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Taxes and Capital Formation

Edited by
Martin Feldstein

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Taxes and Capital Formation

A National Bureau
of Economic Research
Project Report

Taxes and Capital Formation

Edited by **Martin Feldstein**

The University of Chicago Press

Chicago and London

Martin Feldstein is the George F. Baker Professor of Economics at Harvard University and president of the National Bureau of Economic Research. He is the author of *Inflation, Tax Rules, and Capital Formation,* and editor of *The American Economy in Transition, Behavioral Simulation Methods in Tax Policy Analysis,* and *The Effects of Taxation on Capital Accumulation,* all published by the University of Chicago Press.

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(Resolution adopted October 25, 1926, as revised through September 30, 1974)

Contents

Acknowledgments

This volume presents seven relatively nontechnical papers that were prepared as part of a research project by the National Bureau of Economic Research (NBER) on the effects of taxation on capital accumulation. Brief summaries of seven additional studies are also included in the volume. The volume is designed to distribute the results of the NBER's research beyond the usual audience of professional economists and policy specialists. As part of that same effort, the seven papers in this volume were presented at a conference for government and corporate officials in Washington, D.C., on 28 May 1986.

Technical versions of the fourteen studies described here are being published separately in *The Effects of Taxation on Capital Accumulation*, edited by Martin Feldstein (NBER volume published by the University of Chicago Press, 1987). The NBER research on taxation and capital accumulation has been discussed at regular meetings of the bureau's tax program and at special meetings focused on this project.

The collaborative research in this project is made possible by the ongoing activities of the NBER's tax program under the guidance of program director David F. Bradford. National Bureau Directors Andrew Brimmer, Walter W. Heller, and James L. Pierce reviewed the entire manuscript. National Bureau staff members Mark Fitz-Patrick, Deborah Mankiw, Kathi Smith, Annie Spillane, Gail Swett, and Kirsten Foss Davis contributed to the overall effort.

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Introduction

Martin Feldstein

It has long been recognized that there is an important effect of capital accumulation on productivity and economic growth. In fact, more than fifty years ago the pioneering studies of capital accumulation that were done at the National Bureau of Economic Research by Nobel laureate Simon Kuznets began the process of developing quantitative knowledge about capital formation and its link to economic performance.

In the years since Kuznets began his work, many other researchers at the NBER have studied capital formation. In the 1950s, Milton Friedman and Raymond Goldsmith made important contributions to the subject. The list of researchers and the range of issues studied grew rapidly in the 1960s and 1970s.

The NBER is currently engaged in several related studies of the accumulation and financing of capital in the United States. One of these is a study of the effects of taxation on capital accumulation, including the effects on saving, risk taking, and corporate investment in the United States and abroad. The papers presented in this volume summarize seven of the individual research projects within that study.

Longer technical reports on these research projects will appear in a separate volume, *The Effects of Taxation on Capital Accumulation*, edited by me. That volume will also contain technical reports on seven additional studies that are summarized more briefly in the second part of the current volume.

We hope that these summary papers will be of interest to a wide audience of policy officials and staff, members of the business community, and others who are concerned about the effects of taxation on capital formation. In keeping with the NBER's tradition, these papers do not make any policy recommendations. Even when the researcher is convinced that a particular type of tax change will have an undesirable effect on capital formation, he or she does not offer an overall evaluation of any of the recent tax proposals because the effect on capital formation is only one of many criteria by which the desirability of a tax proposal should be judged.

A researcher might conclude, for example, that eliminating the investment tax credit would reduce investment in equipment but might nevertheless favor doing so because the revenue raised in that way could be used to help the poor by raising the zero-bracket amount or to stimulate work effort by reducing personal marginal tax rates. The papers in this volume make no attempt to assess these other aspects of the recent tax proposals and therefore should not and do not make any recommendations with respect to the alternative policy proposals.

The emphasis in these studies is on developing a better understanding of how the economy works and how specific policies would affect particular aspects of the economy. We hope that these analyses will contribute to the formulation of better economic policy in the years ahead.