Discussion of "Redistributive Taxation and Bankruptcy in US States"

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Research Question

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

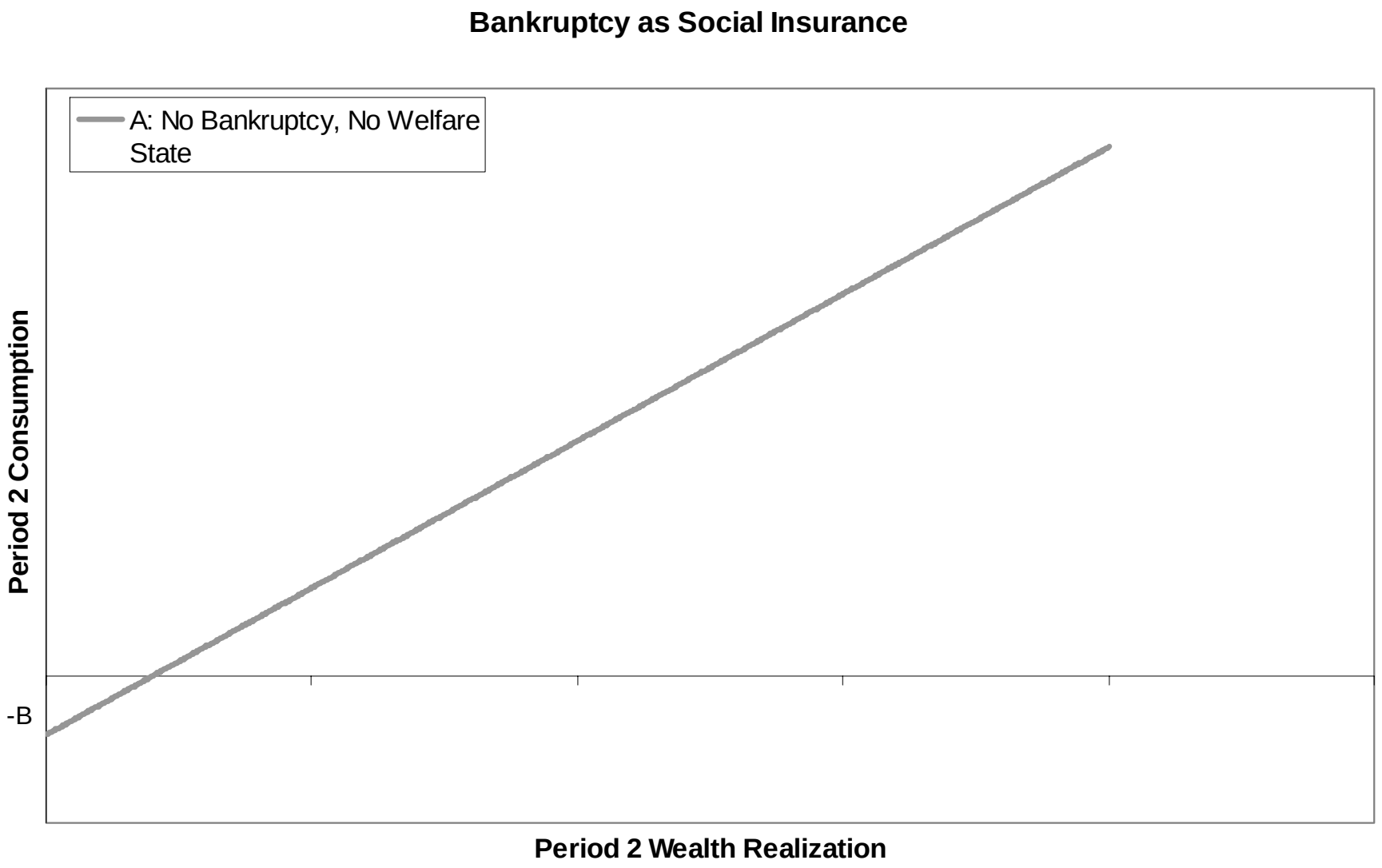
$$Is \quad \frac{d\left[dU/dX\right]}{d\tau} > 0?$$

