



EXECUTIVE SUMMARY

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October 24, 2002

Cutting Capital Gains Taxes Will Hurt, Not Help, Oregon's Economy

By Jeff Thompson

Both major party candidates for Governor in Oregon have proposed capital gains tax cuts as part of their policy response to the state's flagging economy. The more extreme of the two proposals, made by Republican Kevin Mannix, would reduce the top rate from 9 percent to 5 percent.

Analysis of the Mannix proposal to reduce the tax rate on capital gains in Oregon finds little reason to expect additional economic growth. The proposal would actually harm the economy by draining more than \$110 million from Oregon. It would send \$42.5 million more to the federal government and result in \$68 million in lost federal matching dollars. The loss of \$110 million each year from Oregon will result in job losses, reduced consumer spending at local businesses, and further reductions in state and local tax collections. These losses are larger than any small (unlikely) impacts that cutting the capital gains tax rate might have on economic growth in Oregon.

The benefits of the Mannix plan are distributed very unequally, giving most to those with very high incomes. The richest five percent of Oregonians get 73 percent of the tax cut. The average state tax cut for the bottom 80 percent of households is just \$12, while the average cut captured by the richest one percent of Oregonians is \$5,634.

The Mannix plan would result in further budget cuts due to an annual loss of \$177 million in state general funds plus the \$68 million loss in federal matching funds. Legislators would be forced to enact further budget cuts to education, human services, public safety, and corrections. The benefits of the Mannix plan primarily accrue to very few, while the cuts would impact all Oregonians.

Proposals to defer taxation on capital gains reinvested in Oregon, offered by both Mannix and Democrat Ted Kulongoski, would result in much smaller budget cuts, but would still fail to help Oregon's economy. A capital gains tax deferral program has already been tried, and was shown to have failed, in Oregon.

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At a debate presented by *The Business Journal* and the Portland Business Alliance, both major party candidates for Governor of Oregon proposed capital gains tax cuts as part of their policy response to the state's flagging economy.¹ Republican candidate Kevin Mannix proposed special treatment for capital gains income, currently taxed the same as other forms of income, by reducing the top rate to 5 percent, and added that he would also offer some form of tax deferral for reinvestment of capital gains. Similarly, Democratic candidate Ted Kulongoski proposed reducing the tax on capital gains from long-term investments made in companies in Oregon.

The candidates have different proposals, but each appears to have accepted the notion that cutting the tax on capital gains income will generate economic growth in Oregon.² That notion is incorrect. Cutting the capital gains tax is not likely to generate growth. Indeed, such a cut would likely weaken Oregon's economy.

Because of the interaction between the state and federal income tax codes, reducing Oregon's capital gains tax to 5 percent, as proposed by Mannix, would drain \$42.5 million from the state's economy in 2003. Lost federal matching funds would drain an additional \$68 million annually from the Oregon



economy. Research on capital gains tax cuts suggests that Oregon should expect little or no economic growth to offset the predictable loss in federal funding or increased taxes.

Such a cut would force the state to cut services for all Oregonians by more than \$177 million annually. The benefits from a capital gains tax cut accrue almost exclusively to those with high incomes, with the richest five percent of Oregonians getting 73 percent of the tax cut. By giving preferential treatment to income held primarily by the most well-to-do, the Mannix proposal provides unneeded aid and comfort to those most able to weather Oregon's current economic storm, while exacerbating cuts to programs that serve all Oregonians and those most harmed by the economic downturn.

Deferring or waiving the tax on reinvestment in Oregon, as proposed

by both Kulongoski and Mannix, would result in a much smaller tax cut, but would still fail to help Oregon's economy. While none of the candidates has offered specifics of their reinvestment or deferral proposals, a capital gains tax deferral program has already been tried, and shown to have failed, in Oregon.

Oregon's economy is in the midst of what some observers have called an "anemic" recovery. Unemployment has been falling since January 2002, but remains relatively high.

