

Should Japanese tax system be more progressive?

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Many industrial countries had seen their income tax system made flatter since 1970s until recently. Japan is no exception. The Japanese government decreased the number of brackets and lowered the top marginal tax rate in a series of tax reform from the late 1970s to the mid-2000s. The key words for the series of tax reductions included “incentives to work” and “neutrality (no distortion)”. Recent arguments tend to put emphasis distributional aspects. In any case, design of optimal income taxation requires information on household's responses to tax system. However, in contrast to the rich stock of empirical studies on the labor supply response to taxation for North America and Europe, few analogous attempts have been made in Japan. This paper tries to fill this gap and investigate a desirable direction of marginal reform of Japanese income tax system, computing the social marginal costs of public funds (SMCF).

The purpose of this paper is to examine a desirable direction of marginal reform of Japanese income tax system, using a large micro data. To do so we estimate a structural discrete choice model of household labor supply, following van Soest (1995), and calculate SMCFs created by marginal changes in tax parameters, particularly, marginal national tax rates.

Our estimation results show that the average of total elasticity of males ranges between 0.0276 and 0.0521, and that of females between 0.0429 and 0.2134, which is quite consistent with the counterparts of North America and Europe. Using these estimated parameters, we find that the SMCFs for increase in the marginal tax rate of the second highest bracket is smaller than those of lower brackets. This suggests that in our setting the marginal tax rates of the second highest bracket should be raised before those of lower brackets are increased.