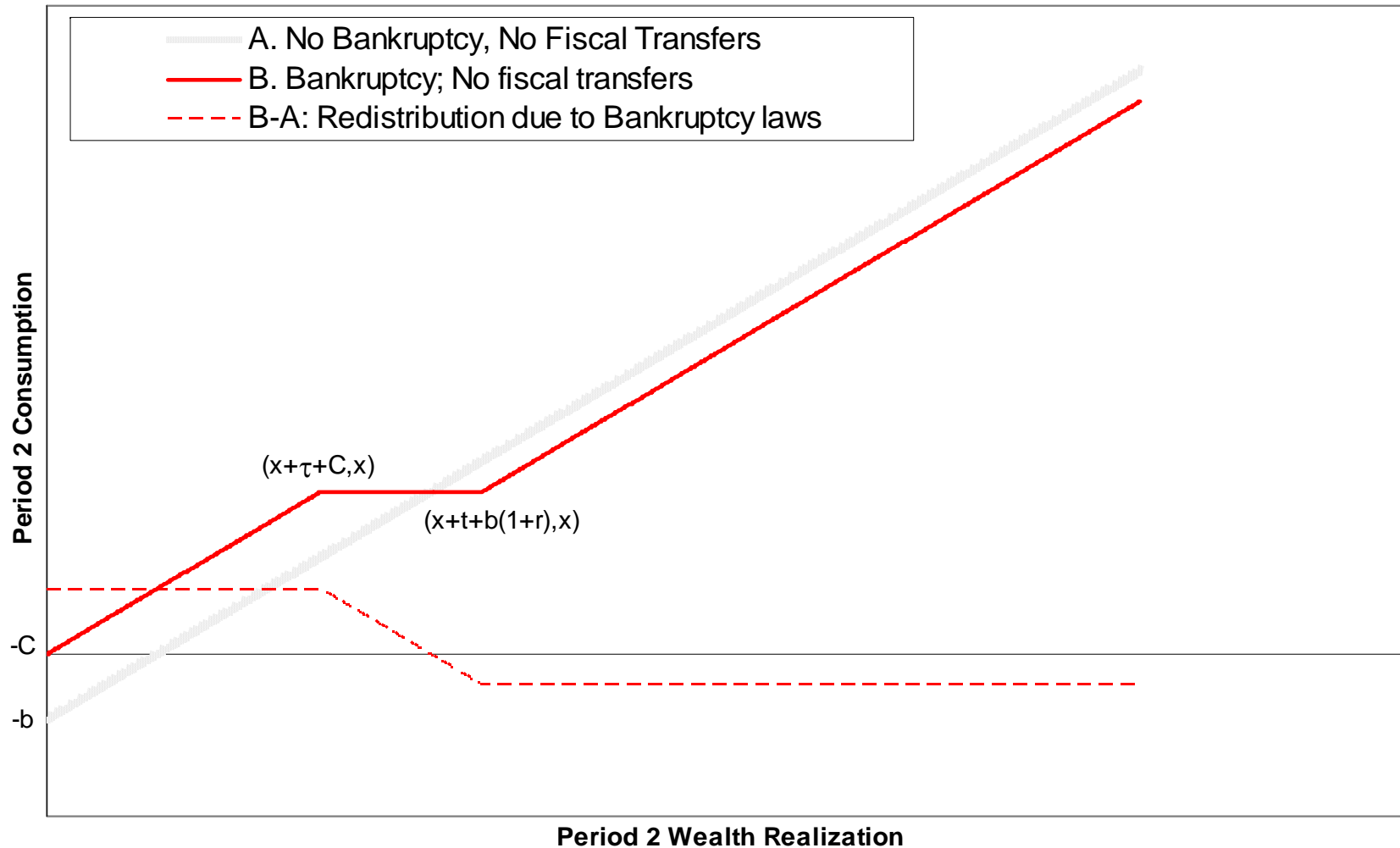
How Bankruptcy Laws Work

Bankruptcy as Social Insurance