Cutting the capital gains tax, however, will not impact unemployment or economic growth in Oregon. Oregon's economic troubles are the result of international and national economic forces beyond the influence of state tax policy. Tinkering with Oregon's capital gains tax will only make things worse.

Size and Details of the Cut

Capital gains income is income realized when an asset that has increased in value is sold. Currently Oregon taxes capital gains at the same rate as other forms of income, at the graduated rates of 5, 7, and 9 percent. There are few specific details on the capital gains tax cut proposals coming from the candidates. However, the Mannix campaign has put forward a proposal to reduce the tax on capital gains to 5 percent. This analysis is

based on this proposal, but is germane to any capital gains tax cut proposal.

Reducing the tax on capital gains to 5 percent in 2003 will cost Oregon state government \$177 million in its first year.³ Because state income taxes are deductible when calculating federal taxable income and tax liability, the cut in state income taxes will result in Oregon taxpayers who itemize paying \$42.5

million more in federal income taxes. Thus, the net benefit for

taxpayers is reduced by 24 percent to \$134.5 million.

Who Benefits from the Mannix Plan?

Reducing Oregon’s tax on capital gains income would deliver a large cut to high-income households and very little to anyone else. If it had been implemented in 2002, cutting the tax to 5 percent would have reduced state taxes on middle-income taxpayers by an average of \$10. (Table 1.) The top one percent, with an average income of \$790,400, would realize a state tax cut of \$5,634. The lowest-income fifth of taxpayers would get nothing from cutting the capital gains tax. The richest five percent of Oregon households would reap 73 percent of the Mannix tax cut, while the bottom 80 percent of households would receive just 9 percent.

With a reduced state tax bill, beneficiaries of the capital gains tax cut would have fewer deductions from federal income taxes, and face a higher federal income tax bill. The richest one percent of Oregonians would pay on average \$5,634 less in state income taxes, but \$1,958 more in federal taxes. This amounts to a \$3,676 net reduction in total income taxes paid for Oregon’s wealthiest residents.

Unequal Distribution of Capital Assets

High-income households reap most of the benefit of capital gains tax cuts because middle-income and low-income households own

Table 1. Impact of Taxing Capital Gains at 5%									
All Oregon Taxpayers, 2002								ADDENDUM	
2002 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%	Bottom 80	Top 5
Income Range	Less Than \$15,000	\$15,000–\$28,000	\$28,000–\$43,000	\$43,000–\$72,000	\$72,000–\$134,000	\$134,000–\$280,000	\$280,000 Or More	Less Than \$72,000	More Than \$134,000
Average Income in Group	\$9,700	\$21,200	\$34,400	\$56,400	\$93,100	\$184,900	\$790,400	\$30,400	\$303,300
State Tax Change Only									
Tax Change as a % of Income	–0.0%	–0.0%	–0.0%	–0.1%	–0.1%	–0.3%	–0.7%	–0.0%	–0.5%
\$ Average Tax Change	\$ –0	\$ –6	\$ –10	\$ –32	\$ –128	\$ –537	\$ –5,634	\$ –12	\$ –1,533
Share of Total Tax Cut	0%	1%	2%	6%	18%	21%	53%	9%	73%
Combined Federal/State Tax Change									
Tax Change as a % of Income	–0.0%	–0.0%	–0.0%	–0.1%	–0.1%	–0.3%	–0.5%	–0.0%	–0.4%
\$ Average Tax Change	\$ –0	\$ –6	\$ –10	\$ –30	\$ –102	\$ –488	\$ –3,676	\$ –12	\$ –1,111
Share of Total Tax Cut	0%	2%	2%	7%	19%	25%	45%	11%	70%

Notes: This analysis includes a deduction for federal income taxes capped at \$3,250 for tax year 2002. The analysis shows the impact of imposing a 5% tax on capital gains instead of the current 5%, 7%, and 9%.