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

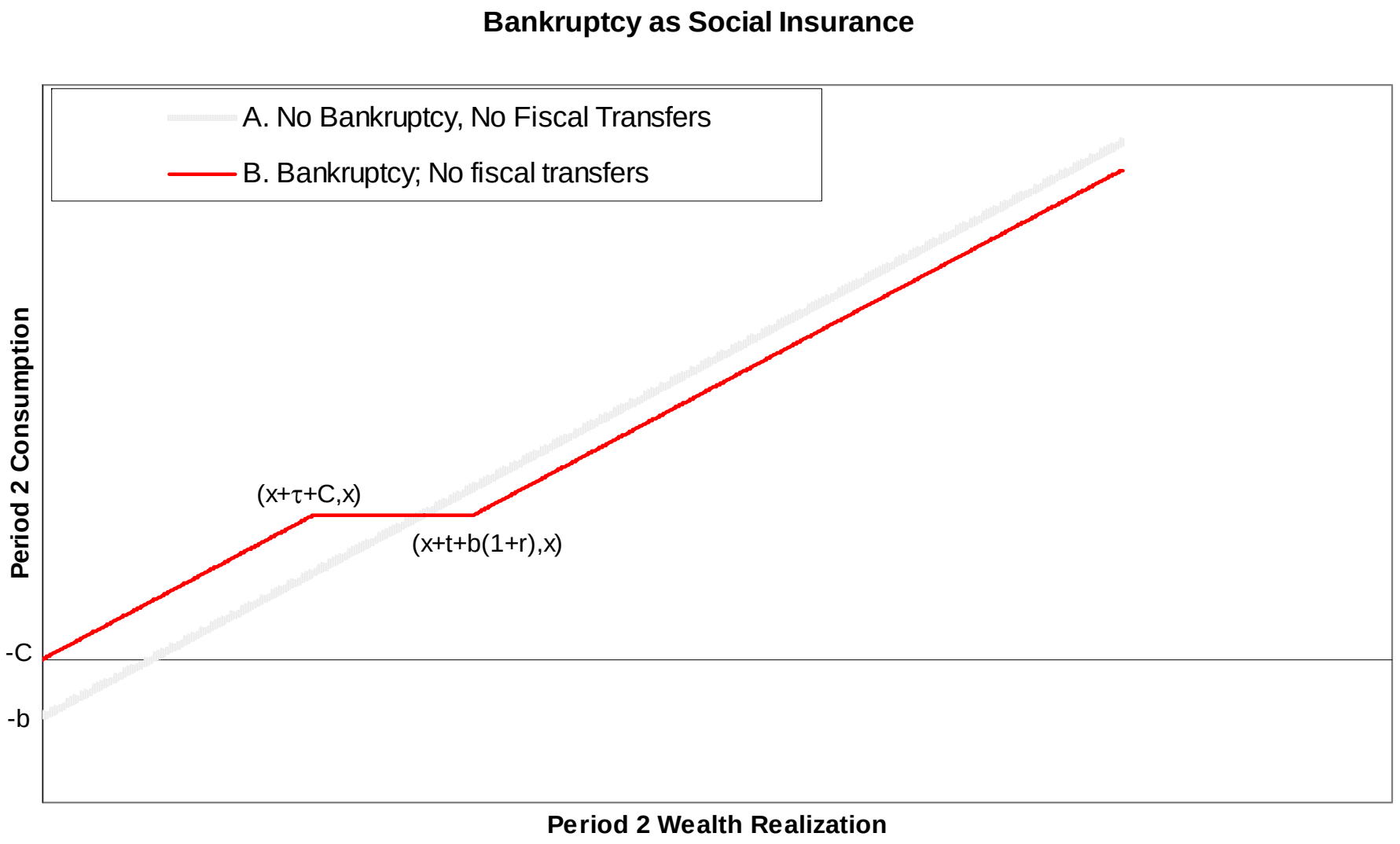
Model Structure

- 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 ω_2-$b(1+r)$, or
    - » Declare bankruptcy and consume min(ω_2, x)?
  - Bank interest rate (r)
    - » Pinned down by zero profit condition