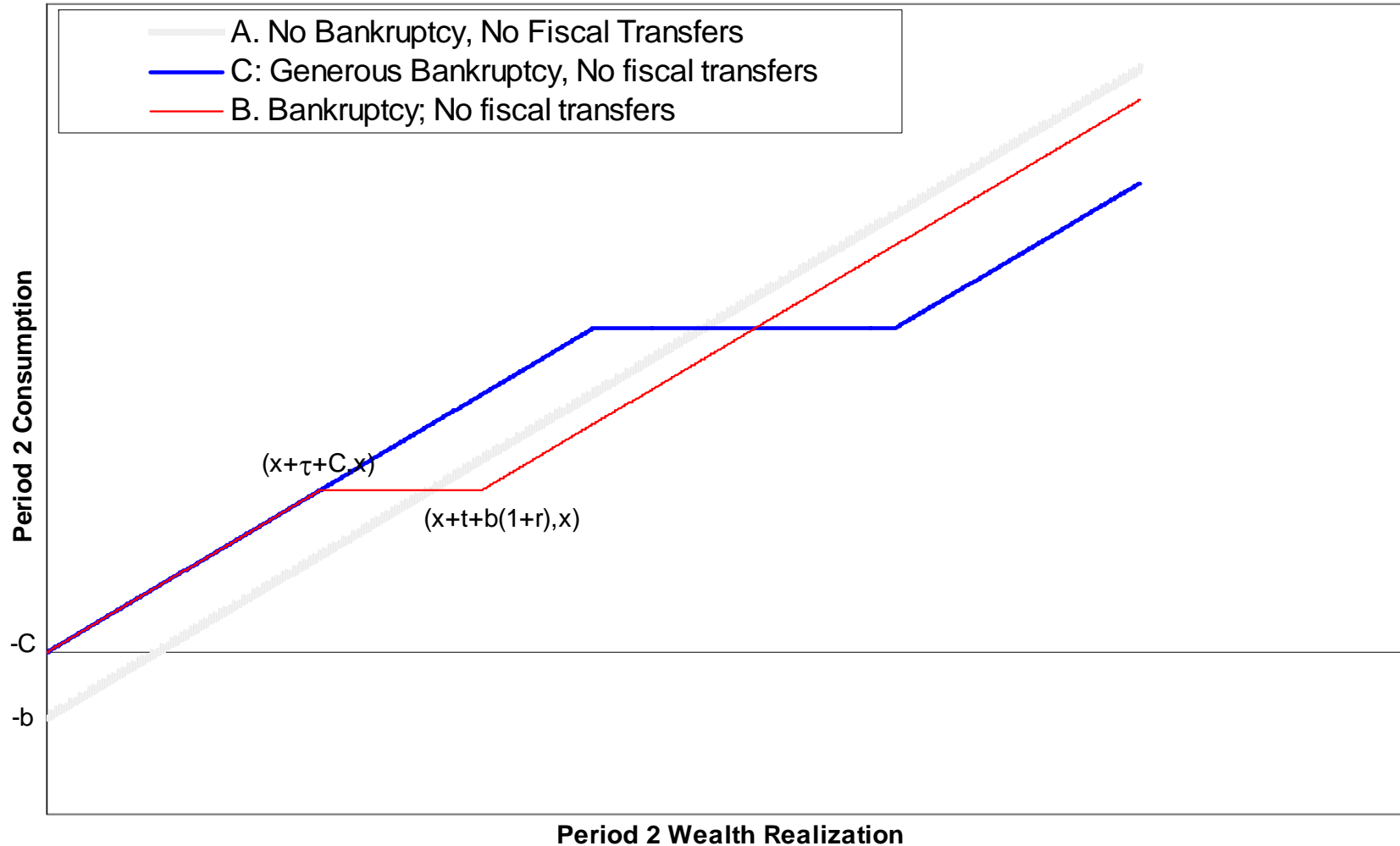
Bankruptcy Provides Insurance

Bankruptcy as Social Insurance