SOURCE: OCPP presentation of Institute on Taxation and Economic Policy, October 2002.

relatively little of the assets that generate taxable capital gains, such as equities (stock) or investment property. Capital gains make up 18 percent of the income of the richest one percent of Oregon households, but provide only one percent of the income of middle-income Oregonians.⁴ The chief asset of most middle-income households is their home. Gains from the sale of owner-occupied housing, however, are almost entirely exempt from the capital gains tax.⁵ Overall, about half of all assets producing capital gains are held in a tax-exempt form.⁶

One common asset that yields taxable capital gains is corporate stock. While nearly half (48 percent) of American households own some form of stock, much of it is in retirement savings and pension plans that are not subject to tax on capital gains.⁷ Just 19 percent of households own stock directly.⁸ Many of the households with direct stock holdings own very little. Only 14 percent of households directly hold stock worth more than \$5,000.

Stock ownership has become more widespread across the last decade, but a minority of upper-income households continues to hold the most stock and would benefit most from a capital gains tax cut. In 1998, the bottom 80 percent of American households owned just 1.7 percent of all non-pension/retirement plan stock.⁹ The average value of all stocks owned by the least wealthy 60 percent of stock-owning households was just \$4,200, while the average among the richest one percent was \$2.5 million.¹⁰

Other assets that produce taxable capital gains are even more unequally distributed than stocks. The wealthiest 10 percent of American households own 82 percent of all stock, but they own more than 91 percent of the assets from businesses that are not publicly traded.¹¹ The most equally distributed capital gains producing asset is investment real estate. The bottom 90 percent of American households own 25.5 percent of non-residential real estate, while the richest one percent of households own 43 percent.¹²

No Economic Growth from a Capital Gains Tax Cut

Advocates of cutting the capital gains tax claim that a lower rate will create jobs and stimulate economic growth. As one recent analysis by the Brookings Institution concluded, however, “the data suggest these claims are false.”¹³ In fact, there are reasons to think that cutting the

capital gains tax will make Oregon’s economic troubles worse.

In 1998, the Congressional Budget Office (CBO) reviewed several leading economic models developed to project the economic growth response to cuts in the federal

capital gains tax. Through its research, CBO found that reducing the federal capital gains tax by five percentage points would have “only a modest effect” on the US Gross Domestic Product.¹⁴ The models that did not rely on “extreme or unwarranted assumptions” yielded only “small increases in GDP – well below 0.1 percent after ten years.”¹⁵ One of the models even projected that a capital gains tax cut would reduce economic growth.¹⁶

“I have never made an investment based on the tax code... If you are giving money away, I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements...”

--- US Treasury Secretary, Paul O'Neill

Why Cutting the Capital Gains Tax Does Not Generate Growth

A capital gains tax cut has little impact on economic growth because capital gains represent a small share of capital income.¹⁷ A tax cut would have a small impact on the “cost of capital,” resulting in little impact on saving or investing.¹⁸ If not made revenue neutral by offsetting tax increases, a federal capital gains tax cut would reduce economic growth by generating deficits that would result in higher interest rates.¹⁹ The realities of capital gains and their taxation make it clear that the claims of tax-cut advocates are over-stated.²⁰

Consider the following facts:

- One half of capital gains producing assets are tax-exempt, including IRAs and 401(k)s, and would not benefit from a tax cut;²¹
- One half of taxable capital gains are realized (sold) each year already, and cannot be thought to be “caused” by a tax cut;²²
- Capital gains income already receives considerable preferential tax treatment (discussed below);
- The vast majority of venture capital is from institutional or overseas investors not subject to the tax on capital gains, and thus not impacted by a tax cut, and;²³
- A considerable share of taxable capital gains are never taxed because they are held until death and transferred through bequests, and thus are not impacted by a tax cut.²⁴

