

# The Role of Empirical Research in Policy Design

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SAFE Inaugural Event

GOETHE UNIVERSITÄT

September 2013

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# The Role of Empirical Research in Policy Design

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- How should we best develop an empirical foundation for policy analysis?
  - Experience at IFS, *independent* non-profit research institute..... with a ESRC Centre at its core..
    - Different areas of research but very similar structure and objectives as SAFE
  - Policy analysis and academic research on an equal footing
    - Policy analysis provides key new ideas for research
    - Research provides credibility and a long-term foundation for policy analysis
  - New studies ‘only’ undertaken if they have the potential to satisfy both objectives
- Take the *Mirrlees Review* as a leading example

# The Mirrlees Review

## *Reforming the Tax System for the 21st Century*

*Chair:* Sir James Mirrlees

Tim Besley (LSE & IFS)

Richard Blundell (IFS & UCL)

Malcolm Gammie QC (One Essex Court)

James Poterba (MIT & NBER)

with:

Stuart Adam (IFS)

Steve Bond (Oxford & IFS)

Robert Chote (OBR)

Paul Johnson (IFS)

Gareth Myles (Exeter & IFS)

# Scope of the Mirrlees Review

- Comprehensive review of reform, drawing on:
  - new evidence
  - new (applied) theory
  - new economic environment
- View the tax system as a whole
  - savings and capital taxation
  - earnings and direct taxation
  - indirect taxation
  - corporate taxation
- For developed open economies
  - the UK as the running experiment

# Some outputs (and inputs)

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- Policy/practitioner presentations: UK Treasury, EU, IMF,...
- Cross-cutting research meetings
- 'Dimensions of Tax Design': published April 2010
  - 13 chapters on particular areas by IFS researchers + international experts, along with expert commentaries
- 'Tax by Design': published September 2011
  - an integrated picture of tax design and reform, written by the editors
- Many academic and policy research publications....
- OUP and open access  
<http://www.ifs.org.uk/mirrleesReview>

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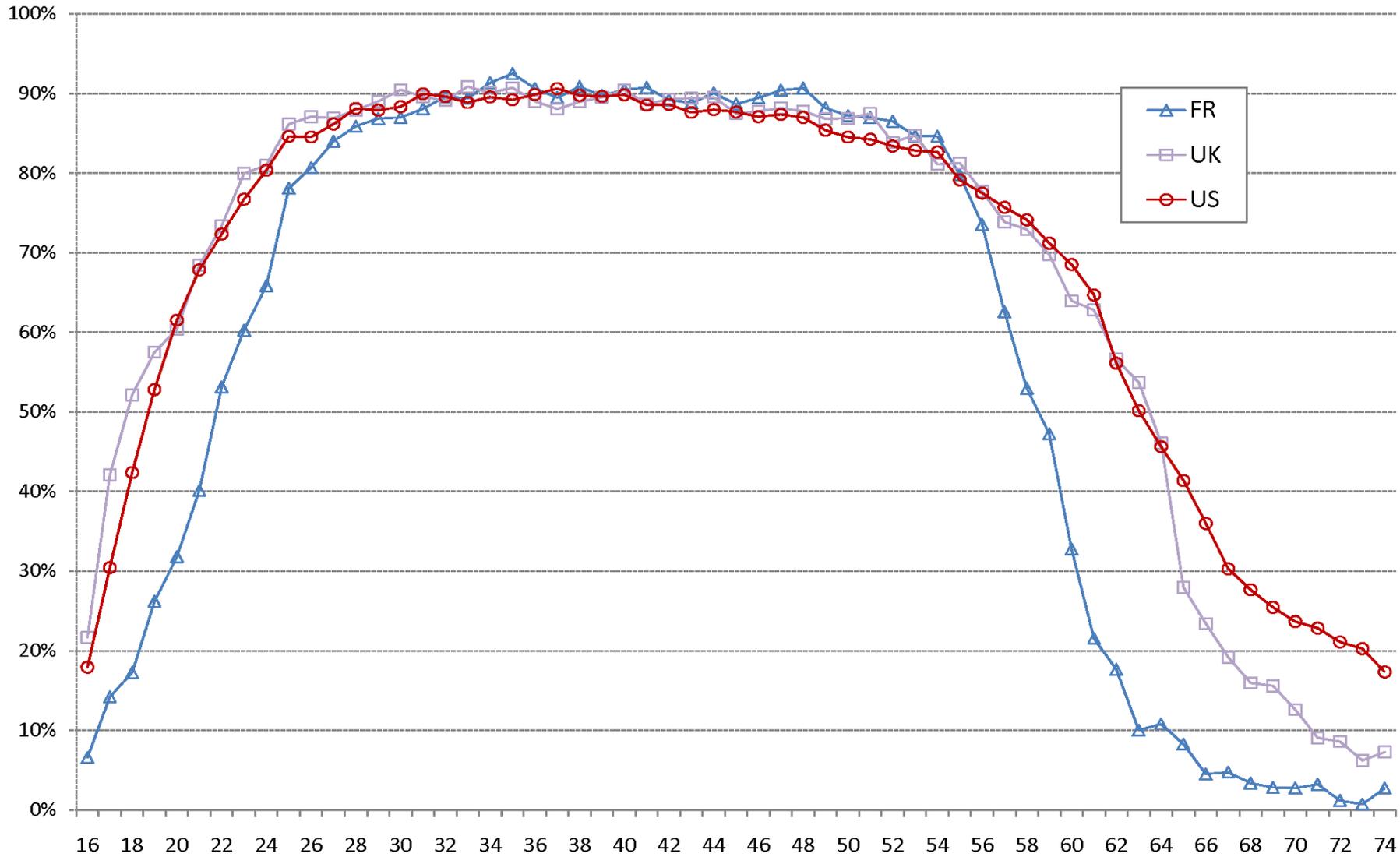
- How can we make the best use of empirical research in policy analysis?
- Consider the role of evidence loosely organised under five headings:
  1. Key margins of adjustment to reform
  2. Measurement of effective incentives
  3. The importance of information and complexity
  4. Evidence on the size of responses
  5. Implications from theory for optimal policy design

