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Introduction

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The annual NBER Tax Policy and the Economy conference is designed to communicate current academic research findings in the areas of taxation and government spending to policy analysts in government and in the private sector. Research papers for the conference are selected both for their immediate bearing on current policy debates as well as for their insight on broad questions that are of longer-term interest.

The papers in this year’s volume focus on a range of topics involving both taxation and social insurance policy. The first two papers are concerned with the implicit taxes associated with Medicaid and unemployment insurance, two important social insurance programs. The first paper is Jeffrey R. Brown, Norma B. Coe, and Amy Finkelstein’s “Medicaid Crowd-Out of Private Long-Term Care Insurance Demand: Evidence from the Health and Retirement Survey.” The authors observe that the Medicaid program imposes a substantial implicit tax on the benefits paid by private long-term care insurance policies. Because Medicaid covers many long-term care costs once a prospective beneficiary’s assets fall below an asset eligibility requirement, those who purchase private long-term care insurance in many cases are simply postponing the date at which they become eligible for Medicaid. The net benefits of purchasing private insurance are therefore smaller than the gross benefits; the difference is the implicit Medicaid tax. The authors demonstrate that while the Medicaid program exerts a negative effect on the demand for private LTC insurance, the effects of changing the asset eligibility thresholds are modest. Even if the Medicaid eligibility thresholds were lowered by about $25,000, LTC insurance demand would rise by less than 3 percentage points. While that represents a 30 percent increase from current levels, it would still imply a very low overall coverage rate for private long-term care insurance in the elderly population.
In the second paper, "Unemployment Insurance Savings Accounts," Martin Feldstein and Daniel Altman consider an alternative to the current means of providing income support to unemployed workers. They analyze a system of individual accounts that would be funded by employer contributions while the individual was working, and drawn down when the individual was unemployed. Unlike current public unemployment insurance systems, however, which pool all employer contributions and pay benefits to all claimants, "UISAs" would involve dedicated accounts for each worker. A worker who never needed to draw on her account to provide income support while unemployed would be able to cash out the account balance at retirement. This provision changes the beneficiary's incentives for job search, since finding a job more quickly would provide a greater payout at retirement. A key question about individual-accounts unemployment insurance plans is whether a relatively small number of individuals experience most of the spells of unemployment, and consequently have zero account balances when they need to draw on their individual funds. A high concentration of unemployment spells means that a system of self-insurance over time will not be able to replicate the current pattern of benefit payments while unemployed. The authors use data from the Panel Survey of Income Dynamics to investigate the performance of a hypothetical UISA system and find that roughly two-thirds of UI benefits are paid to individuals with positive UISA balances at the time of their unemployment spell. This suggests that UISAs offer substantial potential to improve the job search incentives of unemployed individuals, while providing income support to a large fraction of the unemployed population.

The third paper addresses the tax treatment of health insurance expenditures, an issue that involves both tax policy and social insurance concerns. In "Evaluating Effects of Tax Preferences on Health Care Spending and Federal Revenues," John F. Cogan, R. Glenn Hubbard, and Daniel P. Kessler present new estimates of how excluding employer-provided health insurance from taxable income affects the structure of health insurance demand. Many studies have examined what would happen if employer-provided health insurance payments were included in taxable income, thereby placing health outlays financed from such insurance on a similar tax footing as out-of-pocket medical expenditures. This paper focuses on a different approach to reducing the distortion in favor of care financed by employer-provided insurance: allowing out-of-pocket health care expenditures to
be deducted from taxable income. This approach would provide a tax subsidy to all health care outlays, regardless of financing method, and it would remove the incentive for financing through employer-provided health insurance. The authors examine how such a change would affect out-of-pocket health care spending, as well as federal tax revenues. They highlight the key behavioral parameters, such as the elasticity of health insurance demand with respect to its price, and the elasticity of participating in employer-provided insurance with respect to its after-tax cost, in determining the effect of expanding the tax deduction. The authors also apply their framework to evaluate the incentive effects of Health Saving Accounts (HSAs), which currently provide a tax-favored mechanism for taxpayers to finance out-of-pocket medical outlays.

The next paper, by Laurence J. Kotlikoff and David Rapson, explores one of the most central questions in public finance: what are the effective marginal tax rates on labor supply and saving? In "Does It Pay, at the Margin, to Work and Save? Measuring Effective Marginal Tax Rates on Americans' Labor Supply and Saving," the authors model the incentive effects of many different tax structures and means-tested benefit programs to estimate the effective tax rates facing households who earn another dollar of income or decide to save another dollar. The paper focuses on marginal tax rates in a lifecycle setting, and it is more comprehensive than previous work in its detailed analysis of transfer program rules as well as tax schedules. The paper demonstrates that there are a wide range of potentially applicable marginal tax rates, and raises questions about the capacity of many taxpayers to understand the tax rules that they face. The authors note that for some households, particularly those at lower income levels where transfer program phase-outs are in effect, the implied tax rates on labor supply may be very high. Whether the affected households recognize these high marginal tax rates remains an open question. The authors also consider the benefits of contributing to tax-deferred retirement accounts. They find that for high-income taxpayers, the tax benefits associated with contributions are high, and that there are substantial opportunities to increase lifetime consumption levels by participating in these programs.

The final paper, "Federal Tax Policy towards Energy" by Gilbert E. Metcalf, is a careful catalogue of the wide range of tax expenditures that affect incentives for energy exploration, production, and consumption. The paper discusses the economic rationale for tax incentives targeted to energy industries and focuses on a variety of externality issues in energy markets. It then examines the distributional effect of current
energy-related tax policies. The paper discusses a wide range of energy policies, including the depreciation provisions that apply to capital equipment used in the production of various forms of energy and the taxes that apply to various end-stage users of energy products. The paper examines policies that bear on electricity production in particular detail. It suggests that relative to the cost of using different generation technologies in a no-tax setting, the current tax structure provides a net subsidy to the use of wind and biomass production technologies, making them after-tax cost competitive with generation of electricity using natural gas. While solar power technologies receive the largest subsidies, the net-of-tax cost of these generation methods is still substantially greater than the cost of other technologies.

Each of these papers illustrates the type of policy-relevant research that is carried out by the affiliates of the NBER Public Economics Program. These studies provide important background information for policy analysis, but they do not make recommendations about the merits or demerits of particular policy options. They will hopefully provide a valuable basis for both near-term and long-term policy discussions.