Studies of capital gains taxes tend to show that changes in the tax rate can influence the timing of the sale of capital gains assets, but do little to influence investment decisions.²⁵ Capital gains and other tax cuts intended to stimulate new investment end up rewarding activity that would have happened even without the cut. Investors are not as tax-sensitive as anti-tax activists claim.²⁶ As Treasury Secretary Paul O'Neill has said, commenting on his experience as a businessman, “I have never made

an investment based on the tax code... If you are giving money away, I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements..."²⁷

Even Less at the State level

Even the meager response to a federal tax cut is larger than what can reasonably be expected from a state tax cut. A federal capital gains tax incentive works if it generates new investment that would otherwise not have occurred. On the other hand, a state-specific capital gains tax incentive must encourage investment *within the borders of the state* if it is to provide increased economic activity and benefits to the state.

Since many capital gains are from investments in firms outside of Oregon, and will likely be reinvested out of the state, a capital gains tax cut is limited in its ability to influence new investment and growth in the state. Windfalls from cutting Oregon's capital gains tax rate that are invested in Texas, Arkansas, or China do nothing to create jobs in Oregon. Reviewing research on investors' responses to state-level capital gains taxes, economist Leonard Burman showed that "the new research found the measured response to differences in state tax rates – the permanent effect – to be small and not statistically different from zero."²⁸

Why a Capital Gains Tax Rate Cut will Hurt Oregon's Economy

Any future investment generated by reducing Oregon's tax on capital gains would be small or non-existent, but the net loss of income resulting from increased federal income taxes will be immediate and certain. Starting with the first year of a four percentage point reduction in Oregon's capital gains tax (the Mannix plan), \$42.5 million will flow out of Oregon and to the federal government. This figure is the equivalent of 0.04 percent of Oregon's Gross State Product in 2000.²⁹ While a small share of the Oregon economy, it is larger than the economic growth, if any, that might result from cutting the capital gains tax. In its analysis, the Congressional Budget Office found that in the *tenth* year following the implementation of a *five* percentage point reduction in the *federal* capital gains tax, the most optimistic finding from a model that didn't rely on "extreme or unwarranted" assumptions was 0.03 percent of GDP.³⁰

Ignoring for a moment that the miniscule federal results are considerably larger than what Oregon should expect, Oregon's economy would immediately lose more income than it might be optimistically hoped to eventually generate. By any investment calculus, the Mannix plan is a bad deal and a sure-fire recipe for slower economic growth.

Made Worse Through Loss of Matching Funds

Even the \$42.5 million in lost income understates the immediate cost and economic problems that Oregon would face under the Mannix plan. If some of the \$177 million in annual budget cuts are made to programs that bring in federal matching dollars, such as the Oregon Health Plan, the losses will be magnified. Medicaid, the federal program that funds the Oregon Health Plan, mental health, alcohol and drug treatment, services to children, the aged and the disabled, and a host of other human services, matches each state dollar spent with about two federal dollars.

Since human services programs constitute slightly more than one fifth of Oregon's general fund budget, an equally distributed \$177 million cut would reduce human services spending by more than \$39 million annually.³¹ Since each dollar spent on Department of Human Services programs in Oregon brings in about \$1.75 from the federal government, the \$39 million reduction in state spending could be expected to result in \$68 million less in federal spending coming into Oregon.³²

Oregon's economy would lose \$68 million dollars, and providers of and recipients of health care and social services would receive \$107 million less in income each year, under the Mannix plan. An anticipated result is job losses in hospitals, nursing homes, and other providers of health care and social services.

According to an ECONorthwest analysis of reduced spending for long-term care providers, each \$1 million reduction in state general funding of long-term health care providers results in approximately 47 jobs lost.³³ If the \$39 million cut is spread equally across the DHS budget, long-term care, which includes nursing homes, residential care, and assisted living centers, would be reduced by more than \$5 million, eliminating approximately 235 jobs.³⁴ These job losses will result in decreased consumer spending at other Oregon businesses and reductions in state and local tax receipts. Other health care and social service sectors would be impacted similarly as the long-term health care sector.