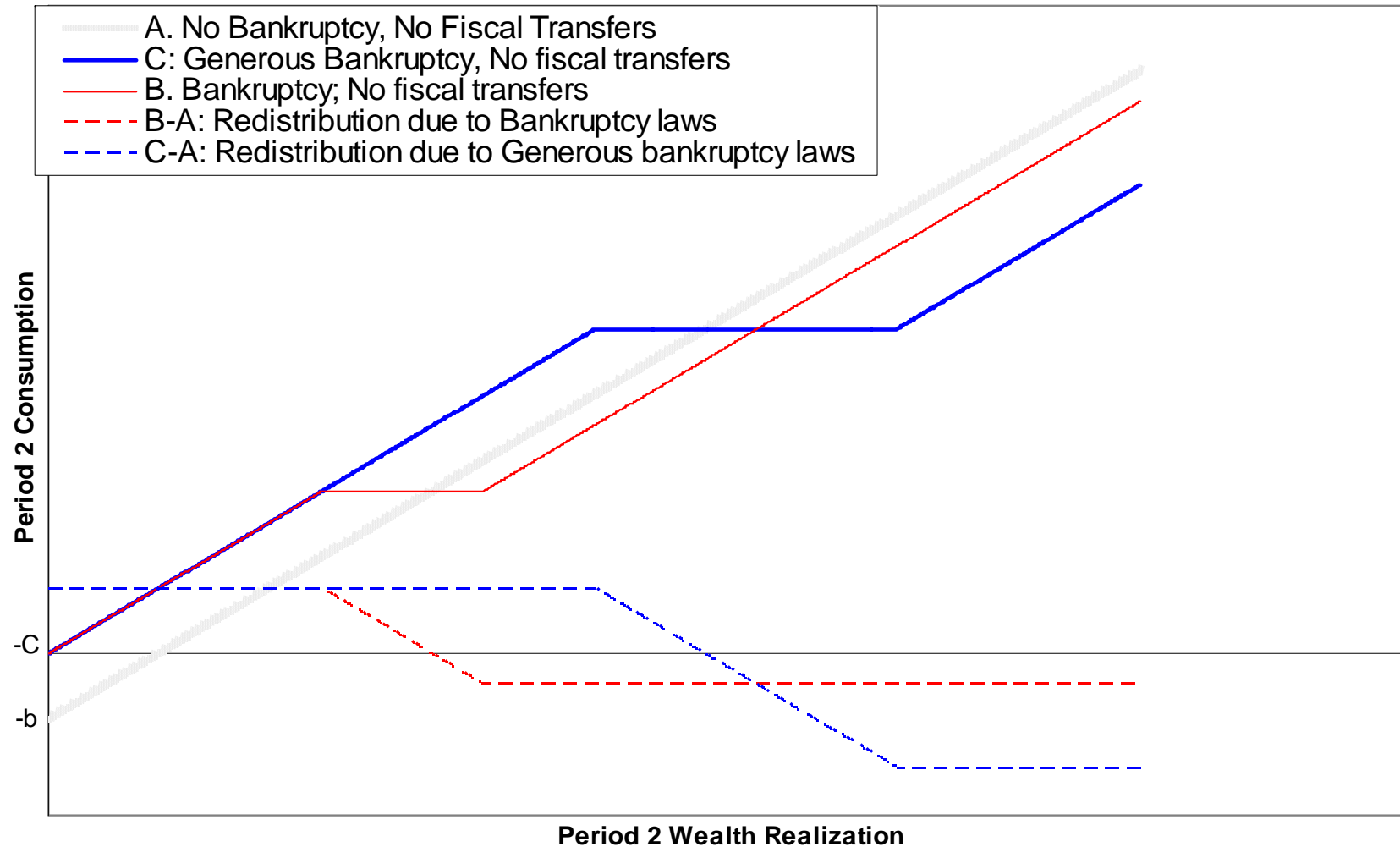
dU/dX : Raising Exemption Levels

Bankruptcy as Social Insurance