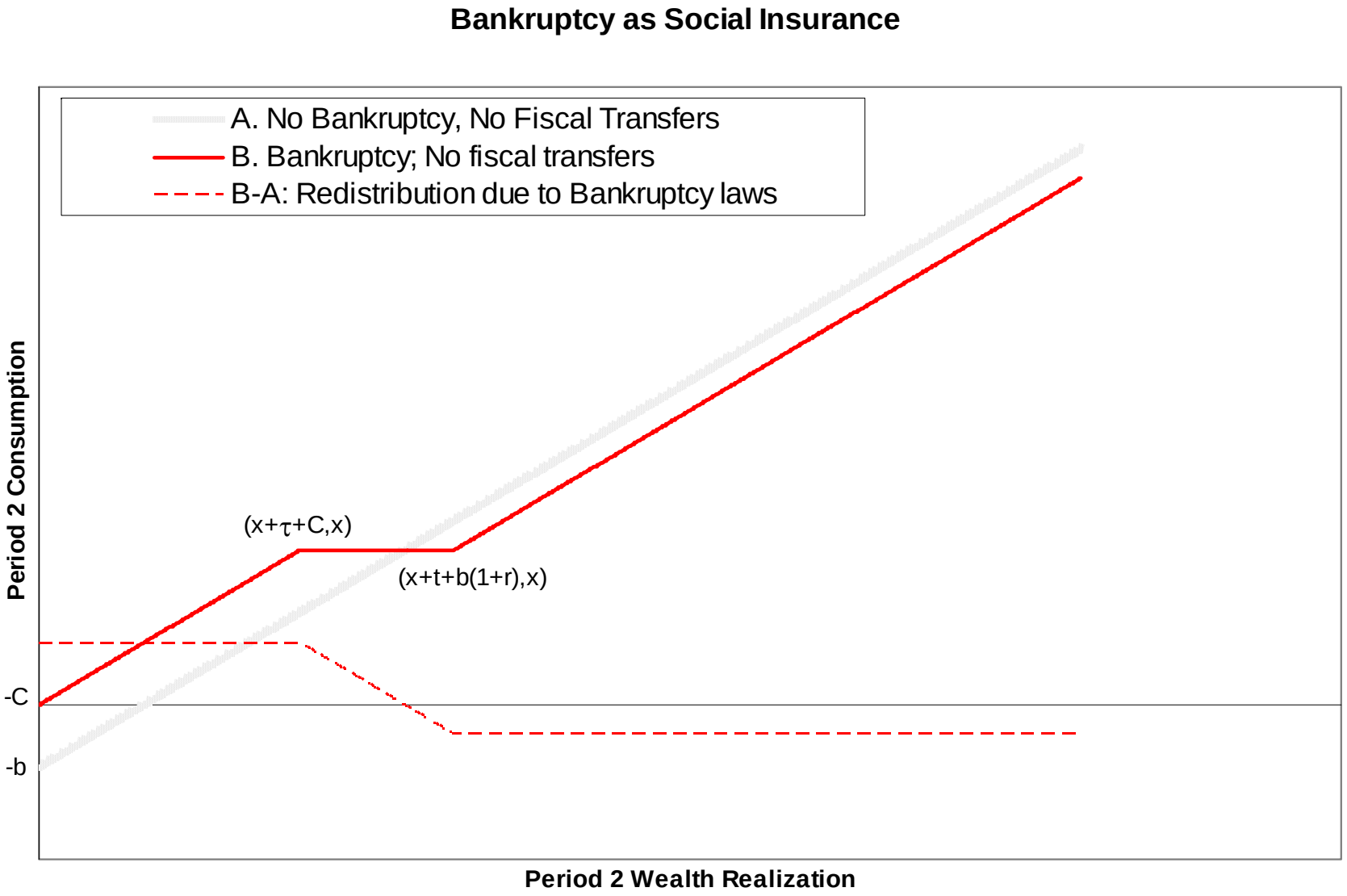
Model: Graphical Interpretation



