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INTRODUCTION

This is the fourteenth issue in the NBER *Tax Policy and the Economy* series. This annual conference communicates new research findings from NBER studies in the areas of taxation and government spending to policymakers in government and to policy analysts in the private sector. The goal of this meeting is to foster interaction between researchers and policymakers in the field of public economics, and I believe that it has been well received in both the research and policy-making community.

One of the pleasures of working in the field of public economics is that there are always new issues to study, and new demands for background research on both emerging and existing policy questions. This year's *Tax Policy and the Economy* volume includes papers on both new issues and more traditional topics. There are papers on the impact of taxation on executive compensation, and on consumer purchases using the Internet. Both of these are tax policy issues that did not attract substantial attention until the 1990s. There are also papers on the economic effects of the capital gains tax, and on estate taxation. These are more traditional issues that have attracted research attention in public economics. Finally, there are two papers on important topics that involve both taxes and expenditure programs: immigration policy and welfare reform. In each paper, the author or authors tackles a well-identified question in tax policy or expenditure program analysis, and presents empirical evidence that is directly relevant to the issue at hand. The goal is to present new research findings, and to summarize existing evidence, in a way that highlights their relevance for the analysis of public policy.

The first paper, by Brian Hall and Jeffrey Liebman, considers "The Taxation of Executive Compensation." The paper addresses three related issues. First, how have taxes affected the growth of stock options rather than cash payments as a primary form of executive compensation? Second, what effect has the tax provision disallowing a corporate tax deduction for executive pay in excess of $1 million for any person, unless that pay is "performance related," had on compensation structures? Finally, how has option exercise by top executives contributed to the apparent sensitivity of taxable income to marginal tax rates? The paper provides useful answers to all of these questions. It argues that taxes play only a modest role in explaining the rise of options in compensation packages, although it concludes that one effect of the $1 million compensation cap has been a shift toward additional use of options packages. The paper also raises new questions about the extent to which expected tax changes, such as those between 1992 and 1993, result in movements of taxable income from one year to another.

Austan Goolsbee is the author of the second paper, on "Internet Commerce, Tax Sensitivity, and the Generation Gap." This paper documents the rapid growth of Internet commerce, and it investigates whether interstate differentials in sales tax rates are related to the buying patterns of consumers in different states. Goolsbee finds that Internet purchasing is more common in states with higher sales tax rates, which is consistent with the view that consumers turn to the Internet in part to avoid paying sales tax on products that are purchased from more traditional retail outlets. The empirical evidence also suggests, however, that there are differences in tax sensitivity between consumers who are new Internet users and those who have used the Internet for several years. Older users are more tax-sensitive, and there is some evidence that as consumers gain Internet experience, they become more tax-sensitive. This finding carries potentially important implications for the evolving structure of revenue yields from state sales taxes.

The third paper and fourth papers are concerned with two of the most active issues in current tax policy debate: capital gains taxes and estate taxes. In "Stock Market Reaction to Capital Gains Tax Changes: Empirical Evidence from the 1997 and 1998 Tax Acts," Douglas Shackelford presents new evidence on how stock prices react to capital gains tax changes. Although some analysts voiced concern when the 1997 capital gains tax reduction was announced that stock prices would decline as investors rushed to sell assets with gains that had previously been "locked in" by the tax, Shackelford finds evidence that points to an opposite-signed effect. When capital gains taxes decline, the market value of companies that generate most of their returns in the form of capital gains, i.e., low-dividend firms, tends to increase. This is particularly clear around the dates of passage of the Taxpaper Relief Act of 1997, although similar effects emerge from analysis of other tax changes as well. The results provide clear evidence that capital gains tax rules have important effects on equity values.

