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Taxing Capital Gains; Let's Reduce The Capital Gains Tax

by Norman B. Ture

WASHINGTON - A capital gains tax-rate reduction is not just a tax break for the rich. People at all income levels stand to benefit. A capital gains cut would boost economic growth. It would lead to faster gains in labor's productivity, employment and real wages.

The current capital gains tax is a major part of the tax system's bias against saving. With few exceptions, individuals and businesses save and invest out of after-tax income. The income their investments produce is also taxed - often under the corporate income tax and again under the individual income tax when corporate earnings are distributed. When the investment is sold, any gain is also taxed, adding another layer of tax.

And because the gain is not adjusted for inflation, the tax is often paid on gains greatly overstated in real terms. The real tax rate can exceed 100%.

A high capital gains tax also imposes a steep barrier to shifting saving into more productive investments. This ''lock-in'' immobilizes saving and keeps it from being used in the most efficient and productive way.

We have less capital than we would have without this penalty on saving and investment. With less capital, employees are less productive, resulting in lower levels of employment and real wages; and U.S. businesses are forced into a less competitive world position.

Reducing the capital gains rate would help ease the tax bias against saving and free up tax-frozen investments. The resulting reduction in the cost of saving would lead people to save more and invest more efficiently, resulting in a larger stock of capital, higher levels of labor productivity, increased employment opportunities, higher wages and greater entrepreneurial innovation. Everyone would win.

Some argue a capital gains cut would be a federal revenue loser, but many expert studies find it would actually increase revenues, both by increasing the amount of capital gains that would be realized and by virtue of its favorable effects on economic growth and efficiency. But revenue isn't the real issue. The real issue is that our current system distorts the economy, discouraging saving in favor of immediate consumption.

Norman B. Ture is president, Institute for Research on the Economics of Taxation