Getting More from Tax Incentives:

When and How Should Tax Incentives Be Provided?

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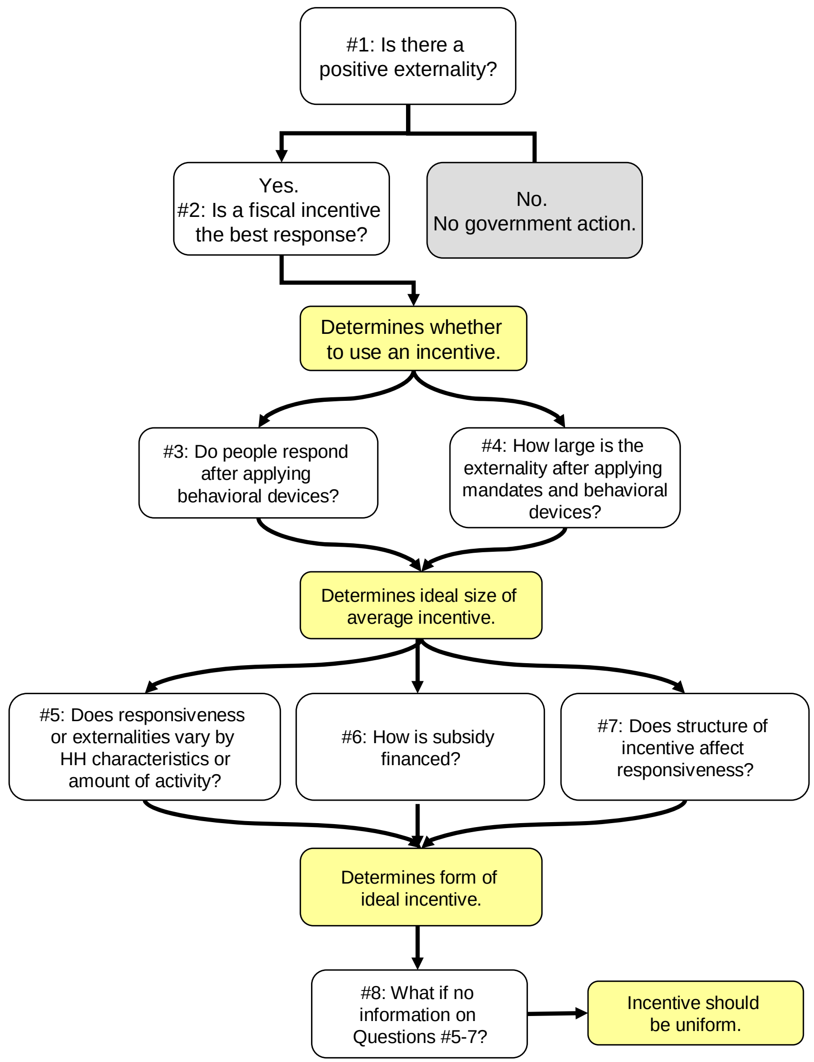
Issues to Consider

- When should a fiscal incentives be provided?
- How should it be structured?
- When is it better to deliver a fiscal incentive through the tax v. transfer system?

What Are Tax Incentives?

- Rationales for government intervention
  - Public goods
  - Fairness
  - **Benefits or costs for others resulting from individual choices (externalities)**
- Rationales for tax provisions
  - Measuring income accurately
  - Allocating tax burdens fairly
  - **Incentives for behavior**

When and How Should Fiscal Incentives Be Offered?



Framework: When and How Should Fiscal Incentives Be Provided?

- #1 Do individual choices result in benefits and costs for others?
  - Which precise individual choices do?
    - Spending solely on the good, or saving funds that might be used for the good?
    - Purchasing insurance related to the good?
    - Purchasing such insurance through a large pool?

