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# Review of: "A Dynamic Model for an Optimal Consumption Tax Rate"

Jorge Martinez-Vazquez[1]

1 Georgia State University

Potential competing interests: No potential competing interests to declare.

This paper titled "A Dynamic Model for an Optimal Consumption Tax Rate" by Muhammad Ashfaq Ahmed and Nasreen Nawaz is an excellent piece of research, providing high rigor and some important insights, which represent significant contributions to the literature on optimal taxation.

The most significant insight in the paper is to highlight that a new tax induces a dynamic adjustment to a new price equilibrium, the presence of efficiency losses during this adjustment process, and therefore the potential need to consider these losses while determining the optimal tax rate. Traditionally, the optimal tax literature has brushed over this aspect by simply comparing the old equilibrium and the new equilibrium. Given that the adjustments process can be long, ignoring the welfare losses associated with this process is a clear oversight. And since those additional welfare losses can be significant, the truly optimal tax rate (which also internalizes those welfare losses) can be quite different. Future research should offer more realistic simulations and possibly some empirical evidence on the potential validity and salience of this process. What difference in optimal tax rates makes to incorporate the welfare losses undergone through the adjustment to new equilibrium process?

There are some other aspects of the paper that perhaps could be improved. Here is a short list:

The role played by the middleman needs to be better explained and justified, or simply be left out. The rationales offered for its presence in the formal economy are not convincing. For example, atomistic price taking producers can, in fact, need to change their prices with a new tax, or go out of business, because of operating losses. Producers can also hold and adjust inventories.

If we are introducing a new tax, as opposed to comparing taxes with similar revenues, there is a need to account for the uses of the tax revenues by government in producing public good in the measurement of welfare changes. The role of Government in the economy should also be modeled.

Welfare changes should be measured using standard instruments, such as the Compensating Variation.