Combining the \$42.5 million loss due to higher federal income taxes and the \$68 million from lost matching funds, the Mannix plan would drain more than \$110 million annually from Oregon's economy. These losses, 0.09 percent of Oregon's 2000 GSP, far outpace even unrealistically optimistic growth projections from a capital gains tax cut in Oregon.

Fast Growth with the Current Tax

In 2001 Oregon's economy fell further than most other states, and in 2002 it has recovered more slowly than many. Over the 1990s, however, Oregon's economy established a solid record of growth. As recently as 2000, Oregon had the third fastest growing state economy in the country, based on per-capita Gross State Product.³⁵ Between

1995 and 2000, Oregon's economy grew faster than any other state.

During this period of rapid growth, Oregon's capital gains tax rate was 9 percent, the current rate. Oregon's economy grew faster than states with lower capital gains tax rates and those with no capital gains tax. Oregon's record demonstrates that a low tax rate on capital gains is not a requirement for rapid economic growth.

Some people have implied that Oregon's capital gains tax is partly responsible for Oregon's currently high unemployment rate. The two states with even higher unemployment, however, Alaska and Washington, do not tax capital gains income. The tax on capital gains income is not responsible for Oregon's unemployment rate.

Can A Tax Cut Raise Revenue?

Some people claim that a capital gains tax cut will actually generate additional revenue.³⁶ Common sense and solid research show capital gains tax cuts cannot be expected to generate additional revenue. In his review of the literature on the revenue impacts of capital gains tax cuts, economist Leonard Burman concluded, "As for its effect on revenues, a capital gains preference almost surely reduces tax revenues."³⁷

During the 2001 legislative session, the Oregon's Legislative Revenue Office (LRO) analyzed a proposal that would have reduced the capital gains tax to six percent.³⁸ The LRO analysis assumed the existence of some revenue generated from "portfolio turnover" and new investment. Even with these assumptions they estimated that the tax cut would cost the state hundreds of millions of dollars each year.³⁹

Changes in the capital gains tax do influence when investors sell capital assets. The types of changes typically thought to generate increased capital gains realizations, however, are *temporary* reductions in the tax rate, which prod investors into action before they lose the opportunity, and tax rate *increases*, which prompt investors to sell before they face a higher rate. Permanent reductions in the rate provide less incentive for investors to sell in the short term.

Generating revenue through capital gains cuts is not sound fiscal policy. The *hypothetical* short-term revenue boost is actually a disguised form of high-interest rate borrowing, substituting more revenue in the future for far less today. Counting on revenue from a short-term boost in sales of capital gains assets has been called "about as good an idea as asking your neighborhood loan shark to float you some money to pay your mortgage."⁴⁰

Capital Gains Already Get Special Treatment

Capital gains already receive favorable treatment. In the federal tax code, capital gains are taxed at lower rates and are not taxed until the asset is sold, or not at all in the case of death.⁴¹ The top rate for capital gains held more than one year is just 20 percent, compared to 38.6 percent for other income.⁴²

The limited capital gains of middle-income people are taxed at even lower rates. In the 15 percent federal income tax bracket, which includes 46 percent of income tax filers and 66 percent of tax payers, long-term capital gains are taxed at just one-half or less of the maximum rate of 20 percent.⁴³ Gains from assets held between one and four years are taxed at 10 percent, while gains from assets

held five or more years are taxed at 8 percent.⁴⁴

Small businesses with capital gains also receive preferential treatment under the existing tax code. Capital gains from the sale of stock from small businesses with assets under \$50 million are eligible for a 50 percent exclusion from the federal capital gains taxes. Gains from the sale of small business stock that are reinvested in other small business ventures are excluded altogether.⁴⁵

Since the federal tax on capital gains is more than twice Oregon's, if any special treatment is going to influence investor behavior, it will be the federal code. Additional breaks through the state tax code will be gravy for high-income households.

