From Edgeworth to Vickrey to Mirrlees: The Vickrey Lecture

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William Vickrey's Agenda for Progressive Taxation is perhaps his best-known work. It stands roughly half way between Edgeworth and Mirrlees, both historically and intellectually. Edgeworth argued that the optimal tax (and transfer) system equalized incomes by taxing above-average incomes at 100 percent and transferring the proceeds to those below average. Mirrlees argued optimality in the presence of disincentive effects, which Edgeworth ignored, placing severe limits on high tax rates. Vickrey proposed 21 tax reforms to make a practical system of personal progressive taxation workable. The two most famous were cumulative lifetime averaging and decreasing power succession taxes. This paper reviews the proposals in light of subsequent intellectual and historical developments. Many of the issues Vickrey explored are relevant today whether the tax system is flat or progressive and whether the base is income or consumption.

I am honored to be here today to present the Vickrey Lecture. Usually the honoree discusses his or her own research. However, for reasons that will become self-evident, I have decided to discuss Bill Vickrey's work on progressive taxation.

I first met Bill Vickrey in 1971. I was attending the National Tax Association meetings in Kansas City to accept their first outstanding doctoral dissertation award. The day before that presentation, we attended a rodeo. Who should sit down next to me but Bill Vickrey.

Over the next quarter century, I saw Bill many times, usually at a meeting to discuss tax issues and invariably including Bill bellowing out that the answer was cumulative lifetime averaging. While I believe his views on progressivity were somewhat softening given the developments in optimal tax theory discussed below, one constant from our first meeting to the last was that beaming smile complemented by that hearty laugh. He is much missed and warmly remembered.

Bill Vickrey was a wonderfully creative economist whose work developed key insight into numerous areas of economics. From auction theory to pricing congestion to tax policy, Vickrey's contributions enhanced our understanding. It is well beyond the scope of my remarks today, and certainly not my comparative advantage, to reflect on his entire career. Instead, I want to focus on the one area of his major contributions that I know best: tax theory and policy. Indeed, he was perhaps best known for his extensive Agenda

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for *Progressive Taxation*, first published in 1947 and reprinted in 1972. For those of you not familiar with his work, Vickrey surveyed, analyzed, and proposed solutions for a large number of issues arising under progressive taxation.

The two most novel ideas in the book, cumulative lifetime averaging and decreasing power succession taxes, are well known to public finance experts. The numerous other practical issues of taxation, some of which arise whether or not the tax is progressive, include the treatment of capital gains, life insurance, undistributed profits, tax-exempt interest, charitable deductions, equivalency scales for the size of the household, imputed income, and what we would today call a consumption tax but which Vickrey called a spending tax.

What I propose to do today is to go through Vickrey’s 21 suggestions for tax reform and discuss where, at least in my opinion, the public finance profession stands on each of these issues and, briefly, where the tax code has come since Vickrey’s time. Before doing so, I do want to spend a moment on the optimal degree of progression. This is standard fare in modern public finance, but, surprisingly, Vickrey spent very little time on it, hence, the title of this paper because, to the best of my knowledge, the first serious analysis of the optimal degree of progression was due to Edgeworth [1919].

Recall that Edgeworth, being the utilitarian that he was, thought tax policy should be used to maximize social welfare, the sum of individual utilities. Because the marginal utility of income was assumed to decline with income and to be interpersonally comparable, the Edgeworth formulation requires transferring income from someone with a high income, and, therefore, a low marginal utility of income, to someone with a low income, and, therefore, a high marginal utility income, until the marginal utilities of income are equalized. Thus, totally ignoring incentive effects, the Edgeworth solution to the optimal degree of progression was the tax and transfer system, which equalized incomes. Except in the unlikely case of everyone having the same pretax income, this implied a 100 percent rate of taxation for incomes above the average and using the proceeds to transfer income to those below the average, with everyone winding up with the average income post-tax. Remarkably, Edgeworth’s writing on taxation is only referenced once by Vickrey, and that in a footnote in Appendix 7, 459 pages into the text. Perhaps this is not surprising since Vickrey [1972, p. iii] "...intended to cover the middle ground between discussions of the broad economic aspects and the theoretical basis of progressive taxation on the one hand, and...analysis of the finer distinctions made by the law on the other." Therefore, he skipped "...briefly over the philosophical and theoretical background of progressive taxation...to discuss point by point just what must be done to weld our progressive tax structure into a consistent workable system, reasonably free from undesirable repercussions and capable of producing substantial redistribution of income."

This constant theme of Vickrey’s—not surprising in a book written in 1947—was the use of the tax system to achieve social policy, in particular to redistribute income from the wealthy to the nonwealthy. Whether a rigorous case can be made for doing so seemed to Vickrey to be somewhat self-evident. It is almost a quarter of a century later when Mirrlees [1971] presented a rigorous reexamination of the optimal tax problem. Mirrlees,