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Introduction

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The 2005 Tax Policy and the Economy conference marks the twentieth anniversary of this very popular and productive series. This conference was first suggested by Martin Feldstein in the mid-1980s, and it was organized initially by Lawrence Summers. The late David Bradford subsequently organized several meetings. For the last fifteen years, I have had the pleasure of arranging the programs for this meeting. The annual conference communicates current academic research findings in the areas of taxation and government spending to policy analysts in government and the private sector. The papers presented at this conference address issues with an immediate bearing on current policy debates as well as questions that are of longer-term interest. This conference has served as a model for researchers in other fields who are interested in bringing their applied research findings to the attention of policy analysts. A number of the papers that were written for this conference series have introduced important analytical tools or suggested durable empirical or conceptual insights about the economic effects of tax and expenditure programs.

Most of the papers in this year's volume focus on the economic effects of taxation, and the last paper presents important insights on the balance between expenditures and revenues. The first paper is Alan J. Auerbach's "Who Bears the Corporate Tax? A Review of What We Know." Public finance economists have debated the incidence of the corporate income tax for many decades. Arnold Harberger's celebrated analysis of this tax remains one of the best-known papers in public economics. Despite many years of research, however, there is still no consensus on who bears the burden of this tax. Different models suggest different results, and conclusive empirical tests of the alternative models have proven elusive. This comprehensive survey paper uses several different models of investment and financing behavior to evaluate the distribution of the burden of the corporate income tax. The paper catalogs what is known, and what remains unknown, about this tax. The paper is likely to become the starting point for almost all further discussions, in both policy analysis and in research, of the corporate income tax.

The next paper is Julie Berry Cullen and Roger Gordon's study of "Tax Reform and Entrepreneurial Activity." There is broad agreement that entrepreneurial activity is an important determinant of long-run economic growth, but much less agreement exists on how such activity is affected by government policy. This paper systematically examines a number of provisions of the personal income tax, the corporate income tax, and the payroll tax that may affect an individual's choice between working as a salaried employee or as a self-employed entrepreneur. The authors emphasize that the interaction between various tax provisions can be important for assessing the incentives for entrepreneurial activity. They demonstrate that the tax system's net incentive to become an entrepreneur varied substantially between 1980 and 2000. The 1986 Tax Reform Act and the 1994 reduction in the capital gains tax rate on gains on stock in small businesses had particularly large effects on these tax incentives. The authors also present empirical results on the potential impact of several tax reforms on the level of entrepreneurial activity. Their results suggest that a shift to a single-rate income tax structure would encourage entrepreneurial activity at low-income levels while discouraging it at high-income levels. They also find that changes in the tax rates at which losses can be deducted are at least as important as capital gains tax rates in determining incentives for entrepreneurship.

The third paper is Nada Eissa and Hilary W. Hoynes's study of "Behavioral Responses to Taxes: Lessons from the EITC and Labor Supply." The EITC is the largest cash anti-poverty program in the United States. It affects nearly 20 million families and costs roughly $40 billion per year. Because the EITC is administered through the tax system and because it can substantially change the marginal tax rate that applies to a household's labor income, a number of studies have tried to evaluate the effect of the EITC on labor supply. This paper provides new evidence on this issue and reviews the central findings from earlier studies. The paper points to two robust findings that emerge from the existing research and corroborates these findings with new data analysis. First, the labor supply subsidies that are provided to families with the lowest earning levels appear to encourage labor supply. This is consistent with the traditional theoretical analysis of how a wage subsidy should affect labor market activity. The second finding, however, is not as easy to reconcile with theoretical modeling of labor supply. The increases in marginal income tax rates on some families that fall into the phase-out region of the EITC do not appear to discourage labor supply. This is puzzling because the high marginal rates reduce the marginal return to an additional hour of work. The authors discuss several potential explanations for this puzzling but robust empirical finding.