Deferral Proposals: Been there, Done that

In 1999 the Oregon legislature phased-out a 1995 law that allowed a tax deferral on capital gains reinvested in small Oregon companies, similar to what the gubernatorial candidates are now proposing. In a study of the impacts of the law, the Legislative Revenue Office and the Oregon Departments of Revenue and of Economic Development (now the Oregon Department of Economic and Community Development) said the tax deferral was a failure. Most, if

not all, of the investments qualifying for deferral would have happened even without the deferral. In 1996 and 1997 Oregon gave up nearly \$8 million in capital gains tax revenue to support investments, chiefly in agricultural and timber land, agricultural equipment and buildings, and restaurants, which were going to happen anyway.⁴⁶

The deferral program was specifically targeted toward capital gains generated from small

businesses and then reinvested in small businesses, and was supposed to spur job-creating new investments. Despite the promised benefits of the program, there were few takers.⁴⁷ The most common deferral was for dairy cattle.

While a targeted program would have less impact on the state budget, there is little reason to expect a different economic outcome this time.

Conclusion: Appropriate Economic Policy for Oregon's Economy

Oregon's economy fell into recession and is mired in an anemic recovery due to global and national forces far beyond the control of elected officials in Oregon. Cutting Oregon's tax on income held by well-off households will not change this reality and runs exactly opposite the advice given by Joseph Stiglitz, a winner of the 2001 Nobel Prize in Economics. The best thing that states can do in the downturn, Stiglitz suggests, is to maintain spending by taxing the incomes of those who earn far more than they spend, those with high incomes.⁴⁸

Economists commonly recognize a reduction in the capital gains tax rate as an incentive for saving. Increased savings do not reverse an economic downturn. In a recession, spending dries up, depriving businesses of a market for their products. Good anti-recessionary economic policy increases spending, generating demand for the goods and services that businesses produce. Increased savings does the opposite.

Cutting the capital gains tax will drain money from the state and will force further cuts in programs that

serve all Oregonians and those most hurt by the downturn. Tax cuts will force further cuts to education, social services, health care, and the state police.

Lacking significant "rainy day" reserves and unable to engage in deficit spending, officials in Oregon are limited in their ability to address Oregon's slow economy. One important thing state officials can do is avoid budget cuts, if necessary by taxing the incomes of those who would otherwise save it. Oregon officials can also urge the federal government to increase federal spending in the states. Two key areas where Oregon might be able to influence federal spending are with Unemployment Insurance and Medicaid. Federal Temporary Extended Unemployment benefits in Oregon are scheduled to end at the end of December 2002. Additional federal benefits will aid tens of thousands of unemployed workers in the state and provide an important boost to consumer spending. Medicaid enrollment increased along with unemployment in Oregon, further squeezing the state budget. Oregon officials should press the federal government to

raise the Medicaid match rate to offset health care costs associated with job loss.

Planning for the future, lawmakers should put in place a rainy day fund to help stabilize program funding and the economy *when the next* recession hits Oregon. Money should flow into the rainy day fund

only after the economy gets back on its feet.

Cutting the capital gains tax only makes Oregon's precarious revenue situation worse. The tax cut would do little or nothing for the state's economy, and those who would benefit most are those who least need it.

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Endnotes

¹ The Libertarian Party candidate, Tom Cox, was also in the debate and voiced support for a full repeal of the tax on capital gains income. See Stout, Heidi J., "Gubernatorial candidates spar over economic issues," *The Business Journal Portland*, October 3, 2002.

² Nokes, Gregory, "Governor's race offers no quick fix for economy," *The Oregonian*, October 7, 2002.

³ Cost estimate provided by the Institute on Taxation and Economic Policy (ITEP), October 2002.

⁴ ITEP, October 2002.

⁵ Homeowners are allowed to exclude from taxation a capital gain on the sale of their home up to \$500,000 (for joint filers, half that for single), as long as the house was the primary residence for at least two of the last five years.

⁶ Congressional Budget Office, "An Analysis of the Potential Macroeconomic Effects of the Economic Growth Act of 1998," August 1998, page 17.

