

Abstract We study a representative agent economy ruled by a benevolent government, and focus on the determination of the optimal size of government and the optimal associated tax rate in an environment in which the government may lack a precommitment technology. We find that if the government can precommit its future actions, it maximizes the welfare of the representative agent in the economy by announcing and implementing a constant tax rate, which we label the "orthodox tax rate". This tax rate turns out to be time inconsistent. Under discretion the government will implement a tax rate that maximizes that period's output. Because of the emphasis on myopic output maximization, we term this the "populist" tax rate. It may be higher or lower than the precommitment optimum, depending on whether the elasticity between private capital and public services in the production function is above or below one. Hence, fiscal populism can be of the standard left-wing variety (discretionary taxes are higher than under orthodoxy) and also of the right-wing variety (discretionary taxes are lower than under orthodoxy). We also explore whether outcomes better than the populist equilibrium can be sustained through the use of trigger strategies. The precommitment outcome may or may not be supported through government reputation depending on parameter values. When the orthodox tax rate cannot be sustained, the best sustainable trajectory of taxes involves a constant tax rate that lies between the orthodox and populist extremes.