Quasi-hyperbolic discounting and the taxation of capital income

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Abstract

The celebrated result of Chamley-Judd shows that capital income should not be tax in the long-run. This supports the use of either a labor income tax or, equivalently, a consumption tax. The result is based on a representative consumer model who discounts future utility exponentially. It is commonly asserted that quasi-hyperbolic preferences create a present-bias that leads to an increase in current consumption and a consequent reduction in saving. Many policy applications arrive at the conclusion that saving should be subsidized to counter this effect. The paper investigates whether this logic extends to a growth model with a representative consumer that has quasi-hyperbolic preferences. It then considers the same question when there are overlapping generations of short-lived consumers.

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