⁷ Mishel, Lawrence, Jared Bernstein, and Heather Boushey, *The State of Working America 2002-03*, Economic Policy Institute, Washington, D.C., 2002, page 290.

⁸ *State of Working America*, page 287.

⁹ Poterba, James, "Stock Market Wealth and Consumption," *Journal of Economic Perspectives*, Spring 2000, page 102.

¹⁰ *State of Working America*, page 288.

¹¹ Kennickel, Arthur, "An examination of Changes in the Distribution of Wealth from 1989 to 1998: Evidence from the Survey of Consumer Finances," Working Paper No. 307. Jerome Levy Economics Institute, July 2000, page 18.

¹² *ibid.*

¹³ Aaron, Henry, William Gale, and James Sly, "The Rocky Road to Tax Reform," in *Setting National Priorities: The 2000 Election and Beyond*, eds. Henry Aaron, et. al, Brookings Institution, Washington, D.C., 1999, page 246.

¹⁴ Congressional Budget Office (CBO), "An Analysis of the Potential Macroeconomic Effects of the Economic Growth Act of 1998," August 1998. Gross Domestic Product is "the output of goods and services produced by labor and property located in the United States," according to the Bureau of Economic Analysis. See <http://www.bea.gov/beatnewsrel/gdpnewsrelease.htm>.

¹⁵ CBO, page 10.

¹⁶ CBO, page 12. See OCPP, "Empty Promises and False Hopes" page 7 for further discussion of this finding.

¹⁷ CBO estimates that taxable capital gains represent just one quarter of income from business capital stock. CBO, page v.

¹⁸ The "cost of capital" is "the tax adjusted real return that firms must provide to compensate their investors for the returns they forgo by investing money in the firms' projects and the depreciation rate on new capital." Fazzari, Steven and Benjamin Herzon, "Capital Gains Tax and Economic Growth," Jerome Levy Economics Institute, 1996, pages 26-27.

¹⁹ Fazzari and Herzon, page 28.

²⁰ The basic reasons behind the lack of an impact on economic growth are laid out in Burman, Leonard, *The Labyrinth of Capital Gains Tax Policy*; Gravelle, Jane, *Economic Effects of Taxing Capital Income*; Gravelle, Jane “Capital Gains Taxes, Innovation and Growth,” and Fazzari, Steven and Benjamin Herzon, “Capital Gains Taxes and Economic Growth.”

²¹ CBO, page 17.

²² Gravelle, Jane, “Limits to Capital Gains Feedback Effects,” *Tax Notes*, 363, 1991, page 364.

²³ Gravelle, Jane, “Capital Gains Taxes, Innovation, and Growth,” *Tax Notes*, 1999. Just 12 percent of venture capital is subject to the capital gains tax.

²⁴ Gravelle, “Limits to Capital Gains Feedback Effects.” Under current law, the beneficiaries of bequests receive them on a “stepped up basis,” and are able to avoid tax on any capital gains which accrued before the bequest.

²⁵ See Thompson, Jeff, “Empty Promises and False Hopes: The Reality of Capital Gains Tax Cuts in Oregon,” Oregon Center for Public Policy, April 9, 2001. Available at <http://www.ocpp.org/2001/es010409.htm>.

²⁶ Fazzari and Herzon.

²⁷ Comments made by Treasury Secretary Paul O’Neill at his confirmation hearings. Available at <http://www.senate.gov/~finance/SFINANC2.pdf>.

²⁸ Burman, Leonard, *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed*, Brookings Institution, Washington, D.C., 1999, page 62.

²⁹ According to the Bureau of Economic Analysis, Oregon’s Gross State Product in 2000 was \$118.6 billion. See <http://www.bea.gov>.

³⁰ By the tenth year following the enactment of the tax cut any impact on growth is thought to be fully incorporated into the economy. In the first year following enactment, the optimistic, yet realistic, model analyzed by CBO projected a 0.01 percent increase in GDP.