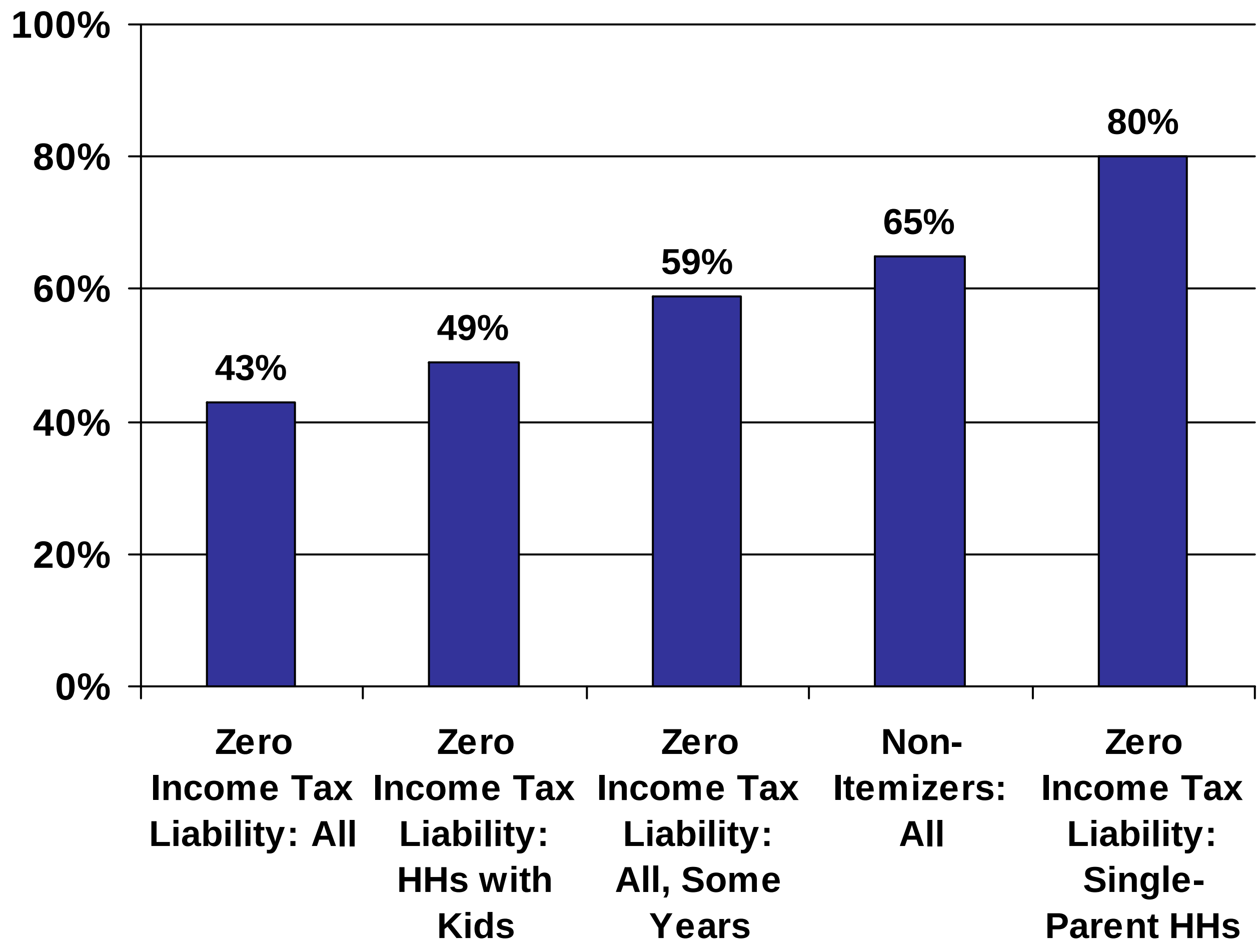
Framework: When and How Should Fiscal Incentives Be Provided? (cont.)

- # 2 Is a fiscal incentive the best response?
  - No government intervention
  - Mandate
  - Fiscal incentive
- #3 Do people respond after applying behavioral devices?
- #4 How large are the external benefits after other appropriate government intervention?

Framework: When and How Should Fiscal Incentives Be Offered? (cont.)