# 1. Key margins of adjustment to reform

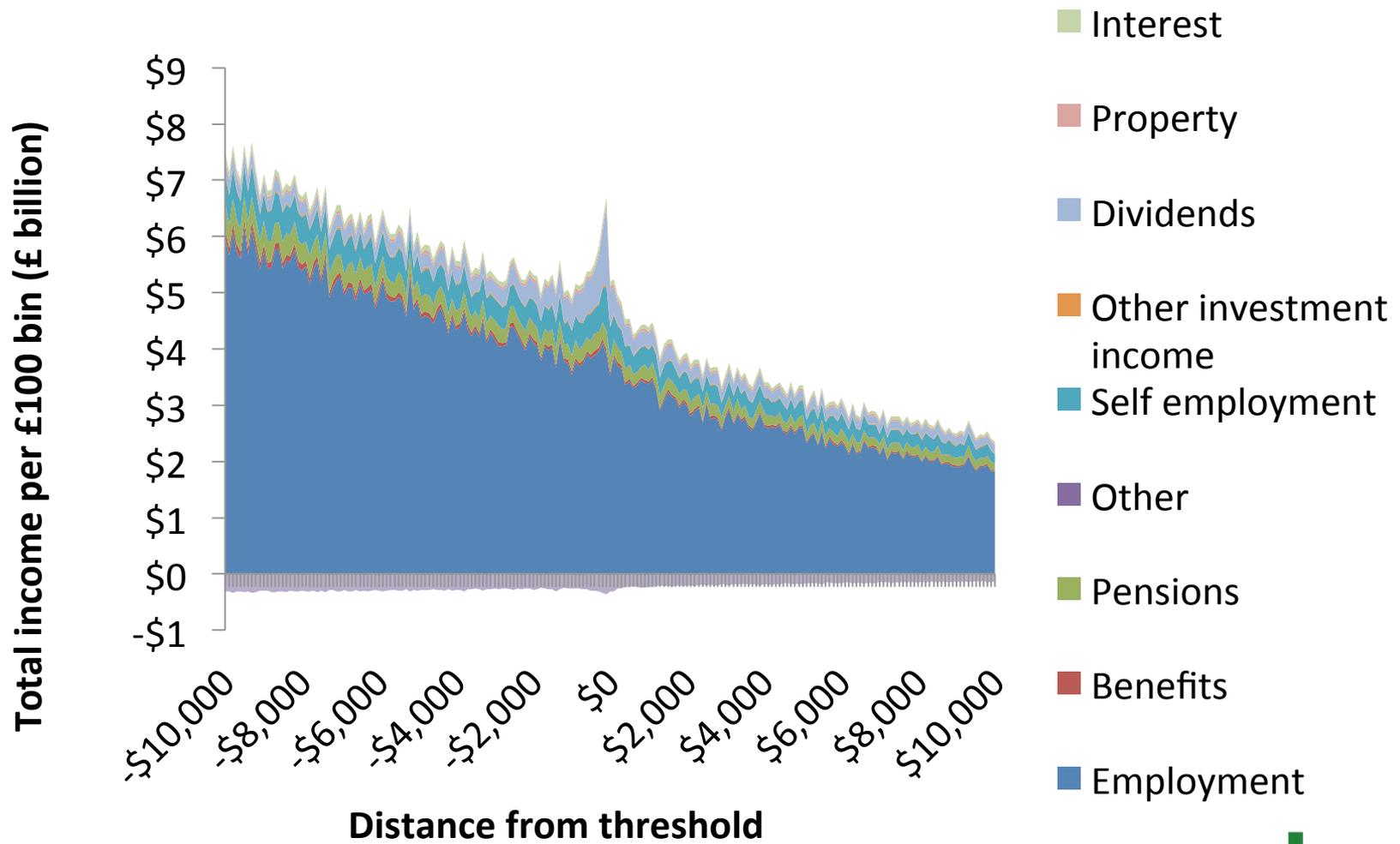
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- A 'descriptive' analysis of the key aspects of observed behaviour
  - not 'causality' just the correlations in the data
  - the key facts!
- Where is it that individuals, firms and governments are most likely to respond?
  - e.g. the margins of labour market adjustment.