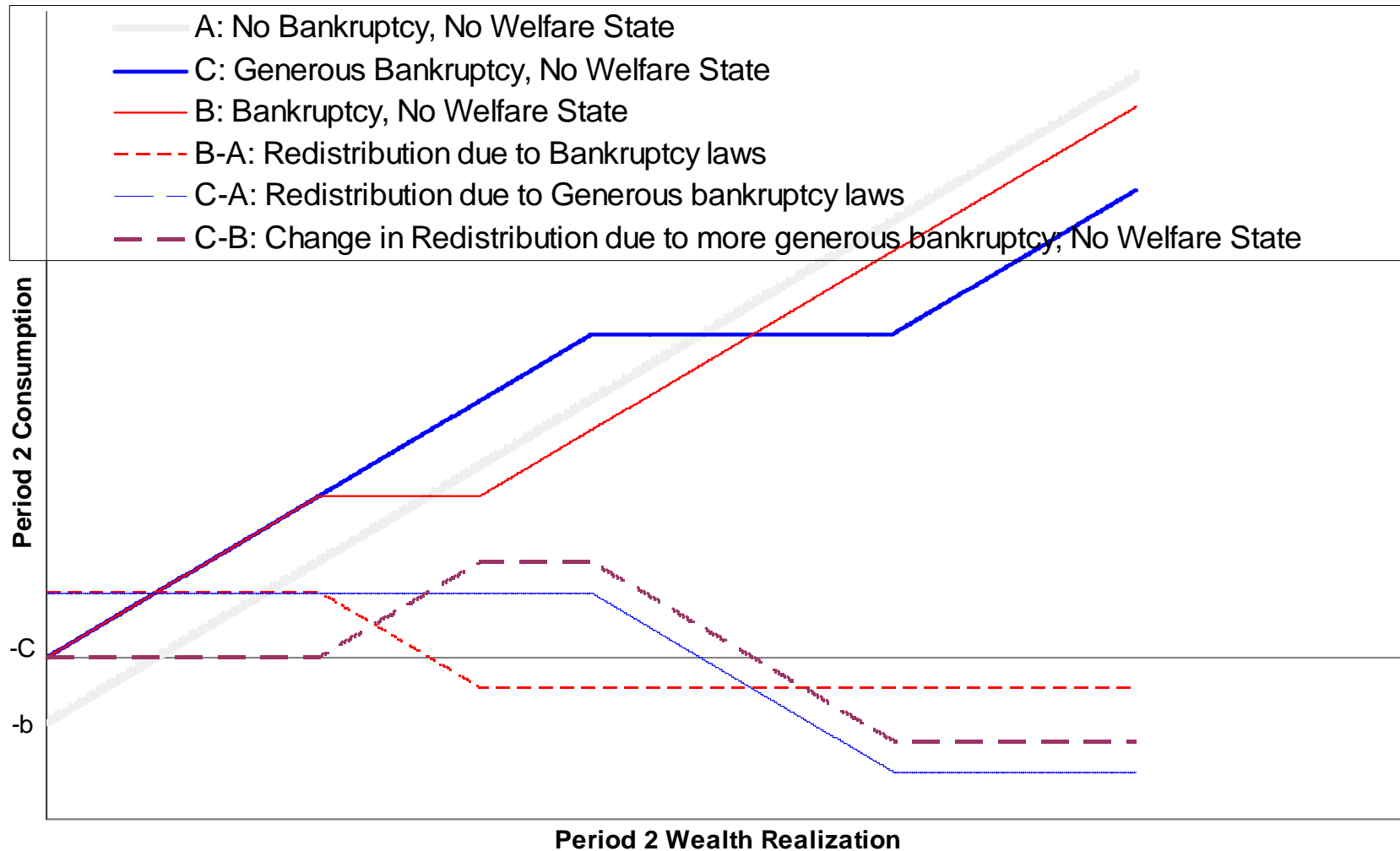
dU/dX : Higher Exemptions \uparrow Redistribution