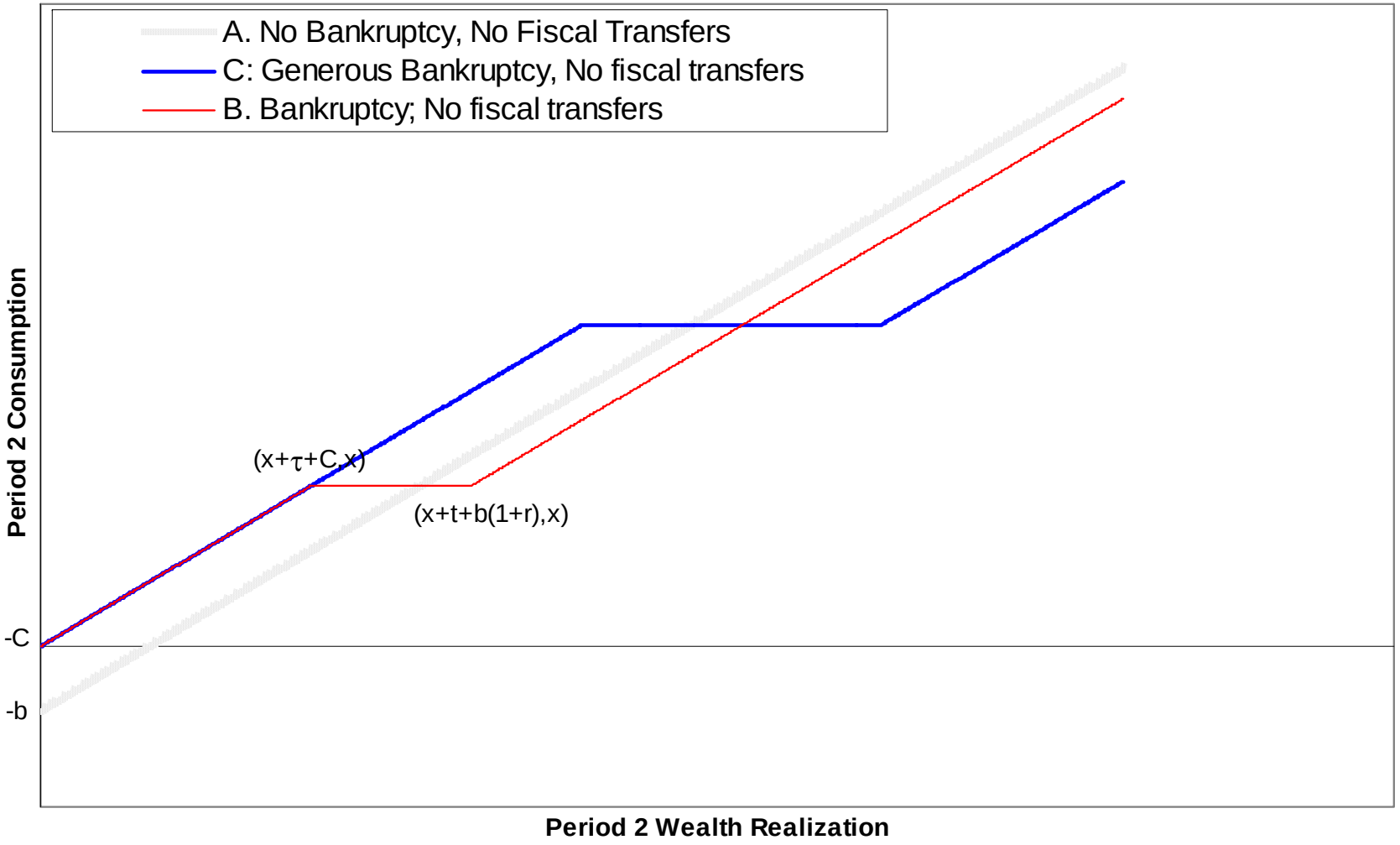
How Bankruptcy Laws Work



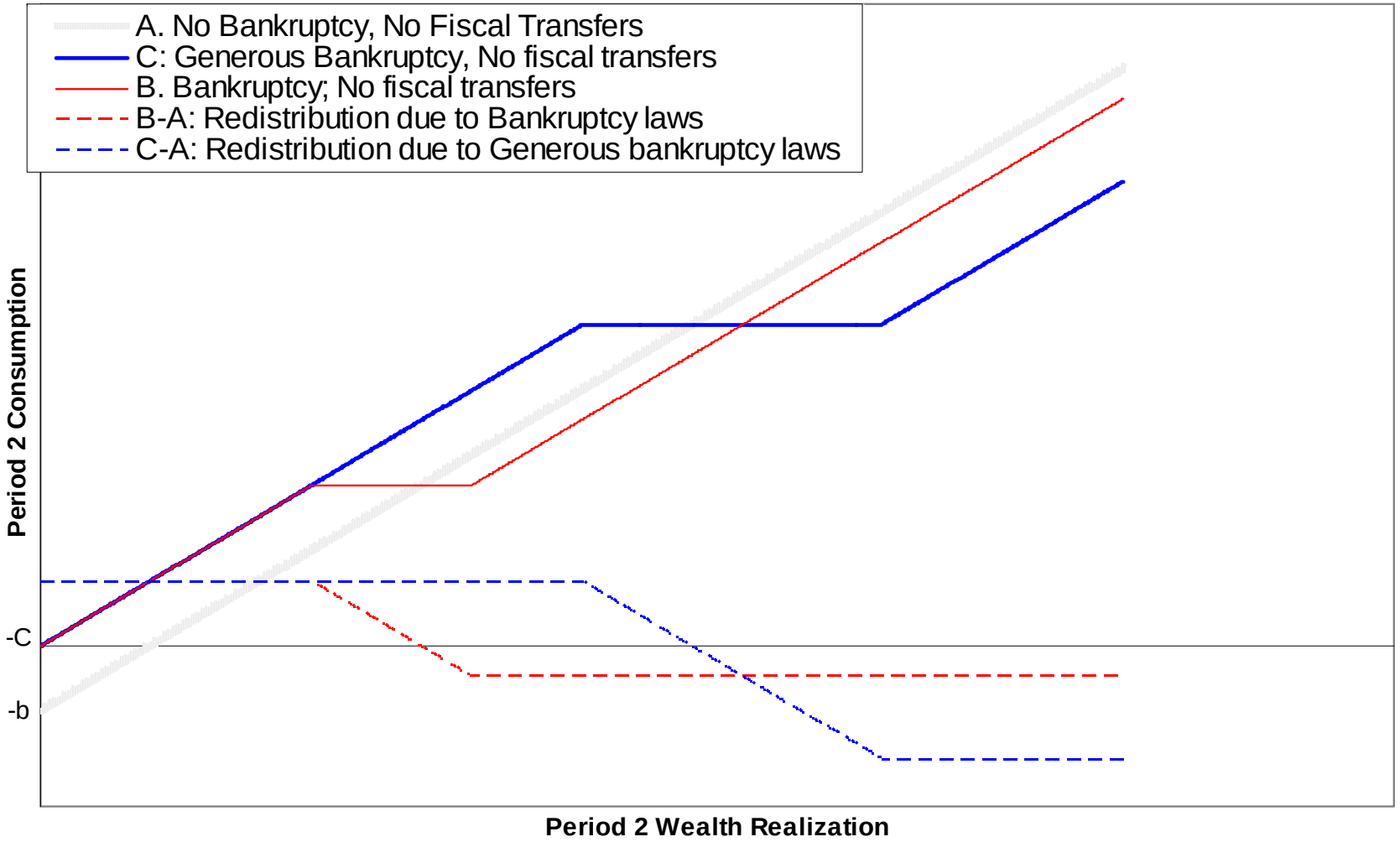
