Well-Being Poverty and Labor Income Taxation: Theory and Application to Europe and the US

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Abstract

We study a model in which agents differ in their productive skills and their preferences over labor time/consumption bundles. We assume there is a poverty line, that is, there is a minimal level of consumption below which society finds it unacceptable to let people live. To avoid conflict with individual well-being, we capture the anti-poverty project be requiring redistribution to take place between agents on both sides of the poverty line {provided they have the same labor time}. We combine this requirement with efficiency and robustness requirements to derive social preferences. Maximizing these preferences under incentive compatibility constraints yields the following evaluation criterion: labor income tax schemes should minimize the labor time required to reach the poverty line. We apply this criterion to tax schemes of European countries and the US.

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