



Tax Policy to Promote Domestic Capital Formation and Efficiency

By Dr. Mason Gaffney

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Bob: Suggestions, now would be timely.

DRAFT

More

Tax Policy to Promote Domestic Capital Formation and Efficiency

Notes re Conference, August 20-23, 1992, Gt. Barrington MA

Co-sponsors:

American Institute for Economic Research, Great Barrington
Robert Schalkenbach Foundation, New York City

Chair: Mason Gaffney

A. Potential Dramatis Personae

? Akerlof?

Robert Aten Pro ITC, fast write-off.
Represents MAPI, in tradition of George Terborgh

Bob Auerbach Banking

Alan Auerbach Taxation, esp. cap gains

? Ben Bernanke? Interest rates; credit discrimination.

??? Al Berry 1 a Land reform
U of Toronto, Scarborough Col, Div of SS, W Hill ON M1C 1A4

Richard Bird Land taxation, LDCs

?? Alan Blinder Federal taxation

Martin Bronfenbrenner
Japanese land tax

Melissa Burman State taxation
State Tax Notes, (TAA, Chas. Field),
703-533-4401, fax -4440

Leonard Burman Federal taxation
Tax Analysis Divn, CBO, US Congr., D.C. 20515
202/226-2680

Martin David Federal taxation
Dep/ecs, U of Wis, Madison WI 53706

James Dietz Taxation
Dept/ecs, CSU Fullerton, Fullerton CA

Gary Dymski Post-Keynesian approach

mason -
Sorry for the delay -
These rounds look good -
my only real suggestion is
John Miller -
But Ed Herman + Hy Minsky
would be interesting +
entertaining
Wisc -
Bill

Ned Eichler, Thrift Debacle

??Martin Feldstein Social security as cause of low savings

David Felix, Banking instability, fragility
Dept. of Economics, Washington Univ., St. Louis, MO

Fred Foldvary Libertarian Georgist, knows Austrian capital
theory and literature
101 Mt. Vernon Av, Alexandria VA 22301
703/683-7769

Daniel Fusfeld Tax history; signer, Gorb. letter.
Dept of Ecs, U of Mich, Ann Arbor MI 48109
313/764-2371, 2355

Fred Harrison English journalist and activist, interested
in capital formation and land taxation. Should come as observer.

John Helliwell Eminent Canadian tax authority; Signer, Gorb.
letter
4659 Simpson, Vancouver BC

Robert Kuttner Smart economics columnist; liberal
61 Dean Rd, Brookline, MA 02146

Stephen Lewis Tax policy, LDCs
President, Carleton College

Sherman Maisel Banking; real estate

Patrick Mason Savings patterns and ethnicity

Joseph Minarik Taxation
XDir, JEC of Congress, G-01 Dirksen SOB, 20510
202/224-5171

Franco Modigliani Life-cycle hypoth.; signer, Gorb. letter.

John Muellbauer Capital gains in nat. inc. accounts, Britain.
Need to account for influence of equity withdrawal on
consumption.
Fellow, Nuffield College, Oxford

Anthony Murphy Capital gains?
Research Officer, Nuffield College, Oxford

Richard Musgrave Taxation; gray eminence. Signer, Gorb.
letter.

Bill Niskanen Public policy, general; sincere and genuine
hyperconservative
Cato Inst, 224 - 2nd St SE, Wash DC 20003

William Peirce Technology and capital formation
Box 154, Gates Mills OH 44040
Dep/ecs, Case Western Reserve Univ., Cleveland, OH 44106
216/368-4131 off
216/442-1921 res

Bob Pollin Cap formation - Keynesian approach

James Poterba Cap gains and Cap formation

Henry Reuss	Banking, finance. Gray eminence.
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?Margaret Reuss Land taxation
470 N St SW, Wash DC 20024

Anthony Scott Macro and resource economics
1873 E. Mall #997, UBC, Vancouver V6T 1Y2

Alan Severn Capital gains
Dep/Finance, U of Detroit, 4001 W. McNichols Rd, Detroit MI
48221 313/927-1161 off; 548-8860 res
Summer: 31 W. Kirke St, Chevy Chase MD

Robert Solo Portfolio substitution of land for capital

John Strasma Taxation: LDCs, minerals
Dep/AgEcs, UW Madison, Madison WI 53706
212 N. Allen St., Madison 53705

Richard Sutch Portfolio substitution, slaves for capital
(in history). Life-cycle thesis of saving.

Nicolaus Tideman Land taxation and property rights, within
Chicago School frame of reference. Co-author, Gorb. letter.

