

somewhat the unfairness of the exemption for overtime pay, there is no way to eliminate that unfairness. In the end, the exemption causes individuals with the same money income to be taxed differently simply because one individual obtained the income from working overtime and the other earned the same amount from working normal hours. That basic unfairness is not removed or even mitigated by the existence of some inverse relationship between leisure and hours worked.

I have not tried to deal here with arguments that call into question the underlying principles of income taxation. In evaluating the Sarkozy plan on fairness

grounds, I think it is proper to start with the assumption that France generally intends to impose an income tax on its taxpayers and is considering a limited departure from that goal in the special case of overtime pay. It is not contemplating the substitution of a consumption tax or an optimal tax or an endowment tax for an income tax. Those arguing for an adjustment to market income on account of some sacrifice of leisure or consumption opportunities or endowment are basically challenging the foundations of the income tax. Interesting issues, to be sure, but they are beside the point, in my view, in evaluating the merits of the Sarkozy plan.

Much of tax policy is deciding what differences in well-being don't matter in assessing tax liabilities. In an income tax, we properly ignore lots of things that might matter in making an overall assessment of an individual's economic position. For example, we ignore wealth, talent, and an ability to eat like a horse without gaining weight unless those attributes are used to produce market gains. For the reasons given above, I believe that different preferences for leisure and different sacrifices of leisure should not matter in assessing tax liability under an income tax. If I am right, then the Sarkozy plan is indefensible on fairness grounds.

A Reply to Professor McIntyre

By Richard L. Schmalbeck

It is far from clear that the Sarkozy plan would provide the stimulus he seeks, and unclear as well whether the plan would have the unfortunate effects on the French labor market that Professor McIntyre predicts. If adopted, the plan would be appropriately viewed as an experiment, and its consequences would require close monitoring. It may also require, as Professor McIntyre suggests, some complementary changes in the French labor laws (which might not be altogether bad).

But I do not share his pessimistic views on this. He seems to have in mind something of a zero-sum labor market in which overtime work by some must deprive others of opportunities to work. That is not impossible, but neither is it inevitable. Unemployment and underemployment usually result from a combination of constraints on market-clearing pricing (e.g., minimum wage laws), and a mismatch between the skills found in the labor pool and the skills sought by potential employers. So it is perfectly plausible that exempting overtime pay could yield higher total output at no loss in either employment or tax revenue. And the secondary effects of greater output—more disposable income and higher profits, for example—could actually lead

to greater employment and revenue.

As for the equity issues, the tax policy advice of long-time Parisian Gertrude Stein—that a dollar is a dollar is a dollar—is the best background principle of taxability. But every tax system finds it wise to make some exceptions. In this case, the proposed exemption of overtime pay targets a decision point that is often a source of significant distortion. Relief of that distortion, rather than equity improvement, is the primary purpose. Still, its effects on taxpayer equity don't seem so bad.

I am not troubled, for example, by Professor McIntyre's comparison of Nicole and Louis. Nicole has extraordinary claims on her "leisure" time (by which we mean simply time not spent in market labor). She is already treated favorably by an income tax that does not impute income for the value of the services she provides to her own household. If her circumstances seem to merit further tax relief, it can be achieved by devices like child-care credits, personal exemptions, earned-income credits, and the like.

This example in fact highlights one important respect in which the Sarkozy proposal would improve equity: A person who works, say, ten hours of overtime each week has that many fewer hours

available to provide services to his household. Had he provided those services to his household—perhaps generating higher levels of cuisine, garden care, and house-keeping—he would not have been taxed on the value thus generated. Exempting overtime achieves a similar tax-free result, producing more equitable treatment between those who provide marginal services at home, and those who provide marginal services in the market.

Finally, as I noted before, concern about the distributional consequences of this proposal is mitigated by the fact that high-income taxpayers—capitalists, actors, athletes, professionals, and executives—rarely work on an hourly basis, and would therefore be largely ineligible for the overtime exclusion.

So the first-order benefits of this proposal would be enjoyed largely by ordinary wage-earners roughly at or below the middle ranges of the income distribution. If it succeeds in stimulating the French economy, of course, the benefits would be more general. The French seem willing enough to experiment with their tax system—witness their on-again-off-again wealth tax over the last twenty years—and this experiment has more promise than most. ■