INTRODUCTION

Fifteen years ago, the NBER started the Tax Policy and the Economy series as a vehicle for communicating current findings from NBER research in the areas of taxation and government spending to policy analysts in both the government and the private sector. The research presented at these meetings has addressed a wide range of issues. Some of this work has had immediate bearing on policy and related to topics in the current policy debate, while other research has focused on long-run issues that underlie many aspects of policy discussion.

The papers in this year’s volume span a range of topics. Some, such as the paper on foreign sales corporations, are directed at policy debates that may be resolved very shortly. Others, such as the papers on social security reform and the budgetary implications of Medicare, are likely to remain part of the policy dialogue for a very long time. Four of the papers focus on issues in tax policy, while two address expenditure-side topics.

The first paper, by David Ellwood and Jeffrey Liebman, considers “The Middle-Class Parent Penalty: Child Benefits in the U.S. Tax Code.” The authors explain that middle-class families currently receive smaller tax benefits for their children than do families with higher or lower incomes. Those in lower income brackets qualify for the Earned Income Tax Credit, while those with higher incomes receive larger tax benefits from their personal exemptions for dependents. The phase-out of tax provisions like the Earned Income Tax Credit also has the effect of raising the marginal tax rates facing some middle-income parents. After documenting the very substantial disparities across income groups in the tax consequences of having children, Ellwood and Liebman consider several different reform proposals that would modify the current tax structure and reduce the differences in child subsidies across income strata.

The next paper, by Mihir Desai and James Hines, explores “The Uneasy Marriage of Export Incentives and the Income Tax.” This paper addresses
a very topical set of policy issues. It begins by summarizing the current, and historical, provisions of the U.S. corporate income tax code that affect American exporters. The authors explain that for several reasons, conventional estimates of the revenue cost of these provisions may significantly understate their true cost. The paper then presents evidence that past changes in U.S. tax policies that affect exporting firms have had substantial real effects. The repeal of domestic international sales corporations (DISCs) and the introduction of foreign sales corporations (FSCs) in 1984 appear to have reduced U.S. manufacturing exports. The initiation of the European Union’s 1997 complaint to the World Trade Organization regarding FSCs was associated with a decline in the share prices of large U.S. exporters.

In the third paper, Andrew Mitrusi and I report new findings on “The Changing Importance of Income and Payroll Taxes on U.S. Families.” We show that during the last two decades, changes in the federal income tax such as the expansion of the Earned Income Tax Credit have reduced the relative importance of income taxes, in comparison with payroll taxes, for many low- and moderate-income families. Payroll taxes currently exceed personal income taxes for 73 percent of all families with some tax liability. In 1979, the proportion was only 49 percent. Our paper explores differences across different types of families in the relative income tax and payroll tax burdens, and it also compares the marginal payroll tax and income tax rates for families at different points in the income distribution.

The fourth paper, and the last concerned with taxation, is “Personal Income Taxes and Growth of Small Firms.” This paper has four authors: Robert Carroll, Douglas Holtz-Eakin, Mark Rider, and Harvey Rosen. It compares the receipts of small proprietorships (individuals filing Schedule C income tax returns) before and after the enactment of the Tax Reform Reform Act of 1986. Because TRA86 sharply reduced marginal tax rates on some taxpayers, it provides a valuable opportunity for studying how tax rates affect small firms. The results suggest that higher marginal tax rates are associated with lower receipts for such firms, and the authors interpret this evidence as supporting a negative relationship between marginal income tax rates and firm growth.

In the fifth paper, Martin Feldstein and Elena Rangelova consider “Accumulated Pension Collars: A Market Approach to Reducing the Risk of Investment-Based Social Security Reform.” Their analysis focuses on a very specific issue that has arisen in the ongoing policy debate about “private accounts” alternatives to the current defined-benefit social security system. If retirement benefits are tied to account balances, and if workers have an opportunity to invest their accounts in corporate
stock or other risky securities, then there is a chance that their benefits might fall below the level promised by the current defined-benefit Social Security system. Some individuals might be unwilling to take this risk, even if their expected benefits are greater than those under the current system. To address this concern, Feldstein and Rangelova investigate the potential cost of buying an insurance contract that would guarantee a prespecified level of retirement benefits. Their particular insight is that by agreeing to forgo some of their retirement benefits in the event of favorable stock market realizations, potential retirees can pay for insurance against adverse outcomes. This implies that the retirement insurance contract is essentially a pair of options on the value of the stock market. The individual purchases a put option, which pays off if the stock market is low, and sells a call option, which pays off when the stock market does well. The authors use standard option-pricing methods to investigate the prices at which individuals might be able to purchase put options and sell calls. They show that by giving up their claim on some but not all of the favorable return outcomes associated with investments in individual accounts, it might be possible for individuals to purchase put options that would lock in all, or most of, the retirement benefits promised by current law.

The final paper is Mark McClellan’s study of “Medicare and the Federal Budget: Past Experience, Current Policy, Future Prospects.” In this paper, McClellan explores the most important sources of uncertainty that arise in making long-term forecasts of Medicare spending. These include the future path of age-specific Medicare expenditure per beneficiary, mortality improvements that affect life expectancy and morbidity at old ages, and changes in the age structure of the population that affect the tax base relative to the expenditure needs of the program. The author argues that modest changes in some of the parameters that underlie Medicare forecasts, changes that are well within the range of current forecast uncertainty, could yield substantially different budgetary outcomes than current forecasts suggest. The paper concludes with a discussion of the budgetary consequences of several proposed changes to Medicare, including the currently-discussed expansion of the program to pay for prescription drugs.

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 in the policy process who are concerned with tax and expenditure program design.
ACKNOWLEDGMENTS

In planning and organizing this year’s Tax Policy and the Economy conferences and the associated volume, I have incurred debts to many individuals. Martin Feldstein, president of the NBER, has been an active supporter of this conference throughout its fifteen-year history. Jennifer Dayton at NBER did an outstanding job in updating the invitation list and in disseminating information about the conference to potential participants. The members of the NBER Conference Department, notably Rob Shannon and Lita Kimble, handled conference logistics with their usual efficiency and extraordinary good cheer. Helena Fitz-Patrick oversaw the publication process with outstanding attention to detail and with exceptional speed and efficiency.

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I am also grateful to Hugh Ault, a professor of law at the Boston College Law School and a special advisor to the OECD, 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 rapid changes in tax policy that are currently taking place in Europe. He outlined the latest developments in the European community’s “harmful tax competition” initiative and described how the OECD and various member states are working to reduce the role of tax havens in sheltering individual and corporate income taxes. He explained more
generally how the growing internationalization of capital and labor markets is affecting tax policy design. His discussion of global tax issues provided an important complement to the domestic focus of most of the papers at the conference.

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.