Introduction

Robert A. Moffitt, Johns Hopkins University and NBER

The five papers in this issue of Tax Policy and the Economy are all directly related to important issues concerning U.S. taxation, transfers, and federal aid.

In the first paper, Natasha Sarin, Lawrence Summers, Owen Zidar, and Eric Zwick revisit how capital gains tax reform should be scored by the Joint Committee on Taxation, meaning how changes in capital gains tax rates affect revenue raised. Many scoring estimates assume highly elastic responses of capital gain revenues to changes in rates and often forecast that increases in those rates may raise little revenue because of large offsetting reductions in capital gains realizations. The authors suggest that these response forecasts may far exceed what actual responses would be for a number of reasons. One is that investors may simply change the timing of their realizations, generating short-run revenue losses, but which result in large realizations in later years. Another is that, today, more than half of capital gains realizations are from pass-through entities and mutual fund distributions which are likely to be relatively inelastic with respect to capital gains rates. Realizations from these and other less elastic forms should also get bigger weight in the score because they are now a larger fraction of realizations. Capital gains rates closer to those for ordinary income may also reduce the distortionary effects of disparate rates arising from the substitution of capital income and other forms of income.

Suggestive simulations by the authors which account for these features suggest that the revenue increases from raising capital gains rates by even 5 percent might be several times larger than official score-keeper estimates.
In the second paper, Suresh Nallareddy, Ethan Rouen, and Juan Carlos Suárez Serrato study the effects of corporate taxation on income inequality. Their exercise uses cross-state variation in corporate tax rates and how income inequality in a state changes following a reduction in those state-level rates. Examining this relationship using a variety of different econometric techniques, the authors find that tax rate reductions increase income inequality. The authors’ measure of inequality is the share of income going to a top percentile of the income distribution, and they find that the increase in that share following a cut in corporate taxes arises from increases in income at both the bottom of the income distribution and at the top, but a disproportionately larger increase for the latter than for the former. Examining forms of income, Nallareddy and coauthors find that the larger increase in income among those at the top of the income distribution arise in part because, while earned income decreases slightly at the top, capital income gains at the top more than offset those decreases. In addition, capital income does not increase at all at the bottom. These results suggest that those with high earnings shift income from wage income to capital income following a tax cut.

Alan J. Auerbach and William G. Gale, in the third paper, note that interest rates on government debt have experienced a long-term decline, and ask what implications this might have for tax policy design. The authors argue that at least four important issues in tax policy design are affected when sustained low interest rates are experienced. The first is the relative merits of income and consumption taxation, each of which has elements that affect different forms of income differently. The authors argue that the differences in tax burden and efficiency shrink when interest rates are low. A second is the relative merits of wealth taxation and capital income taxation, which can be analyzed by realizing that a wealth tax rate has an equivalent capital income tax rate, but which is higher as interest rates fall. Auerbach and Gale argue, as
interest rates fall, a given wealth tax rate becomes more distortionary relative to a given capital income tax rate. A third issue in taxation that is affected when interest rates are low is the relative merit of different forms of depreciation deductions offered by the tax authority to firms. Interest rates affect the relative impacts of immediate versus spread out depreciation deductions, for example, and hence a reduction in interest rates reduce the differences between the two forms. Finally, a fourth aspect of taxation affected by low interest rates concerns carbon abatement policies with, say, the benefits and costs of a carbon tax an important question for the merits of such a tax. The authors argue that, because the benefits are so backloaded, and occur at such different times as the costs, a reduction in interest rates enormously increases the benefits of such taxation relative to its costs.

The next paper, by Nora E. Gordon and Sarah J. Reber, examines the substantial federal relief to school districts during the COVID-19 pandemic. Gordon and Reber ask whether the aid was sufficient to cover the likely costs of COVID-19 mitigation and recovery and how that varies across types of districts. The authors note that the aid was distributed to school districts using existing formulas that favored high-poverty districts relative to lower-poverty ones. The authors argue that the pandemic impacted costs in high-poverty districts more on average, compared to their lower-poverty counterparts. Gordon and Reber simulate the net fiscal impact under four scenarios with different assumptions about how the pandemic affected costs and revenues. They estimate that, on average, high poverty districts received more in aid than they needed to cover additional costs related to COVID-19, and many low-poverty districts experienced small to moderate shortfalls because estimated pandemic-related costs were larger than federal aid. The authors note that many high-poverty districts have longstanding unmet needs, including for capital investments, and suggest that such districts could use the surplus
funds to address those needs. They argue that state governments are generally in a good fiscal position and could assist low-poverty districts to cover their pandemic-related costs.

In the final paper, Jacob Goldin, Elaine Maag, and Katherine Michelmore study the fiscal cost of reforms to the federal Child Tax Credit (CTC) that have recently appeared in policy discussions. The authors note that a common criticism of the CTC as it existed in most years since it was enacted in 1997 is that limitations on the amount of the credit that could be received by families with low income (the so-called “nonrefundability” provision) meant that low income families received little or nothing from the credit, and far less than higher income taxpayers. They consider the costs of three different expansions of the CTC—one that removes those limitations (restoring “full refundability”), one that also increased the size of the credit, and one that does not phase it out with income but instead makes it universal. The authors calculate the direct fiscal cost of each expansion but also estimate two other costs—the increased cost resulting from labor supply reductions, but also the likely decreased cost arising from higher adult earnings of children in families receiving the credit, an effect revealed by recent research. The authors find that the direct costs of the three variations rise with its expansion—higher benefits raise costs relative to just restoring full refundability, and a universal credit raises costs even more. They also find that in none of the three expansions are increases in costs from reduced labor supply very large as a percent of the direct cost. But they find that the reduction in costs from higher child earnings in the future often reduce fiscal costs by 15 to 20 percent.