Norman Ture Lobbyist, Washington

William Vickrey Tax policy, gray eminence. Co-author, Gorb.
letter.

?SusanM. Wachter
Prof. of Finance, Wharton School, U of Pa 19104

??Charls Walker Lobbyist, Washington
Am Council for Capital Formation, #400, 1850 K St 20077-2450

Andrew Winston Efficiency in use of capital

B. TOPICS

1. Property tax

Effect of prop tax on capital formation.

Effect of exempting capital from property tax, limiting it to land.

I put this first to be sure it gets covered and emphasized. Most people are used to ignoring the issue, but it is RSF's major interest in the conference and attendant research.

Case of "the four tigers," rapid capital growth coupled with substantial property taxation.

2. "Business Keynesianism," a la Walter Heller

Needed: basic "business Keynesian" view from 1960s, lower taxes on K to spur invt. Bob Aten will provide this.

Fast write-off, expensing, and ITC are technical means available. They are means of lowering effective income-tax rate on investing in new capital, while keeping high tax rate on rents from land. John R. Commons pointed this out long ago. Fast write-off etc. do to the income tax what exempting buildings and personal property do to the property tax: convert it into a land tax. (Granted, the "taxable events" are different, and the coverage of imputed income very different.)

Fast write-off involves both tax life, and depreciation pathways. No time to get very technical about the pathways, we're covering too many other topics.

Art Laffer, supply siders overstated and/or misstated this case ca. 1980, have been scoffed at. This is a key issue, however, to be soberly considered on its economic merits regardless of prior political grandstanding. The case for exempting capital from taxes, in whole or in part, rests on assuming or finding that A) The supply is elastic; and B) It is elastic to rates of return after tax.

There are doubters whether higher rates of return (or higher interest rates) spur saving; but no one can doubt they attract outside capital, and keep domestic capital at home. That will always make a strong case. The question for us, however, is the effect on domestic capital formation.

3. "High-income Keynesianism"

The early, optimistic, "we-can-have-it-all" Keynesianism, allegedly validated by W.W. II, says higher income means higher saving, you just have to keep providing investment outlets. Government bonds do nicely, and high taxes don't hurt.

Bob Pollin may take this view. It should be considered.

There is a lot of this in Henry George, too. He wrote that a healthy society "secretes" necessary capital, like a well-balanced organism. His critics, e.g. Walter Spahr and E.R.A. Seligman, faulted him for this, and demanded to know where the capital was coming from to improve all the vacant land. They thought in terms of a fixed capital stock, (making capital resemble land). This is like "the Harberger model" today. George thought capital was augmentable, easily and indefinitely.

Permanent income thesis. Does higher income really generate saving, or is this just a "regression fallacy"?

4. Diminishing marginal utility of assets

Portfolio substitution of land for real capital.

Richard Sutch, sees "crowding out," in context of slave economy where slave investment crowded out real capital. Not clear if Sutch sees parallel of slaves and land as substitute assets crowding out real capital, but I think he does.

Many others see government debt crowding out private investment. Others, of the Ricardian equivalence school, see private savers anticipating effects of government debt on their future private wealth, and saving more to offset it.

In either view, lower land prices promote saving.

Robert Solo has stated the case explicitly in respect to land. Solo's entry route was to ask what sense there is in the common fallacy that savers in LDCs abort capital formation by buying land? The idea is false because this is a zero-sum transaction, the savings remain for the land-seller to invest. Solo concludes, however, the real point is that bidding up the price of land upvalues an alternative asset that substitutes for capital, reduces incentives to save further, and fosters extravagance - for confirmation, see "Life-styles of the rich and famous," Saddam's castles, al-Sabah's gold plumbing, blue-grass horse farms, etc. "Shirtsleeves to shirtsleeves in three generations"?

However, Sutch may well say all taxes lower land prices, not just land taxes. This is more than half right (IF the supply of capital is elastic). The point about land taxes is not just that

they lower land prices: they do so without having negative marginal effects. Sutch may deny there are any important marginal effects. We need to integrate Aten with Sutch: Aten's stress is on marginal effects primarily.

No one that I know has developed the obvious thesis that higher interest rates promote saving by lowering the price of land. So, of course, do higher tax rates on land. This will be Gaffney's theme, if no one else can be found.

5. Equity withdrawal: "living high on the old homestead"

8 Jan 91, Lowell H. writes Dick Noyes, agreeing "Speculation in land can hurt. ... prof. ecsts. have given the subject less attn. than appropriate ... We should pursue the matter..."