Bankruptcy as Social Insurance



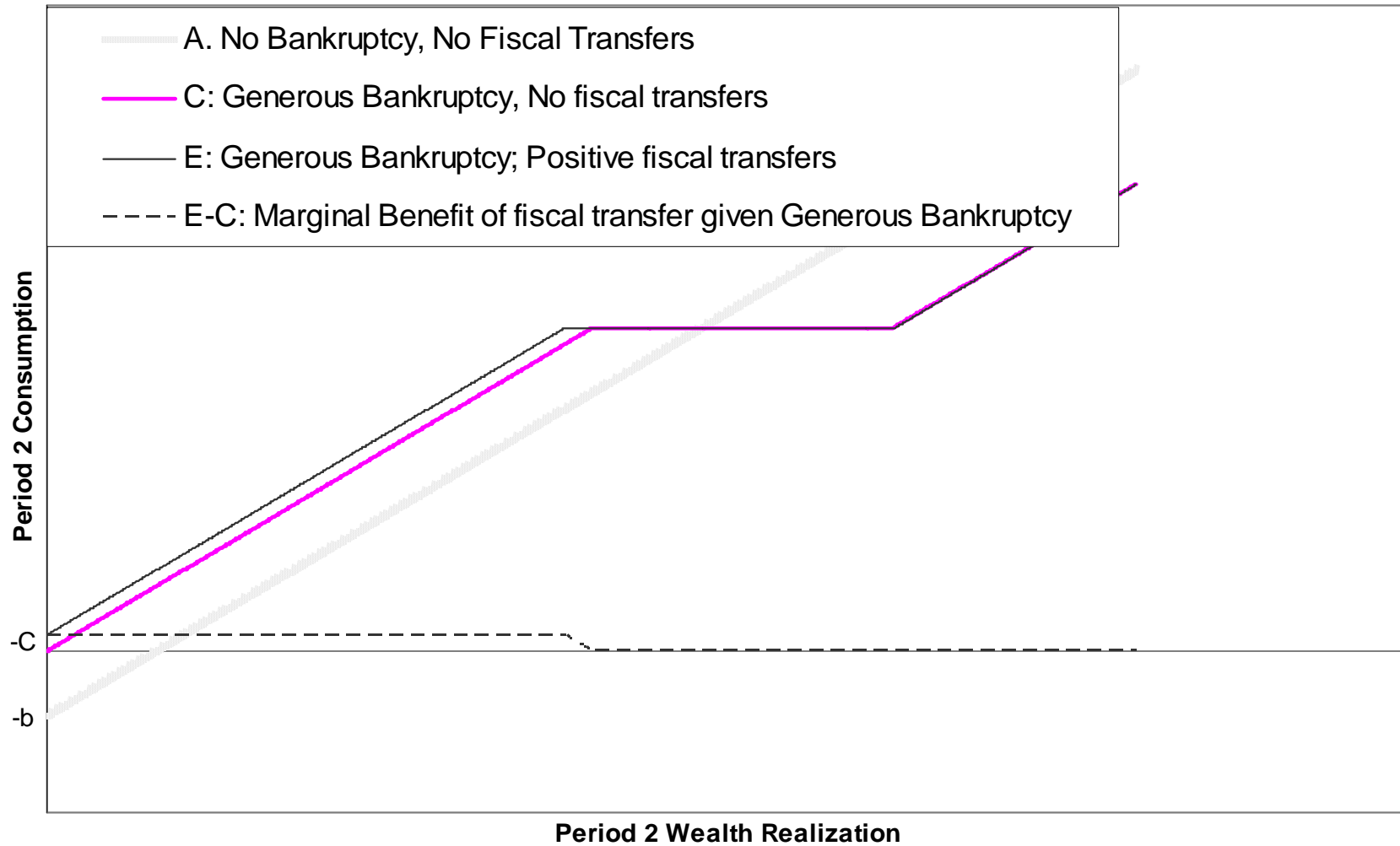
dU/dX: Definitely Positive

Bankruptcy as Social Insurance



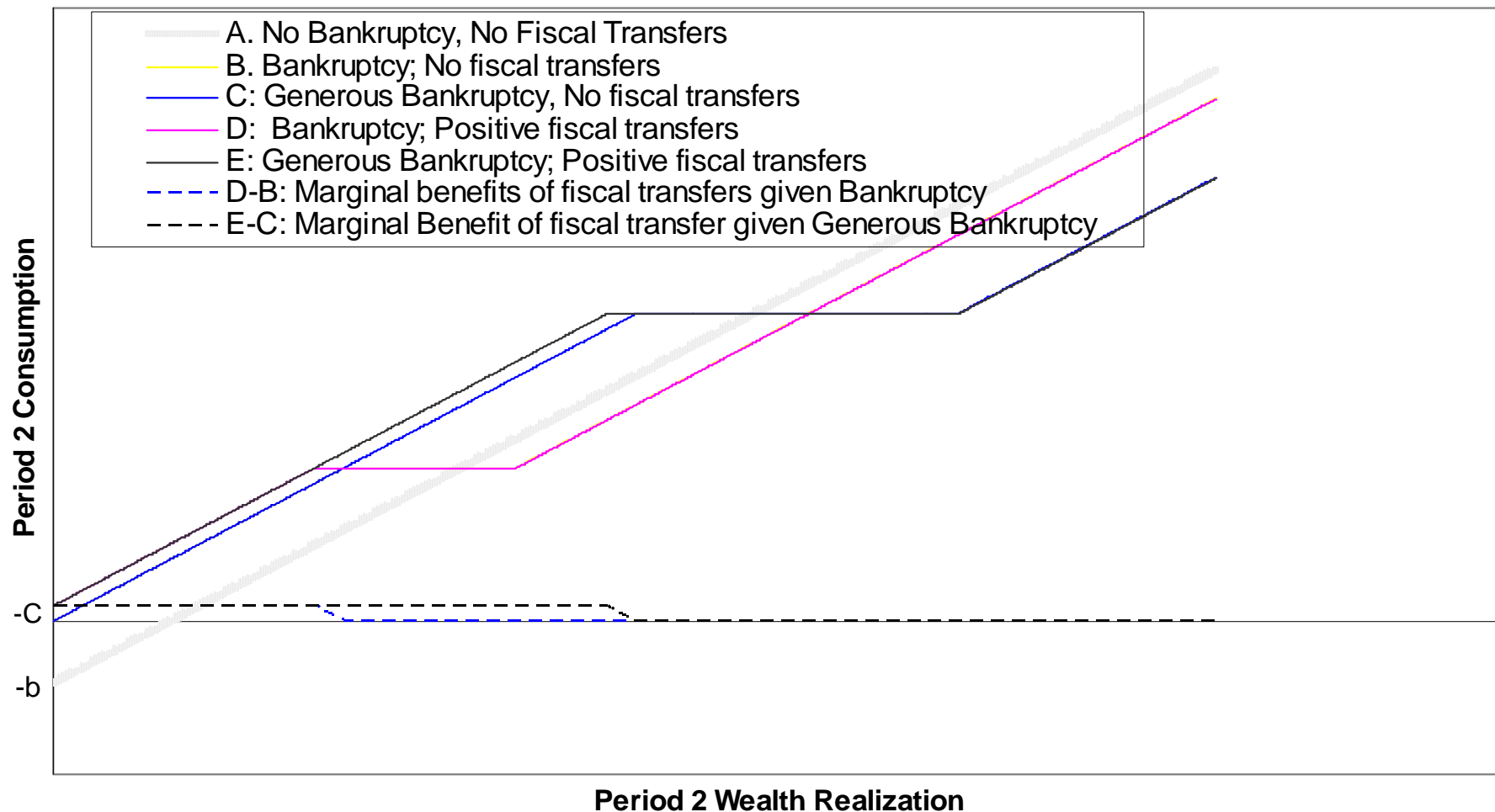
$dU/d\tau \mid x^{\text{High}}$

Bankruptcy as Social Insurance



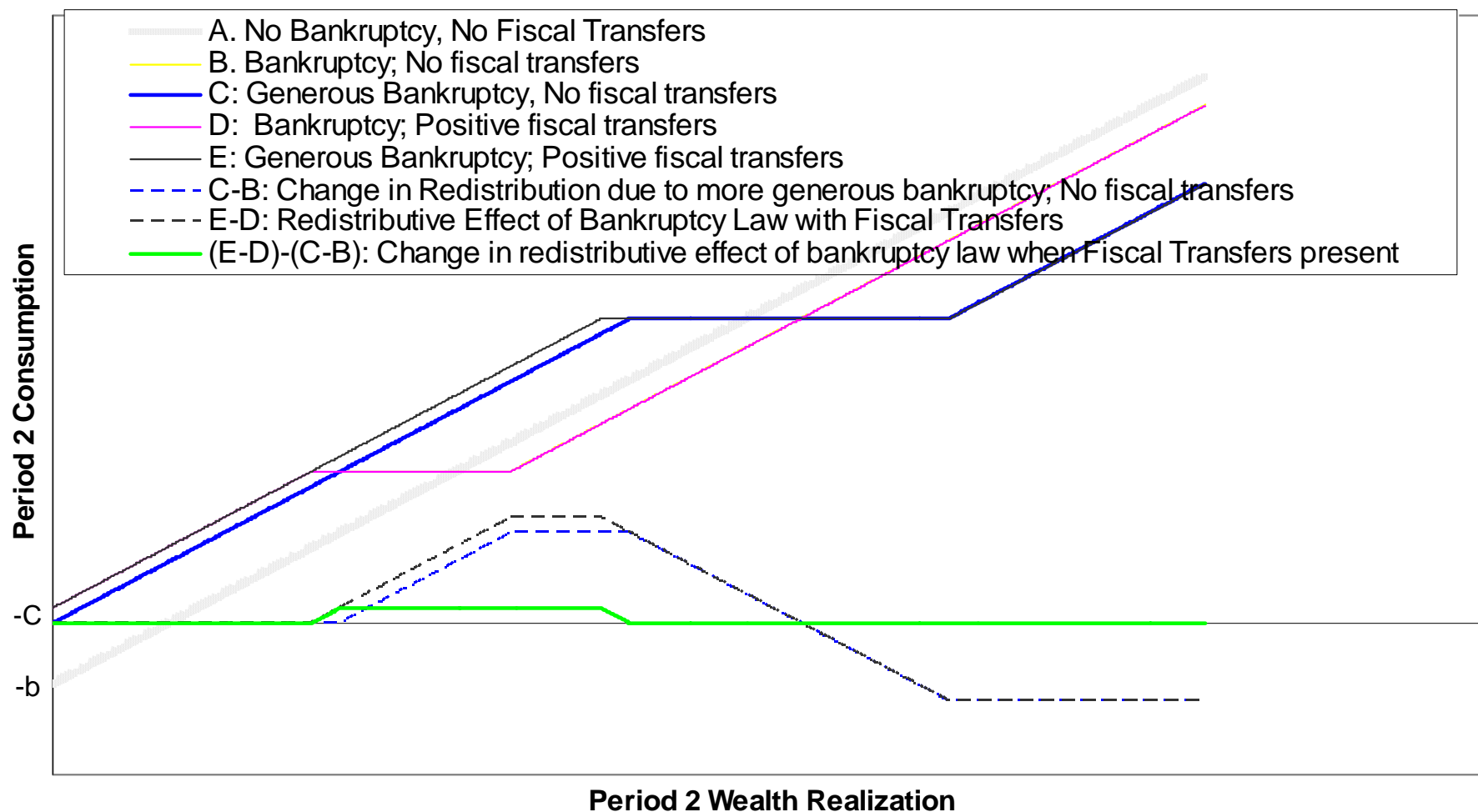
Complementarity: $d[dU/d\tau]/dX > 0$

Bankruptcy as Social Insurance



Complementarity: $d[du/dx]/d\tau > 0$

Bankruptcy as Social Insurance



Insights from the Model

- ◆ Bankruptcy offers insurance
 - Poor don't repay loans
 - Rich repay their loans + an interest premium
- ◆ Exemptions offer insurance (to those in the middle)
 - Exemptions increase insurance to reach those in the middle:
 - » Without exemption: Would have paid debts
