

DIMENSIONS OF TAX DESIGN

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# DIMENSIONS OF TAX DESIGN

*The Mirrlees Review*

*Chair*

SIR JAMES MIRRLEES

*Editors*

Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond,  
Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles,  
and James Poterba

*for the*

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## *Preface*

Thirty years ago the Institute for Fiscal Studies published a seminal review of the UK tax system, the fruits of a commission chaired by the Nobel Laureate Professor James Meade. Explaining the motivation for the review, Dick Taverne, then Director of the IFS, lamented: ‘For too long, tax reforms have been approached *ad hoc*, without regard to their effects on the evolution of the tax structure as a whole. As a result many parts of the system seem to lack a rational base. Conflicting objectives are pursued at random; and even particular objectives are pursued in contradictory ways.’

Unfortunately, this critique still holds true today. In some important respects the tax system has evolved in the way that the Meade Report recommended, but it remains the product of often incoherent piecemeal changes rather than strategic design. The tax system has also struggled to adapt to profound changes in the economic, social, and institutional environment in which it operates. And tax design has not benefited as much as it could from advances in theoretical and empirical understanding of the way features of the system influence people’s behaviour.

For all of these reasons, we felt that the time was ripe once again to ask an expert commission to take a hard look at the tax system: to try to identify the characteristics that would make for a good tax system in an open economy in the twenty-first century; and to suggest how the British tax system in particular might be reformed to move closer to that ideal. This volume and the companion volume of the Review’s final conclusions, *Tax by Design*, are the result.

In thinking of a worthy successor to James Meade as chair of the Review, there was one obvious choice: the Nobel Laureate and founder of the modern theory of optimal taxation, Professor Sir James Mirrlees, of Cambridge University and the Chinese University of Hong Kong. We are very grateful to him and to the other directors of the Review’s work: Professor Tim Besley of the Bank of England and the London School of Economics; Professor Richard Blundell of the IFS and University College London; Malcolm Gammie QC of One Essex Court and the IFS Tax Law Review Committee; and Professor James Poterba, President of the National Bureau of Economic Research in the US. They have been joined in editing this volume and writing *Tax By Design* by Stuart Adam of the IFS; Professor Stephen Bond of Oxford University; Paul

Johnson of the IFS and Frontier Economics; Professor Gareth Myles of Exeter University; and me.

The Meade Report confined its attention largely to direct taxes in the UK, whereas we wanted the Mirrlees Review to examine the tax system more broadly and from a global perspective as well as a British one. To provide a foundation upon which our final conclusions could be built, we therefore began by asking small teams of experts from the IFS and around the world to address a number of key themes in tax design, with equally distinguished experts to comment on their work. These authors and commentators were not constrained by the views of the core review team, and neither was the core review team constrained to agree with all or any of their conclusions. We are enormously grateful to them all for their analyses, which are of considerable interest and value in their own right, above and beyond any inspiration they have provided for the final report. They are published in full in this volume, while the conclusions of the core team are to be found in *Tax by Design*.

From the outset, the intention of the review was to take a ‘big picture’ view of tax design, asking what society wants the tax system to achieve and how best it might be structured to accomplish that. In the final report we have tried both to set out an overarching vision for the tax system and to suggest some desirable incremental reforms. The starting point has been to look at the economics of the tax system, although we have received a great deal of useful input from tax lawyers, advisers, and practitioners, as well as those currently and in the past involved with the practicalities of tax design and implementation. Inevitably, some of those who spend most of their time thinking about tax design and implementation from these perspectives might have identified different priorities and have taken different approaches if they were to have undertaken this Review themselves. Economists cannot claim to have all the answers to good tax design—and some of our answers will pose new questions. But thinking hard about the economics of the tax system is essential if it is to work effectively.

In addition to administrative practicality and the difficulty of turning economic intentions into robust legislative language, proposals for tax reform are of course constrained by politics—not least the unfortunate observation that those who lose from tax reforms tend to be vengeful while those who gain from them tend to be ungrateful. But there is no point in a Review of this sort confining itself only to recommendations that we could confidently expect to receive immediate and enthusiastic support across the political spectrum—it would be a very short report if it did. In the final report we have tried to take explicit account of the political economy of tax reform in setting out a possible path to a better system, but there will always be a tension to

some extent between what is economically desirable and what is politically practical.

One of the most important and well-known lessons from economics is that there is no such thing as a free lunch. We must therefore express our heartfelt thanks to those who have paid for this one: the Nuffield Foundation and the Economic and Social Research Council. Both have long been much valued supporters of IFS and we hope that they will think their investment in this project worthwhile. It just remains for me to echo Dick Taverne's words on the launch of the Meade Report: 'We hope and believe that this Report will be a rich quarry for tax reformers and a valuable reference point for students of taxation for decades to come.'

Robert Chote  
Director  
Institute for Fiscal Studies

The Nuffield Foundation is a charitable trust with the aim of advancing social well-being. It funds research and innovation, predominantly in social policy and education. It has supported this project, but the views expressed are those of the authors and not necessarily those of the Foundation. More information is available at [www.nuffieldfoundation.org](http://www.nuffieldfoundation.org).