The next paper, by Sondra Beverly, Daniel Schneider, and Peter Tufano, is "Splitting Tax Refunds and Building Savings: An Empirical Test." This paper examines the potential impact of changes in the administrative treatment of tax refunds on the saving behavior of low-income households. A large fraction of the traditional policy debate surrounding tax incentives and saving focuses on the behavior of middle- and high-income households who might vary the share of their income that they save in response to tax incentives. This paper suggests that the rules surrounding the payment of income tax refunds may affect wealth accumulation by low-income households. Current tax administration rules require that a taxpayer's refund be directed to a single recipient. That could be the taxpayer, who would receive the refund in the form of a check, or it could be a single financial institution. This paper reports findings from a pilot experiment in Tulsa, Oklahoma, in which low-income households were allowed to split their tax refunds, asking in particular for part of the refund to be directed to a savings account at a financial institution and part to be returned to them. The results suggest that the flexibility provided by refund-splitting leads a substantial group of taxpayers to contribute some of their refund to a savings account. The empirical findings in this study suggest an intriguing and feasible way to try to increase saving and wealth holdings among low-income households.

The fifth paper, which Jeffrey R. Brown and I co-wrote, is "Household Ownership of Variable Annuities." Variable annuities were one of the fastest-growing financial products of the 1990s. They provide buyers with a wide range of investment options and with an opportunity to defer taxes on investment income through the "inside buildup" that is associated with investment products. This paper summarizes the tax treatment of variable annuities and explains how the after-tax returns on these products, relative to the returns on other financial instruments such as mutual funds, are affected by marginal tax rates on dividends, capital gains, and ordinary income. The paper then examines data from the 2001 Survey of Consumer Finances to evaluate the concentration of variable annuity ownership among households in the highest income tax brackets. The paper finds that the probability of owning a variable annuity is higher for those in higher marginal tax brackets than for those in lower brackets, but the relationship is not monotonic. The ownership probability for those in the highest marginal tax bracket is lower than that for taxpayers in slightly lower tax brackets. Ownership of variable annuities is somewhat more diffuse than the ownership of a number of other financial products. Households in the top 10 percent of the wealth distribution in 2001 owned 73 percent of all variable annuities, compared with 90 percent of corporate stock, 79 percent of mutual funds, and 90 percent of tax-exempt bonds.

Finally, the last paper is Jagadeesh Gokhale and Kent Smetters's analysis of "Fiscal and Generational Imbalances: An Update." This paper presents new evidence on the long-run fiscal position of the federal government. The authors base their calculations on estimates of the rate of economic growth, population growth, the evolution of the population age structure, and the rate of growth of health care outlays relative to other components of gross domestic product. They evaluate the present discounted value of both tax revenues and federal expenditure commitments under current law. Their findings suggest a substantial imbalance between spending and revenues. Their best estimate of current fiscal stance suggests that the present discounted value of projected outlays exceeds the corresponding present discounted value of revenues by $63 trillion. This is substantially greater than the authors' previous estimate of $44 trillion, which was based on policies in place and economic projections in 2003. The enactment of the Medicare prescription drug benefit is the largest factor contributing to the worsening of the projected fiscal position.

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, without making recommendations about the merits or demerits of particular policy options. We hope they will provide a valuable basis for policy discussions both in Washington and in the broader policy community.

Acknowledgments

In planning and organizing this year's Tax Policy and the Economy conference and the associated volume, I have incurred debts to many individuals. NBER President Martin Feldstein has been an active supporter of this conference throughout its history. Conference Department Director Carl Beck, Lita Kimble, and especially Rob Shannon have continually helped to keep our invitation list up to date and handled conference logistics with efficiency and good cheer. Helena Fitzpatrick has overseen the publication process with outstanding attention to detail and with exceptional speed and efficiency.

I am grateful to Dr. Ben Bernanke, the Chair of the Council of Economic Advisers, for delivering a fascinating set of luncheon remarks at the conference at which these papers were presented. Ben's remarks focused on the role of federal economic policy in contributing to economic recovery in the wake of the disaster caused by Hurricane Katrina. His remarks focused on broad macroeconomic themes, such as the importance of tax policy in contributing to long-run economic growth, as well as on particular policy design issues associated with disaster relief.

Finally, I wish to thank the authors of this year's conference papers. They have worked hard to communicate their important research findings in a readable and clear fashion. I appreciate their efforts and their enthusiasm for participating in this interchange between the research and policy communities.