Tax Policies, Tax Analysis, and the NTA: Progress and Prospects

At the beginning of his NTA presidential address in 2006, Joel Slemrod related the advice he had gotten from NTA Executive Director Fred Giertz: the address could cover a substantive topic in public finance or a policy issue, or just be a paean to the NTA, but the most important thing was to keep it short. As my title suggests, I plan to cover all the topics Fred suggested, but I will also keep my address short. So I will attempt to provide an overview of the progress and prospects on each topic using a few specific examples that I think are representative. (Too many data points might get in the way of my conclusions.)

The NTA

I begin with the NTA, and use the Annual Conferences over my career to illustrate its progress and prospects. I joined the NTA in 1970, but the first Annual Conference I attended was the one held in Washington, DC in 1972. The Conference was held in early October and covered three and a half days (Monday through noon on Thursday). Planning for the Conference was done by a finance committee of five members (all businessmen) and by a five-member program committee. While the program committee was small by later standards, the program was quite limited: there were five general sessions (one of which was held in the evening), but only two time periods for concurrent sessions, with only two sessions (of three papers) in each. So there was a total of only nine sessions, conducted at a leisurely pace, leaving time for sightseeing and golf.

Flash forward 28 years to our last Annual Conference in Santa Fe in 2000. Like this year, the Conference met in early November over two and a half days, Thursday through noon on Saturday. There were two general sessions (excluding the business meeting), and a period for meetings of the various standing committees (e.g., on federal taxation) of the membership. The six concurrent session periods each featured three sessions, with one of these sessions dedicated to the tribute for Holland Medal winner John Due. So there was a total of 20 sessions (not counting the committee meetings, which sometimes included presentations of papers).

This year, one of the general sessions is dedicated to the tribute to this year’s Holland Medal winner, Jim Poterba, and there are no longer standing committees. This left eight time periods for concurrent sessions, and all but one have eight sessions (the other has seven). So there is a total of 65 sessions, with one devoted to papers by students (a recent innovation). In addition, for the first time this year two short courses are being provided (by the Office of Tax Policy Research at the University of Michigan) on Saturday afternoon.

What does this brief sketch tell us about the progress and prospects of the NTA? One clear pattern is the accelerating growth rate in the number of sessions offered: over the 28 years between 1972 and 2000 the number of sessions grew from nine to 20, while over the next 14 years the number grew from 20 to 65. So one prospect is that in a few years no city in the United States will have enough convention space to hold an NTA Annual Conference. A more realistic prospect is that NTA will not be able to broaden participation much more in the future by adding sessions.
Another clear pattern is that NTA has largely lost its business members, and the financial support they provided for Annual Conferences. In recent years, the expenses related to Annual Conferences appear to have far outstripped associated revenues (including sponsorships), accounting for much of NTA’s ongoing structural deficits. We cannot continue to rely on robust returns on our endowment to cover operating deficits, and it is not clear whether we can raise much more revenue from higher registration fees for the Spring Symposiums and Annual Conferences (which were raised this year) or for membership and library subscriptions (which will increase next year). Other ways for NTA to remain financially viable will need to be found.

There is another aspect of losing business members, and also tax administrators, who were an important segment of the NTA membership until fairly recently. The appeal of the NTA to individuals in these fields has waned for several reasons, but in part because the Annual Conference has become much more focused on presentations of academic research papers. Such papers don’t appeal to a lot of non-academics, like businessmen and tax administrators, who don’t have the technical training to understand them (or, perhaps, just the patience to try). But it has been the focus on academic research that accounts for the successful growth in the number and breadth of sessions at Annual Conferences. So any prospect of making NTA once again attractive to a broader range of tax professionals will require some new approach, perhaps a separate conference or segments of conferences designed specifically for non-academics.

Tax Analysis

The analysis of current tax law and tax proposals using microsimulation models, and the data used in these models, illustrate much of the progress in tax analysis since 1970, and prospects for the future. Microsimulation modeling was a relatively new, and exciting, development in 1970. Joseph Pechman had spearheaded the development of microsimulation modeling in order to analyze the Revenue Act of 1964,1 and the Carter Commission in Canada had relied on results of a microsimulation model developed by John Bossons a few years later.2 These models were based entirely on samples of tax returns, and produced only straightforward revenue and distributional analyses. Treasury’s Office of Tax Analysis and other groups began to develop much more detailed and sophisticated models in the early 1970s. These models were based on statistical matches of tax return records to the records from the Current Population Survey and other matches or imputations that supplied information missing on tax returns (such as health insurance coverage, consumption and wealth variables), and to represent the non-filing population. These extensions of the data base supported analysis of a much broader range of tax policies, including changes in payroll, estate, and consumption-based taxes, as well as income tax changes affecting current non-filers. The capabilities of these models were also extended to the analysis of effects of policies on marginal tax rates, marriage penalties, and alternative measures of changes in tax burdens. Measures of income and incidence assumptions were refined for distributional analysis, and extrapolation methods were also refined. Further, certain behavioral responses were incorporated to aid in preparing revenue estimates from the models.