Bankruptcy Provides Insurance



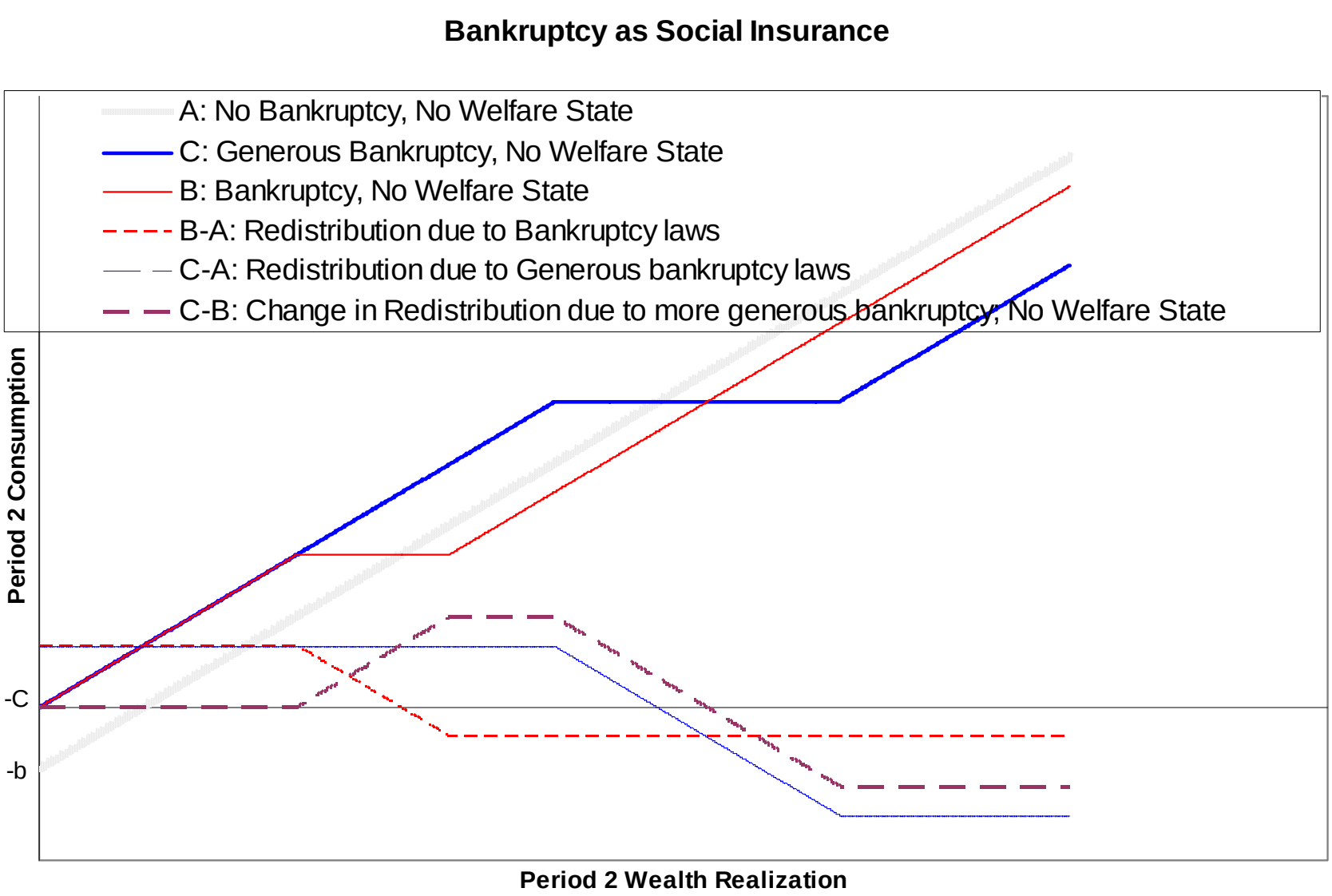
dU/dX: Raising Exemption Levels



