

JEL Classification Numbers
H21, E31, E60

Summary of
WP/93/60

"Collection Lags and the Optimal Inflation Tax:
A Reconsideration" by Alex Mourmouras and José A. Tijerina

It has long been argued that the case for inflationary finance is greatly weakened when allowance is made for lags in the payment of taxes that erode fiscal revenues (Tanzi (1978)). Recently, however, Dixit (1991) has rejected this argument on the basis of a general equilibrium optimal tax analysis. Specifically, he employed a version of Végh's (1989) "shopping time" monetary model with costly income taxation to show that introducing collection lags and allowing the government to recalculate its optimal tax mix may result in unchanged or even higher rates of inflation.

This paper reconsiders the effects of collection lags on the optimal tax menu in a version of Samuelson's (1958) consumption loans model. A Ramsey formula is derived that demonstrates that optimal inflation is (a) proportional to the marginal cost of income tax collections; and (b) inversely proportional to the marginal propensity to consume and the interest elasticity of real money demand. It is also shown that, depending on the specification of the collection cost function and the size of government spending in GDP, collection lags may result in higher, unchanged, or lower rates of desired inflation. Specifically, if real collection costs are a function of real revenues realized, there is a threshold value of the size of government spending in GDP such that the optimal rate of inflation is lower (higher) when lags are present (absent). However, if real collection costs are a function of real revenues accrued, the optimal tax menu does not change in the presence of collection lags.