Along with improvements in the models, the Statistics of Income (SOI) Division in IRS modernized its sampling and processing of tax return micro data underlying the models. Much more detail from tax returns began to be processed, allowing analysts to incorporate data on an ever-expanding set of special tax provisions aimed at encouraging myriad forms of behavior or providing income supplements. The sample was also redesigned and carefully adjusted over time to incorporate significant portions of longitudinal samples, which support a wide range of analyses and multi-year microsimulation modeling.³

Microsimulation models are now well established as the “work horses” of applied tax analysis in the Treasury’s Office of Tax Analysis, the Joint Committee on Taxation, the Tax Analysis Division of CBO, and in non-governmental groups like the Urban-Brookings Tax Policy Center. But in an important respect, the models have not lived up to the early goal of being fully integrated tax and transfer models. Microsimulation models of transfer policies were developed in parallel with tax microsimulation models, but transfer models are built on different databases and often use different methods of analysis and presentations of results. As a result, analysts are still unable to provide policy makers and the public unified analyses of the effects of proposals that simultaneously reform the tax and transfer systems. Perhaps reforms of the tax and transfer systems will not be seriously considered over the next few years, so there will still be time to develop the integrated models needed to inform the public debate over such reforms.

The development of the Compliance Data Warehouse (CDW) in IRS provides another important illustration of the progress and prospects of tax analysis. The CDW contains data from most tax return forms and schedules for all individuals and businesses for multiple years, and software to quickly access and analyze the data. Like microsimulation modeling in 1970, the CDW is a relatively new and exciting tool for tax analysis that will undoubtedly contribute significantly to the progress of tax analysis. A number of important analyses have already been supported by the CDW. For example, a group in Treasury’s Office of Tax Analysis used the CDW to examine the cross-sectional characteristics of small businesses and their owners, and a group led by Raj Chetty and Emmanuel Saez used the CDW to examine the influence of a child’s birthplace on their intergenerational mobility.⁴ But the CDW will permit a vast number of new analyses that would have been impossible to perform just a few years ago, and those analyses will change our understanding of the effects of tax laws and our ability to inform tax policy debates.

**Tax Policies**

An oft-stated goal of tax reformers in 1970, as today, is to broaden the tax base and lower rates. A lot of progress has been made on the lower rates portion of this goal. The top individual income tax rate in 1970 was 70 percent, well below the 91 percent top rate that had generally

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prevailed from 1946 through 1963. 5 Today, the top rate on most forms of income is 39.6 percent. 6 The top rate on dividends fell even more over this period, from the 70 percent rate on ordinary income in 1970 to the same special top rate that applies to capital gains, currently 23.8 percent. 7 The top corporate income tax rate was reduced over this period from 49.2 percent to the current 35 percent, and the top estate tax rate was reduced from 77 percent to the current 40 percent. While tax rates were generally cut, tax bases were generally eroded: the individual income tax base by new or enhanced incentives for saving, education, health, energy conservation, and other purposes; the business income tax bases through accelerated cost recovery provisions, a deduction for domestic production, and new credits for research and experimentation and other purposes; and the estate tax base through various special provisions, such as special use valuations for farms and family-owned businesses and the favorable treatment of assets held in Roth accounts. In addition, tax bases have shrunk due to the development of new forms of business organization and new financial instruments, use of what would have previously been considered very aggressive forms of tax planning, the (unintended?) consequences of certain regulatory guidance, and the lack of regulatory guidance in other areas.

The reductions in top rates, and (perhaps to a lesser extent) the erosion of tax bases, since 1970 have provided significant tax cuts to taxpayers at the top of the income distribution, allowing them to accumulate (and transmit to their heirs) much higher levels of wealth than would have been possible without these changes. Many other economic and demographic changes have occurred since 1970, so it is not easy to disentangle the effect of tax changes on the significant growth in the concentration of income and wealth over this period, but I think it is highly unlikely that tax policies did not play an important role. Likewise, it is difficult to think that tax policies will not play an important role in addressing the concentration of income and wealth, should the country decide these are issues that need to be addressed through public policies.

I don’t mean to suggest that all of our tax policies since 1970 were misdirected. Certainly high tax rates can negatively affect incentives, and although the sizes of these incentive effects appear to be smaller than once thought, they aren’t zero. Further, the tax system is no doubt the most efficient mechanism for providing income support for workers and children, so the EITC and child tax credit can best be viewed as transfer programs administered through the tax system, rather than “base erosion”. 8 There is also, of course, the Tax Reform of 1986, which was not comprehensive enough for many tax reformers when it passed, but in retrospect would be considered by many to be the high point of tax policies enacted since 1970.

The most important tax policy since 1970 in my judgment, however, is not anything that was enacted, or any pre-1970 policy left in place, but rather the failure to enact a value-added tax. It is remarkable that VATs have been adopted by virtually every country in the world, and in every high-income country as an adjunct, not a replacement, to their income taxes, but not here. And it is all the more remarkable given the strong support for adoption of an add-on VAT among NTA

5 During the Korean War years of 1952 and 1953, the top rate was 92 percent.
6 Interest and certain other forms of investment income received by high-income taxpayers can be subject to the additional tax of 3.8 percent, making the top statutory rate on these forms of income 43.4 percent.
7 This rate includes the 3.8 percent on net investment income.
In addition to providing revenue to help address the long-run imbalance in the Social Security, and more importantly, the Medicare trust funds, a VAT could provide revenue to ease some of the painful choices that will need to be made if the income taxes are reformed. And adoption of a VAT could provide a template for reform of state and local sales taxes, and for significant simplification of the way we tax business income under the income tax and, for pass-through businesses, also under the payroll tax. Having a VAT in place would also allow us to change the relative emphasis placed on consumption and income taxes as sources of revenue, rather than continuing to make the income tax an odd, complex, and inefficient, hybrid of the two.

The public is much less enthusiastic about the adoption of an add-on VAT than NTA members, though, so it may be another while before the U.S. adopts a VAT. It will likely take a fiscal “crisis” to sway public opinion, perhaps the long-term structural deficit in the Medicare system will provide that crisis.

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