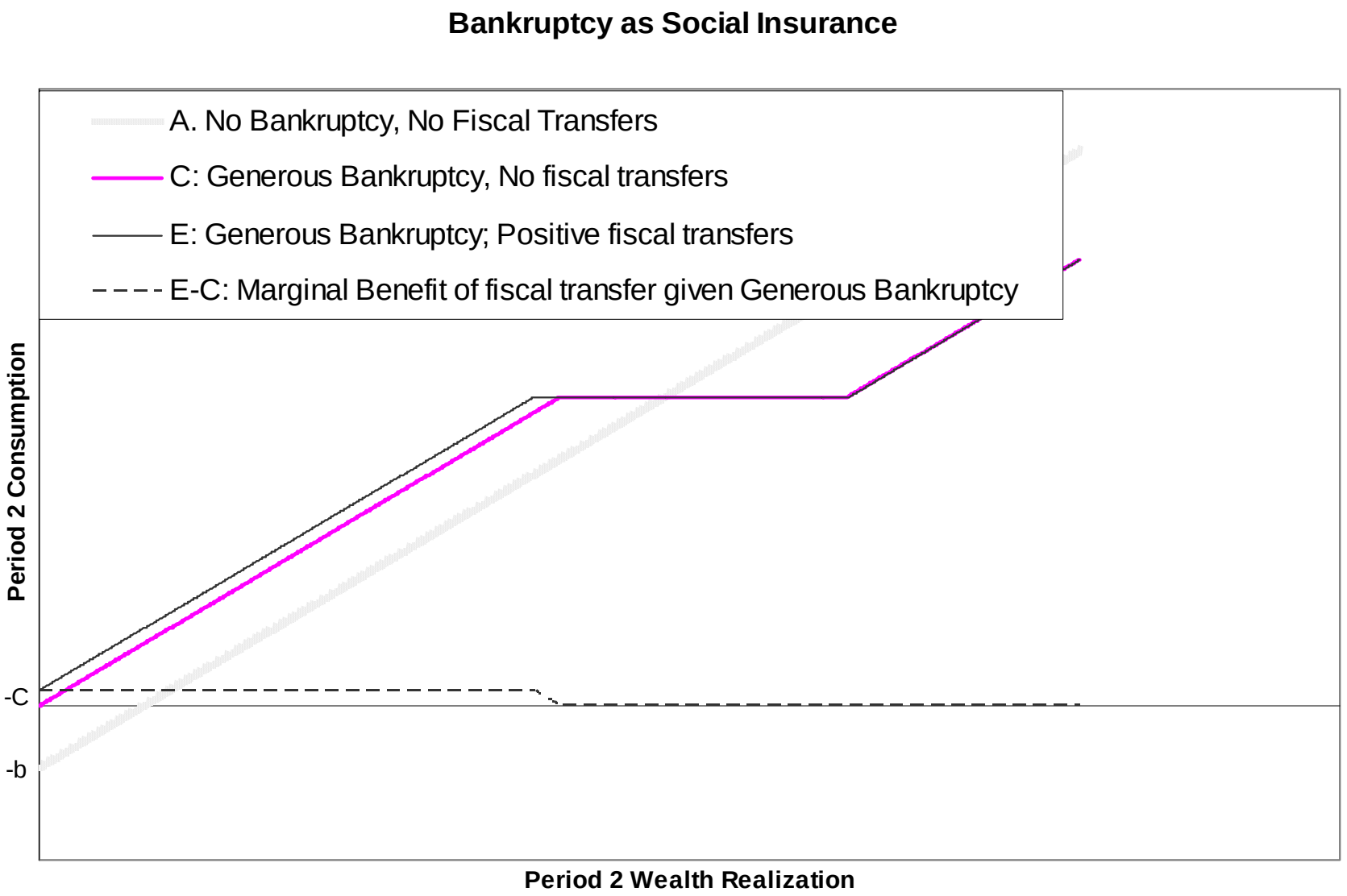
dU/dX: Higher Exemptions ↑Redistribution