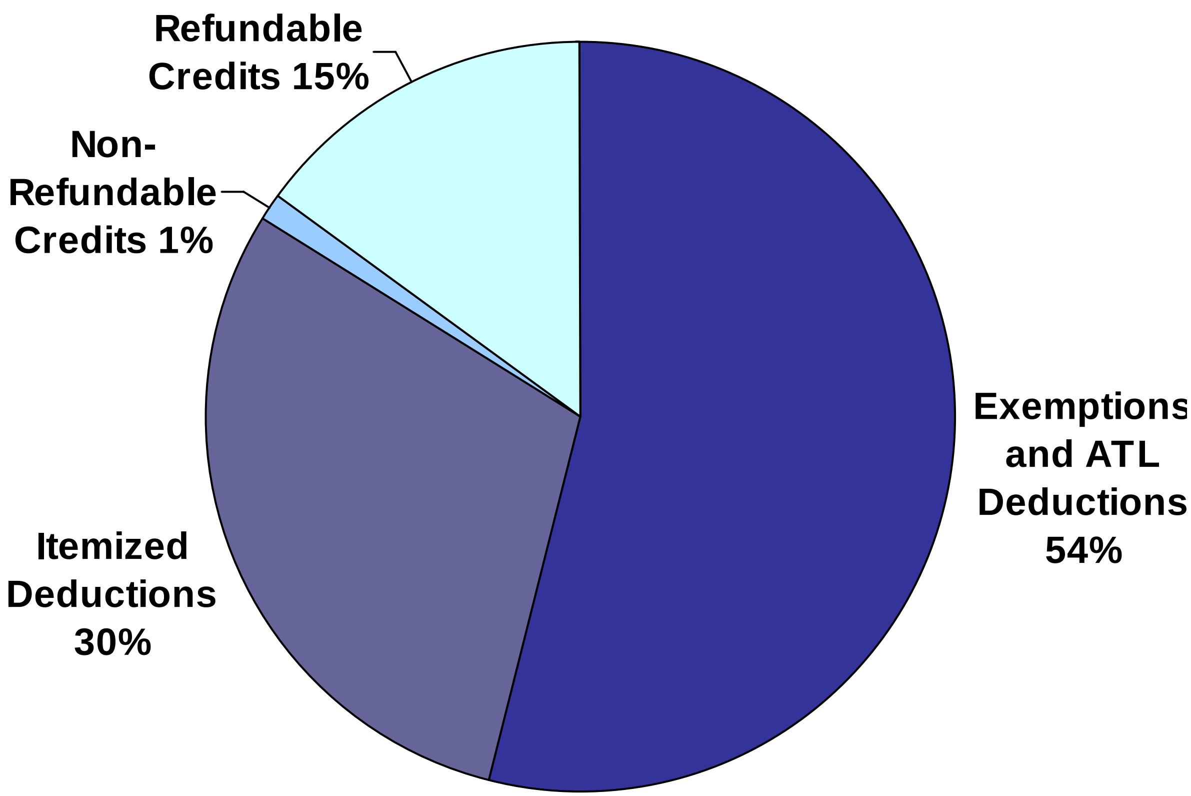
- #5: Do responsiveness or external benefits vary by household traits or the amount of activity?
  - Phase-ins and phase-outs
  - Subsidize purchasing one unit of good or amount spent on good
  - Subsidy floors
- #6: How is the subsidy financed?
- #7: Does the structure of the incentive affect responsiveness?
  - Refund v. match
  - Uniformity
  - Myopia
- #8: What if policymakers have little or no information about #5-7?

Many Don’t Itemize or Have Positive Income Tax Liability



Source: Batchelder, Goldberg and Orszag (2006); Toder and Rosenberg (2007); TPC (2009).

Form of Major Non-Business Federal Income Tax Incentives



Source: Burman, Geissler & Toder (2008) excluding special tax rates.

When Should Fiscal Incentives Be Delivered as Tax Cuts v. Transfers?

	Defaults	
	Tax Incentive	**Spending Subsidy**
Distribution of subsidy	Limit to positive income tax liability; rise with income	Flexible
Annual appropriation	No	Yes
Budget cap	No	Yes
Accounting period	Annual	Shorter or longer
Claim process	Self-report; review afterwards	Pre-certification
Specialized knowledge	Annual income, family structure	Other

Conclusions

- **Five questions for conference**
  1. An area where government should be intervening?
  2. Fiscal incentive preferable an explicit mandate or “soft paternalism” (such as a change in default rules)?
  3. Deliver as tax incentive or direct spending program?
  4. Structured as deduction, credit, or other type of incentive? What other design features might have more effect on behavior?
  5. Given the above and political environment, what are feasible policy recommendations?

- **Have to make a choice about defaults.**
- **To extent provision justified as encouraging behavior, should always be <u>some type of refundable credit</u>.**
- **If evidence of differential responsiveness or external benefits unclear, default should be <u>uniform refundable credit</u>.**