Muellbauer is pushing to revise Brit national accounts used for forecasting, to account for drain on savings caused by converting rising home equities into cash for consuming.

We should, however, consider all equities, not just residential.

6. Land cycle and financial intermediaries

Continental Illinois bailout, \$5 billion lost, largest individual bailout. Symbolic, indicative, portentous.

S&L bailout; fragility of banking structure. (Honor to those who gave early warning, e.g. Upgren and Edmunds; Harwood; probably Minsky, if you can cut through the fog and the hedging.) David Felix does excellent work, e.g. on Argentine debt repudiation.

Old hands Eichner; Maisel; Reuss. Dozens of new arrivals.

Paul C. Roberts now says we should reflate lv to build up K of banks et al so they can lend more. [Inconsistent for a supply-sider to favor spending our way out of recession, but he uses those words.]

7. Capital gains tax

Effect of cap gains tax on cap fmtn. Poterba; Alan Auerbach; Minarik.

Use of low rate, in tandem with fast write-off, to raise RORAT on fixed investment, especially in income properties.

Inefficiency (leakage) in the method. Subsidy to land speculation. Subsidy to old buildings. Overstimulation of durables with high vacancy rates.

Case for a special tax on land gains, as in Taiwan.

8. Consumer taxation

Is this the way to foster more saving? There is a head of steam and a long tradition behind this idea, but does it work? Aten assumes it is true.

Japan: high saving with no sales tax. Philippines: low saving with high sales tax. Is this contrast fair? Are there historical counterexamples to support thesis that consumer taxation fosters saving?

Leakages: kinds of consumption that evade "consumer" taxes. Imputed service flow of land as untaxed consumption.

9. Payroll taxation

Does this encourage capital formation? How explain rise of U.S. payroll tax with fall of domestic saving?

Effect on efficient use of capital, overall demand for capital. Substitution of capital for labor.

Can tax be uniform? Avoidance, evasion, underground economy, undocumented immigrants, crime, drug economy, etc.

(Consider payroll taxation separately from social insurance.)

10. Rational expectations

As expounded by McCandless, makes tax policy all a game between Tsy and taxpayer. Lowering tax on K, e.g. ITC, only helps once, and it doesn't really help at all overall, but just bunches investment in periods of high ITC, stealing from other periods.

By McCandless, ITC is self-defeating. 2nd round, investors hold back, waiting for it.

Curiously, this view brings together extreme right and extreme left wings: Marxists see it this way, too.

11. Social Insurance, (and private insurance, too)

Is social insurance the enemy of saving? Feldstein and his critics. Evidence from international comparisons.

Sutch vs. social insurance. Sutch vs. efficient private insurance, too.

Life-cycle hypothesis. Modigliani. Effects of unexpected longevity. Do life-cycle effects swamp tax effects? Is taxation relevant?

12. Peace dividends and capital formation

Historical record of life after peace dividends: have they increased capital formation, or extravagant consumption? Why did the English industrial revolution occur during a long series of wars, for example?

13. Response to crisis vs. long-term restructuring.

Both are to be addressed at the conference. There is a present crisis, which is why we can draw a crowd. There are also enduring and theoretical issues.

This is not a serious conflict. Most economic doctrines have sprung from addressing immediate issues. John Dewey defined ideas as solutions to problems that arise in a social context.

14. Capital efficiency

Do we need more K, or is it enough to use any given stock better? Andrew Winston.

What tax policies are most compatible with efficient use of any given stock of capital. What policies interfere with efficient use?

Vacancy rates in U.S. office buildings are perhaps 15% nationally. Tax incentives take part of the blame. Industrial capacity is not nearly fully utilized. 10% of all dwelling units are vacant. Much industry is cartelized, with excess capacity on hold. A large share of our farm capacity is held on standby by government programs. Schools and infrastructure are underutilized in many declining neighborhoods, while new ones are built in outlying, inefficient locations.

At the same time, there is a shortage of disposable funds, tight credit, a manifest need to borrow abroad, and sell assets to foreigners. There is a widely held view there is a world capital shortage, and worse to come.

Norman Thomas used to preach "The problem is not production, but distribution." A modern Chicago economist might complain, "The problem is not capital accumulation but allocation." (It could also be both.)

At the least, we should rule out policies that may foster capital accumulation at the expense of efficient allocation. This idea goes back at least to Ricardo, and is central to the older Austrian economics. Perhaps we can find a neo-Austrian to drive home the point today.