Contact: Mark Primoff
845-758-7749
primoff@levy.org

FOR IMMEDIATE RELEASE

CAPITAL GAINS TAX CUT WILL NOT SPUR SUBSTANTIAL INVESTMENT AND ECONOMIC GROWTH, NEW STUDY SHOWS

ANNANDALE-ON-HUDSON, N.Y.--Claims that a capital gains tax cut will stimulate substantial new business investment and economic growth are overblown, according to a new study from The Jerome Levy Economics Institute. "A lower capital gains tax rate will not have a big economic impact, particularly in regards to business investment," says Levy Institute Research Associate Steven Fazzari, who wrote the Institute's new Public Policy Brief with Benjamin Herzon.

In their study, ***Capital Gains Taxes and Economic Growth,*** Fazzari and Herzon look at the role capital gains taxes play in business investment decisions and find that lowering the tax rate from 28 percent to 19.8 percent, as currently proposed in Congress, would have a negligible effect on business investment and economic growth.

"Faulty assumptions in the popular discussion about the capital gains tax result in misleading conclusions about its economic impact," Fazzari says, pointing to journalistic accounts that claim that lower capital gains taxes will automatically increase business investment by a substantial amount. "Our results show, however, that lower capital gains taxes hardly affect decisions by firms to make business investments."

The authors also find that cutting the capital gains tax rate will have a minimal long-term effect on economic growth. "The long-term effect on economic output would amount to less than one third of one percent of GDP, or roughly two months of normal economic growth," Fazzari says. "And it would take years to realize even this small benefit."

While individual investors clearly benefit from a decline in the capital gains tax rate, Fazzari and Herzon find that this benefit would not translate into substantially higher entrepreneurial activity or economic growth. The authors cite studies showing that less than a third of reported capital gains result from the appreciation of corporate equity and that only a small fraction of these benefits go to venture capital or small businesses. "The view that a lower capital gains tax will somehow stimulate considerable investment and growth has little support," Fazzari says.

"Without substantial benefits in terms of investment, economic growth, and overall standards of living, it's difficult to justify this tax cut, the benefits of which accrue disproportionately to the wealthiest members of our society," he adds.

Fazzari points out that many of the stated goals of such a cut could better be reached through more targeted policy measures. "If stimulating investment in research and development is a goal, for example, a targeted tax break would be more effective," he says.

Given the costs associated with the current tax proposals, the burden of proof lies with those who advocate lowering the capital gains tax rate, Fazzari and Herzon contend. "Our findings call into question one of the major arguments invoked to provide that burden of proof and weaken the case for a capital gains tax cut."

Public Policy Brief No. 25, ***Capital Gains Taxes and Economic Growth,*** *Effects of a Capital Gains Tax Cut on the Investment Behavior of Firms,* 1996