P.S. to the NEWS
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HOW TAXES HURT CAPITAL FORMATION

"Get America back to work again" is one of the Reagan promises which should receive priority attention from the new Congress convening in January. And the agenda to achieve that goal should start with a reduction in federal income taxes.

The structure and the rates of the current federal income tax are the primary reason for the sluggish capital formation in the United States. Our present tax system discourages savings through (1) the high marginal rates of the progressive income tax system, and (2) the heavy reliance at the federal level on income taxes as opposed to consumption taxes.

High marginal tax rates discourage savings because they grab much income which would otherwise go into savings. To discourage savings means to discourage capital formation, which in turn means to discourage the creation of jobs.

The close relation between savings and growth is reflected in the experience of other countries. Our big competitor, Japan, has a savings rate which is 4.4 times that of the United States, and a real Gross National Product growth rate which is more than ten times that of ours.

The United States also suffers by comparison with the savings and growth rates of Germany, France and Canada, although they are not as high as Japan's. These unhappy comparisons are despite the fact that we are about 60 percent self sufficient in oil, whereas Japan, Germany and France are almost totally dependent on oil imports.

Fortunately we don't need to speculate -- we have clear proof -- about what good results will flow from a reduction in one component of the income tax: the capital gains tax. In 1978, the capital gains tax was reduced from 49 percent to 28 percent, and the effects were spectacular.

Equity capital raised by small companies in 1979 was 4.3 times the level in 1977, which was the last full year of the old higher tax. New equity issues during the first half of 1980 were 2.2 times their level in the same period of 1979.

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Even though Congress has taken credit for voting a number of "tax cuts" since 1965, these have not been enough to cover the increases in real taxes caused by inflation. We have suffered a striking net increase in taxes due to tax bracket creep, the popular term for the effect of inflation in raising the rates on individual taxpayers by pushing them into higher tax brackets.

Look at how the jaws of the progressive income tax joined with inflation bit into and crushed the individual who had a $10,000 income in 1965. Between 1965 and 1979, his taxes were supposedly reduced $520 by legislative tax cuts, but actually inflation alone increased his taxes by $2,185. At the $40,000 income level, Congress supposedly reduced taxes $1,449, but inflation actually increased the individual's taxes by $18,999. It is obvious that inflation makes windfall profits for the government.

Inflation has made the progressive tax system become progressively more progressive even over the last five years. In 1973, one fifth of the taxpayers were paying 63.7 percent of federal income taxes. By 1978, one fifth of the taxpayers were paying 66.6 percent of the federal tax burden.

The second way our federal tax system discourages savings is through its heavy dependence on income taxes for revenue. The federal government receives 57 percent of its revenue from personal income taxes, as opposed to 4.7 percent from consumption taxes.

An income tax penalizes savings because it taxes money as it is earned and also money which that earned income produces after it is invested. By contrast, money spent on consumption is taxed only once.

France, Germany, Japan and Canada all rely more heavily on consumption taxes. As we have seen, those countries have much higher savings and growth rates. Their productivity growth is also higher than ours.

In the last two years, U.S. productivity has actually declined. No wonder we are being priced out of the market even in goods for which America has traditionally been the world's leader.

In the famous Carter-Reagan debate, Reagan asked Americans, Are you better off today than you were four years ago? The American voters answered no to that question. The best way to fulfill the election mandate is to reduce the income tax, including the capital gains tax.

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