# Employment for men by age – FR, UK and US 2007



# Composition of income around the higher rate tax threshold

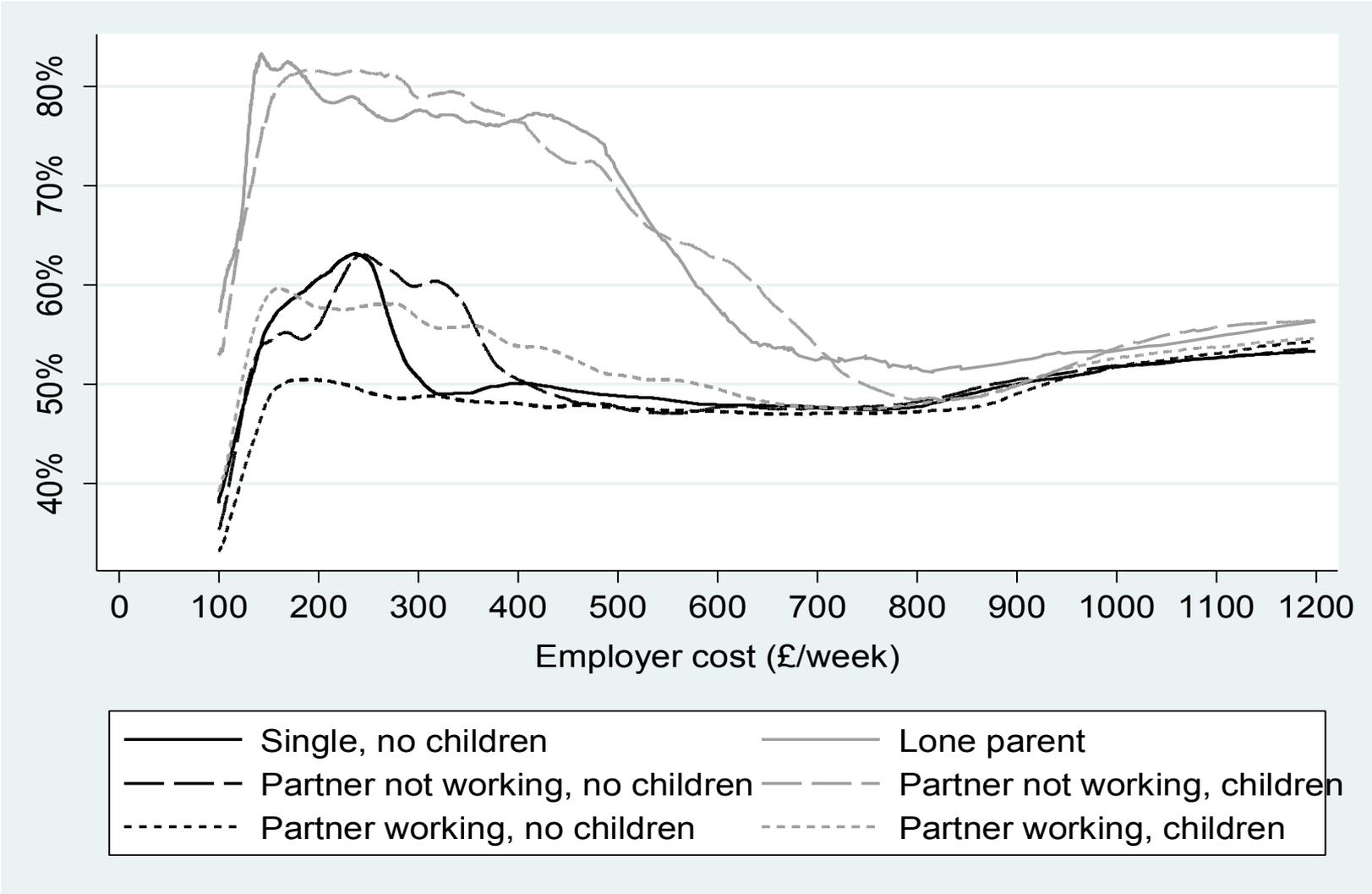


## 2. Measurement of effective incentives

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- Precisely how is the policy likely to impact on the incentives facing the key players?
- For example, in terms of tax policy – what are the ‘true’ effective tax rates on labour earnings?

# Average EMTRs for different family types



### 3. The importance of information and complexity

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- How is the policy likely to be understood by the agents involved?
- For example, how salient are the various tax incentives in the policy reform?

## 4. Evidence on the size of responses

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- This is where the rigorous econometric analysis of structure and causality comes in
- Two steps involved:
  1. Quasi-experimental/RCT/reduced form evaluations of the impact of (historic) reforms
    - robust but limited in scope
  2. A 'structural' estimation based on a the simultaneous interactions of decisions and agents
    - comprehensive in scope but fragile

## 5. Implications from theory for policy design

- This is the normative analysis or optimal policy analysis
  - requires structural model estimate
  - for example, in the design (and reform) of the capital income tax schedule, of savings and pensions taxation, or the personal income tax schedule.

# A flavour of the 'proposals' from Mirrlees Review

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- Treat the system as a whole
  - A single integrated welfare benefit, and employer and income tax
  - Use what we know about how people respond to taxes
  - Aligning tax rates across employment, self-employment and profits
- Move towards neutrality
  - Widening the VAT base; e.g. financial services
  - Not taxing the normal return to capital, neutral between debt & equity
- Whilst proposing sensible deviations from neutrality
  - Imposing a consistent tax on GHG emissions and on congestion
  - Special treatment for childcare costs, pension saving, and innovation
- Achieve progressivity through the direct tax and benefit system
  - Recognising constraints imposed by responses to incentives
  - see 'Tax by Design' <http://www.ifs.org.uk/mirrleesReview>

# The Role of Empirical Research in Policy Design

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- Five building blocks for the role of evidence in policy design....
  1. Key margins of adjustment to policy reform
  2. Measurement of the effective incentives
  3. The importance of information and complexity
  4. Evidence on the size of responses
  5. Implications from theory for optimal policy design
- ◆ Congratulations SAFE – best wishes for the future!
- ◆ We're SAFE in their hands!