We Can't Afford Not To

By Richard W. Rahn

WASHINGTON

The capital gains tax — what you pay on the difference between the price you paid for a corporate stock, farm, small business, family home, and the price you sold it for — is an important tax. Because taxpayers are very sensitive to its rate, it can directly and broadly affect the economy. Indeed, high rates dramatically reduce investment in new ventures, diminish international competitiveness, impede technological innovation and actually reduce Federal tax revenues.

Richard W. Rahn is vice president and chief economist at the U.S. Chamber of Commerce.

In the Tax Reform Act of 1986, Congress raised the top rate for capital gains from 20 percent to 33 percent — a 65 percent increase. That proved to be a mistake. The United States has the highest long-term capital gains tax rate of any major industrialized country. Now, many entrepreneurs and small businesses are unable to raise needed capital. Investors are unwilling to take the large risk of investing in unproved technology or new business if they know that the Government will take a third of the profit.

The capital gains tax can also have a devastating impact on homeowners, small business owners, farmers or ranchers whose property has been held for a long period of time. Often inflation will have caused the price to double or triple over a decade or two. Yet, after adjusting for inflation, the homeowner or business owner may have only a modest gain or an actual loss. Taxing purely inflationary gains is both unfair and counterproductive.

Perhaps the most misunderstood aspect of the debate is the fact that our present high rate not only harms economic growth but undoubtedly costs the Federal Government revenue. For instance, during the 1970's, Congress increased the capital gains tax rate from a maximum of 25 percent to 49 percent. The result? No new tax revenues, stagnation in the economy and the stock market and a decline in new ventures leading to a loss of competitiveness and jobs.

In 1978, the maximum rate was reduced from 49 percent to 28 percent. Although the rate was almost cut in half, tax revenues from the capital gains tax went up. Why? Quite simply, taxpayers were more willing to sell capital assets at a profit because the tax penalty for doing so was lower. In fact, they sold so many more assets that, even at the lower tax rate, the Government came out ahead. In 1981, Congress cut the capital gains tax rate from 28 to 20 percent. Again, tax revenues increased!

Research by economists, notably Assistant Secretary of the Treasury Michael Darby and Harvard Professor Lawrence Lindsey, shows that the present 33 percent capital gains tax rate is substantially above the rate that would maximize the Federal Government's take. In fact, Professor Lindsey's research indicates that 15 percent would be about right.

The predictable crowd of high-tax politicians, economists and media pundits is already claiming that President Bush's proposals to cut the capital gains tax will reduce revenues. But, remember, these are the same people who told you that the 1978 capital gains tax would lose revenue — in fact, the Congressional tax staff predicted the rate cut would cost the Treasury $1.8 billion in 1979 and $1.9 billion in 1980. In fact, the Government collected an extra $2.6 billion in 1979 and $3.4 billion in 1980.

This is also the same high-tax crowd who said the 1981 tax rate cuts would cut revenues and increase inflation, and that we couldn't possibly have the long and strong economic recovery we have had.

Opponents scream that lowering the rates will benefit the rich — and that's true. What is also true is that lower rates benefit everyone who owns a home, a farm, a small business, corporate stock, wants a job or wishes to start a business.

President Bush is right when he says that a lower capital gains tax will bring in more revenue, lead to increased competitiveness, more jobs and more economic growth. He understands that to most Americans fairness does not mean punishing success but creating more opportunity — and a lower capital gains tax would do just that. □

- February 8, 1988 - N.Y. TIMES A27 -
We Can't Afford Not To-(Cap.gains)