Kathleen McGarry's paper on "Inter Vivos Transfers or Bequests: Estate Taxes and the Timing of Parental Giving" provides a detailed analysis of the tax incentives for making gifts to potential heirs while a donor is alive, and for making them part of the donor's bequest. The tax incentives generally favor lifetime giving, yet most households seem reluctant to make such gifts. They rely instead on substantial gifts as part of their estate. McGarry finds that the prospective estate tax rate that an individual would face if he or she were to die this year has a substantial effect on the probability of making *inter vivos* gifts. She demonstrates that if the estate tax were eliminated, there would probably be a decline in the number of *inter vivos* gifts, and a corresponding increase in the amount of wealth transferred in the form of bequests.

The last two papers focus on important issues in both tax and expenditure program design. The fifth paper, by Alan Auerbach and Philip Oreopoulous, is "The Fiscal Impact of U.S. Immigration: A Generational Accounting Perspective." This paper extends the well-known generational accounting framework, which provides a powerful means of analyzing the long-term fiscal effects of different tax policies and expenditure programs, to incorporate plausible assumptions about future immigration patterns. It then uses this framework to study the fiscal-policy effect of different immigration policies. The results show that the net impact of future immigration on the lifetime tax burden of current citizens depends in an important way on the age and skill composition of the future immigrants. In addition, the impact of future immigrants depends on assumptions about the structure of future fiscal policy and on the timing of taxes versus future expenditure flows. This paper also documents the substantial change in the net fiscal position of current generations that has resulted from favorable economic growth in the last few years and from revisions to the long-term budget outlook for the U.S. federal government.

The last paper is by Pamela Loprest, Stefanie Schmidt, and Ann Witte. It considers "Welfare Reform Under PRWORA: Aid to Children with Working Families?" This paper documents the very substantial changes in the structure of U.S. welfare policy that were enacted in the 1996 welfare reform legislation (the Personal Responsibility and Work Opportunity Act). The paper focuses on the switch from Aid to Families with Dependent Children, a previous transfer program, to Transitional Assistance for Needy Families (TANF), and the incentive effects of this program reform. It also considers the substantial change in incentives for low-income families to obtain child care, and in the associated impact of such changes on labor-market behavior for the adults in such households. The paper shows that since the enactment of the 1996 welfare reform, there has been an increase in the fraction of low-income families with children in which there are working adults, and a coincident decline in the total number of recipients of welfare benefits. These changes are likely to be in part the result of the new incentives created by the legislative reform, but identifying these effects precisely is difficult at this point.

The papers in this volume illustrate the type of policy-relevant research that is carried out by the affiliates of the NBER Public Economics Program. Each of the papers provides important background information for policy analysis, without making recommendations about the merits or demerits of particular policy options. I hope that each of these papers will provide useful input to various participants' policy process who are concerned with tax and expenditure program design.

ACKNOWLEDGMENTS

In planning and organizing this year's *Tax Policy and the Economy* conference and the associated volume, I have incurred debts to many. Martin Feldstein, President of the NBER, has been an active supporter of this activity through its fourteen-year history. Julie Peters at NBER has been very helpful in carrying out a thorough updating of the invitation list for our annual Washington conference, and in disseminating information about the conference to potential participants. The NBER Conference Department, particularly Conference Director Kirsten Foss Davis, Rob Shannon, and Joel Whalen, have organized the conference logistics with their usual efficiency and extraordinary good cheer. Helena Fitz-Patrick has overseen the publication process with outstanding attention to detail and with exceptional speed and efficiency.

I am also grateful to Eugene Steuerle, who is a Senior Fellow at the Urban Institute, for delivering a fascinating set of luncheon remarks at the conference at which these papers were presented. His talk provided many important insights into the interplay between government fiscal rules, particularly rules that one legislature enacts in order to bind the choices of a future legislature, and the opportunity for policy innovation and design.

Finally, I wish to thank each of the authors whose papers are included in this volume for striving to communicate their important research findings in a readable and clear fashion. I appreciate their efforts and willingness to participate in this very important opportunity for interchange between academics and policymakers.