³¹ In 1997-99, 22.5 percent of the state’s general fund budget went to the Department of Human Services.

³² The 1997-99 actual spending by DHS included \$1.89 billion in general fund dollars and \$3.3 billion in federal funding. The vast majority of federal spending by DHS is on Medicaid matching dollars, which totaled 69 percent of the agency general fund budget. Some other programs have even higher match rates, while others receive federal funding, but not on a matching basis.

³³ ECONorthwest, “The Economic Impacts On the Oregon Economy from the Loss of Federal Matching Funds for Long-Term Care Services for Seniors and Persons With Disabilities,” 2002, page 3.

³⁴ The 1997-99 actual spending, Medicaid long-term care services occupied \$251 million in general fund dollars, accounting for over 13 percent of DHS general fund dollars.

³⁵ OCPP analysis of BEA data.

³⁶ *The Oregonian* quotes Mannix: “I believe that within six months the economy would be so improved that the regular income taxes coming in would make up for any cash reductions from the reduction in capital gains.” Nokes, Gregory, “Governor’s race offers no quick fix for economy,” *The Oregonian*, October 7, 2002.

³⁷ Burman, *Labyrinth*, page 146.

³⁸ LRO analysis of SB 67 available at <http://www.leg.state.or.us/comm/sms/SMS01Frameset.html>.

³⁹ LRO analysis of SB 67 showed that it would cost \$250 million per year when fully implemented. Projected revenue losses from a capital gains tax cut in 2003 will be smaller than a similar size cut in 2000 because the stock market collapse has eliminated a considerable amount of anticipated capital gains.

⁴⁰ Burman, Leonard, "The Answer Isn't Capital Gains," *The Houston Chronicle*, September 30, 2001.

⁴¹ Example of benefits of deferred taxation from Brookings, "The Rocky Road to Tax Reform," page 229, note 26. "A simple example illustrates the size of this differential. Suppose that a person in the 28 percent bracket invests \$1,000 in a thirty-year bond yielding 10 percent annually in taxable interest and invests the interest earnings in bonds also yielding 10 percent. At the end of thirty years the investment will have grown to \$8,051. Suppose instead that the investor buys an appreciating asset that grows at an annual rate of 10 percent, sells the asset after thirty years, and pays the capital gains tax of 20 percent on the appreciation. The investor will realize \$14,160 after paying tax, a value 76 percent larger than on the bond. The annual tax rate equivalent of the capital gains tax is only 7.6 percent."

⁴² A 28 percent rate does apply to gains from the sale of some small business stock held more than five years, but the tax only applies to half of the gain, excluding the other half entirely from taxation. Sales of collectibles, including antiques, are taxed at the 28 percent rate.

⁴³ In 1999 a couple filing jointly with up to \$43,000 in taxable income is in the 15 percent bracket. Brookings, "The Rocky Road to Tax Reform," page 216.

⁴⁴ Burman, *Labyrinth*, page 12.

⁴⁵ Oregon Department of Revenue and the Legislative Revenue Office, "Oregon's Capital Gains Deferral Program," 1999, pp. 10-11.

⁴⁶ *ibid.*

⁴⁷ The agencies noted that there is some movement of taxpayers to Washington state to avoid Oregon capital gains taxes, but this does not necessarily mean that investments in Oregon leave the state or that deferral stops the flow of people and their tax dollars. The study noted that "[t]he movement of Oregon residents to Clark County, Washington, even if it is to avoid Oregon's income tax on capital gains, does not necessarily lead to less investment in Oregon." The agencies found "no evidence that, in its first two years, Oregon's capital gains deferral program has slowed the movement of taxpayers to Clark County."

⁴⁸ Stiglitz, Joseph and Peter Orszag, "Budget Cuts Vs. Tax Increases at the State Level: Is One More Counter-productive than the Other During a Recession?" Available at <http://www.cbpp.org/10-30-01sfp.pdf>.