Introduction

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The six papers in the issue of Tax Policy and the Economy are all directly related to important issues concerning the U.S. tax system, its transfer system, and issues related to its design and effects on revenues, expenditures, and economic behavior.

In the first paper, Andreoni provides a study of Donor Advised Funds (DAFs), which are financial vehicles offered by investment houses, community foundations, and other charitable organizations to provide savings accounts for tax-free charitable giving. A substantial share of charitable giving, more than 10 percent, flows through these funds every year. Giving deposited in a DAF can be taken immediately as a tax deduction by the giver but the DAF sponsor can save and invest the donation to dole out to qualified charities later, at the discretion of the original giver. Breaking the link between when the donor makes a deductible contribution and when it is disbursed to a recipient provides flexibility in timing and allow smoothing of contributions relative to income. The DAFs also have advantages of convenience and can also serve as commitment devices. They can also be used to reduce exposure to capital gains taxation by strategically contributing appreciated assets to the DAF, thus avoiding both income and capital gains taxes. Because tax savings are higher for those in higher income tax brackets and who have more non-cash assets with significant capital gains to contribute. DAFs are of most advantage to high income individuals. Using data which allow him to estimate rates of return to funds in DAF savings accounts as well as data on how long the funds stay in the accounts before being disbursed, Andreoni shows that the relative size of benefits and costs of DAFs to society (rather than to the individual) hinges on how much new charitable donations they generate, as well as on rates of return, discount rates, the percent of assets in capital gains, and other factors. Some
simple analyses conducted by the author surrounding the 2013 changes in income and capital gains tax rates suggest that the amount of new donations generated may not be sufficiently large to outweigh the tax cost.

In the second paper, Hoxby uses data from IRS tax returns and other forms combined with data reported by post-secondary educational institutions to analyze the use of tax credits by students enrolled in online post-secondary education. Hoxby finds that the number of students enrolled in online post-secondary institutions is high and growing, and that they account for some of the highest uses of federal tax credits. For-profit educational institutions account for the bulk of enrollments and tax expenditures. Another important finding is that the type of student enrolled in online post-secondary education is quite different than the traditional school-age student studying full time and living residentially at the educational institution, for online students tend to be older, to often be employed, to more often be their own tax filer, and to not reside at the institution. Their enrollment episodes are often short, including cases where tuition is paid but the student does not complete the course or program. Take-up of tax credits varies across the type of student and the type of credit but, on average and over all types of institutions, is fairly high but less than 100 percent. Hoxby also examines trends in individual labor earnings from before to after taking the credit, finding that the changes vary with type of institution. Based on these findings, Hoxby outlines several practical steps that might improve the administration of the credit, the accuracy of reporting, and takeup.

Rees-Jones and Taubinsky survey some recent literature on psychological biases by taxpayers that lead to incorrect perceptions and understanding of tax incentives. They present an analysis of how such biases affect optimal tax rules, an old and venerable topic in the economics of taxation. The literature they review shows evidence of confusion, adoption of heuristics, and
salience, as well as specific forms which result in ironing and spotlighting. They then go on to show that the presence of these biases disrupts the common two-stage procedure of first deriving optimal tax incentives under a direct mechanism, and then reverse engineering the tax system that induces those incentives. Depending on the nature of the biases, their presence can enhance or reduce welfare under optimal policies, and thus provide useful policy levers for the social planner in some circumstances. More generally, they show that optimal tax formulas can have different effects depending on the exact form of their implementation. In one application, they show that the deviations from the classical Ramsey approaches to tax analysis introduced by information asymmetry may be mitigated in the presence of bias. They conclude by suggesting that an approach to optimal taxation using sufficient statistics may be more fruitful to simultaneously solve the problem of optimal tax formulas combined with implementation, optimized over a limited set of tax instruments.

Clemens and Ippolito provide new research on the implications of block grant reforms of the Medicaid program for receipt of federal support for different states. The Medicaid program currently has an open-ended matching structure where a fraction of additional state expenditures on the program are paid for by the federal government, whereas block grants cap the federal subsidy in differing ways. Some block grant programs cap the per-beneficiary amount that the federal government will pay and make that cap the same across all states, but some block grant proposals adjust the federal subsidy by a measure of state need. Block grant proposals also differ in whether, and how, they are adjusted over time and whether they are adjusted during business cycles. The analysis of Clemens and Ippolito shows that there would be extremely large gains and losses by different states in the amount of federal funds received relative to the current Medicaid program, losses in some cases exceeding 10 percent of states’ own-source revenues in
a uniform need-based block grant. They also show that block grant structures not adjusted for business cycle conditions could significantly increase the exposure of state budget to stress during recessions. Finally, the authors provide a discussion of how adjustments in block grants affect state incentives to make adjustments on the extensive margin (number of beneficiaries) versus the intensive margin (expenditures per beneficiary).

In his paper, Samwick addresses the issue of means-testing of Medicare and federal health benefits under recent legislation. He notes that the Medicare Modernization Act of 2003 introduced means-testing of Medicare and that the Affordable Care Act of 2010 introduced premium subsidies which are inversely related to income, and in both cases the measure of income is as of the current year. Samwick considers an alternative measure of means which is a long average of covered earnings, similar in spirit to what is used for old-age retirement benefits. He notes that use of current income provides an incentive to reduce savings and work, an incentive to manipulate the level and composition of income, as well as being a noisy measure of ability to pay. All these effects would be reduced if a measure of average earnings were used instead (although current income could be a better provider of insurance against short-term fluctuations in income). His analysis of data from the Health and Retirement Study shows that current income fluctuates enough that there is considerable short-term variation in the Medicare premium for those who pay it, much more than if average earnings were used, and that current income is often not highly correlated with lifetime earnings. He finds similar larger variation in current income used to determine ACA subsidies relative to lifetime average earnings. Samwick suggests more research into this issue and for future studies to address possible behavioral responses to the nature of income testing.

Meyer and Mok provide a comprehensive examination of the incidence and effects of
disability among U.S. women from 1968 to 2015, studying the impacts of disability on income, consumption, and public transfers as well as its incidence. They note that most research on this issue has concerned men rather than women and has emphasized the work disincentives of programs. They find that women are actually more likely than men to have experienced a disabling event in the early part of their lifetime but the nature of the disability tends to be less severe than that of men. For both men and women they find that a disabling event results in a decline in income and consumption but the magnitudes are smaller for women and depend on the nature of the disability. However, women who experience disabling events have lower than average levels of income and consumption even prior to disability than men and hence are drawn from a more disadvantaged population. They also find that reductions in income and payroll taxes, and the receipt of public transfers, after a disabling event has a major effect in cushioning the effect of disability on income. The largest transfers come from the Social Security Disability Insurance and Supplemental Security programs but Workers’ Compensation and food stamp receipt play an important role as well.