 - » With exemption: Keep your house and eliminate debts → Prefer bankruptcy
 - » Paid for by higher repayments by the rich
- ◆ Fiscal redistribution offers insurance
- ◆ Interactions:
 1. Complementarity: Welfare state “crowds in” the poor. They can now benefit from bankruptcy exemptions.
Thus: $d[dU/dx]/d\tau > 0$
 2. Diminishing returns: As social insurance increases, the returns to further redistribution decline ($U'' < 0$)
 - $d[dU/dx]/dx < 0$
 - $d[dU/dx]/d\tau < 0$

Empirics: Some Questions

- ◆ Sufficient statistical power given the likely size of the effect?
 - How many people are on the margin of declaring bankruptcy?
 - And how much insurance does the exemption give them?
- ◆ Are there other margins of substitution?
Surely this complicates comparative statics
 - Firing costs
 - Anti-discrimination legislation (disability)
- ◆ Identification: What if states have different demands for redistribution?
 - Apples and oranges are clearly substitutes, but some people eat more of both.
(They eat more of everything.)
 - What is the ideal experiment?
(Shocks to technology of tax collection?)
- ◆ Theory yields more subtle (and potentially more testable) implications
 - Fiscal redistribution to lenders
 - Fiscal redistribution to specific points in the income distribution

Some thoughts

- ◆ Regulation as a substitute for government spending
 - What if there are other margins?
- ◆ OLG model: Same results?
- ◆ Political economy: This is the demand for types of intervention; what if total amount of intervention higher?