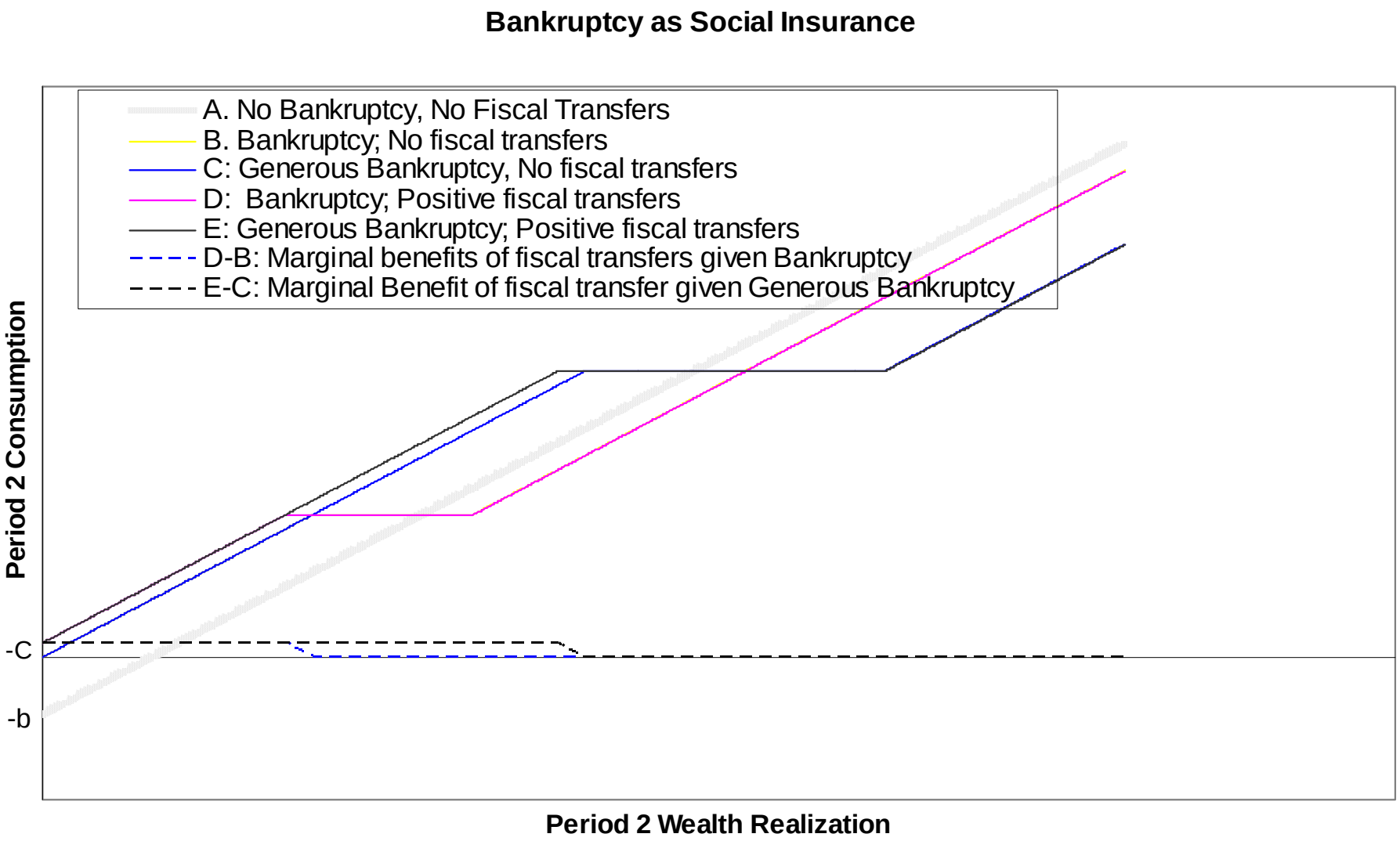
dU/dX: Definitely Positive



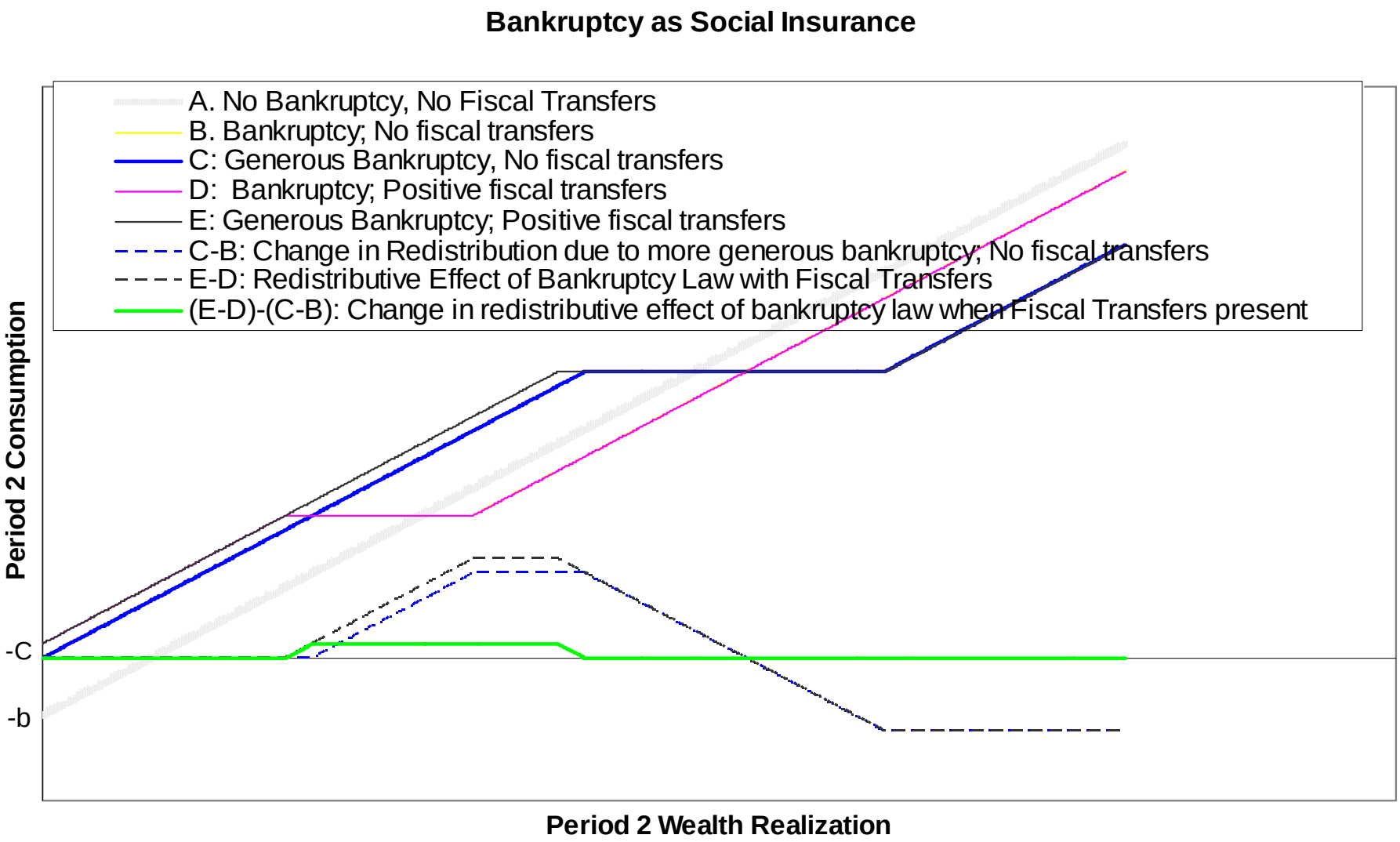
$dU/d\tau \mid x^{High}$



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



Complementarity: d[du/dx]/dτ>0



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: Keepy 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. (The 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?