The Economic and Social Research Council (ESRC) funds research and training in social and economic issues. It is an independent organisation, established by Royal Charter, receiving most of its funding through the Department for Business, Innovation and Skills.



## *About the Editors*

**Sir James Mirrlees** is a Fellow of Trinity College and Emeritus Professor of Political Economy at the University of Cambridge, Laureate Professor at the University of Melbourne, and Distinguished Professor-at-large at the Chinese University of Hong Kong. He is a Fellow of the British Academy and past President of the Econometric Society, the Royal Economic Society, and the European Economic Association, and has been awarded numerous honorary degrees. Working primarily on the economics of incentives and asymmetric information, he founded the modern theory of optimal taxation, and was the joint winner of the Nobel Prize for Economics in 1996. He was knighted in 1997 for contributions to economic science.

**Stuart Adam** is a Senior Research Economist at the IFS. His research focuses on the design of the tax and benefit system, and he has written about many aspects of UK tax and benefit policy, including income tax and National Insurance, capital gains tax, tax credits, incapacity benefit, work incentives and redistribution, support for families with children, and local government finance.

**Timothy Besley** is Kuwait Professor of Economics and Political Science at the LSE, a Research Fellow at the IFS, and from 2006 to 2009 an external member of the Bank of England Monetary Policy Committee. His work has been mainly in the fields of development economics, public economics, and political economy. He is a former co-editor of the *American Economic Review*, Fellow of the Econometric Society and of the British Academy, and is President-elect of the European Economic Association. He was a 2005 recipient of the Yrjö Jahnsson Prize.

**Richard Blundell** CBE is Research Director of the IFS, where he is also Director of the ESRC Centre for the Microeconomic Analysis of Public Policy. He holds the David Ricardo Chair of Political Economy at UCL. His research has been mainly in the fields of microeconometrics, household behaviour, and tax policy evaluation. He is a Fellow of the British Academy, honorary Fellow of the Institute of Actuaries, President-elect of the Royal Economic Society, past President of the European Economic Association and of the Econometric Society, and former co-editor of *Econometrica*. A winner of the Yrjö Jahnsson Prize and the Frisch Medal, he was awarded the CBE in 2006 for services to economics and social science.

**Stephen Bond** is a Senior Research Fellow at Nuffield College, Oxford, a programme director at the Oxford University Centre for Business Taxation, and a research fellow at the IFS. His main interests are in corporate tax policy and the effects of corporate taxation on the behaviour of firms. Other interests include empirical research on company investment and financial behaviour, and the development of econometric methods for the analysis of panel data.

**Robert Chote** was appointed Director of the IFS in October 2002. He was formerly an adviser and speechwriter to the First Deputy Managing Director of the IMF. He was Economics Editor of the *Financial Times* between 1995 and 1999, and previously served as Economics Correspondent of *The Independent* and a columnist on the *Independent on Sunday*, where he was named Young Financial Journalist of the Year by the Wincott Foundation. He is a governor of the National Institute of Economic and Social Research and a member of the Advisory Board of the UK Centre for the Measurement of Government Activity at the Office for National Statistics.

**Malcolm Gammie** CBE QC is a barrister at One Essex Court. He has been associated with the IFS for almost thirty years, and is currently Research Director of its Tax Law Review Committee. He was a senior tax partner at the City law firm of Linklaters until moving to the Bar in 1997, becoming a QC in 2002. He was named Tax Lawyer of the Year 2008 at the LexisNexis Taxation Awards. A past president of the Chartered Institute of Taxation, he teaches at universities in Australia, the Netherlands, and the UK. He has advised governments of several countries, the European Commission, and the OECD on tax policy issues and was awarded the CBE in 2005 for services to taxation policy.

**Paul Johnson** is a Research Fellow at the IFS and an associate of Frontier Economics. From 2004 to 2007 he was Director of the Public Services and Growth Directorate and Chief Microeconomist at HM Treasury, as well as Deputy Head of the Government Economic Service. He previously worked in senior posts at the Department for Education and Skills and the Financial Services Authority. Until 1998 he was a full-time researcher at the IFS, eventually taking on the roles of Deputy Director and Head of the Personal Sector Research Programme.

**Gareth Myles** is Professor of Economics at the University of Exeter and a research fellow at the IFS. He is a Fellow of the Royal Society of Arts and has been a Professorial Fellow at the Australian School of Taxation. He is a managing editor of *Fiscal Studies* and an associate editor of the *Journal of Public Economic Theory*. His main research areas are public economics,

labour economics, and microeconomics. His publications include numerous research papers on taxation with imperfect competition, international taxation, and public goods. He has also written the textbooks *Public Economics* (1995) and *Intermediate Public Economics* (2006).

**James Poterba** is Mitsui Professor of Economics at MIT, President of the National Bureau of Economic Research, and President of the National Tax Association. He is also a Fellow of the American Academy of Arts and Sciences and of the Econometric Society. His research focuses on how taxation affects the economic decisions of households and firms. He served as a member of the US President's bi-partisan Advisory Panel on Federal Tax Reform in 2005, and is a past editor of the *Journal of Public Economics*. He studied economics as an undergraduate at Harvard University, and received his doctorate in economics from the University of Oxford.