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Recent U.S. Investment Incentives

Prepared by Christopher M. Towe ¹/

Authorized for Distribution by Jorge Márquez-Ruarte

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Abstract

The apparent slowdown in U.S. investment and productivity growth in recent years has led to a number of proposals to stimulate investment through the adoption of tax incentives. This paper describes the incentives that were contained in the February 1993 Budget and estimates their effect on the user cost of capital. The recent evidence regarding the effect of tax changes on investment in the United States is reviewed, and the likely effect of the Budget's proposals on investment and overall economic activity is simulated. The simulations suggest that the proposals would have had a stimulative but largely transitory effect on U.S. investment and output.

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Summary

Concern that the tax changes adopted during the 1980s contributed to the secular decline in net investment in the United States has led to interest by both the previous and current Administrations in the adoption of investment tax incentives (ITC). This interest was manifested in proposals in the January 1992 Budget that included a reduction in the capital gains tax and proposals in the February 1993 Budget that included the reintroduction of an investment tax credit. Estimates are reported that suggest a decline of roughly 10 percent in the user cost of producer durables could have been expected to result from the Administration's February 1993 proposals.

However, empirical study of the 1980s, a period in which changes to the tax code had even larger effects on the cost of capital, has not supported the conclusion that tax policy has been responsible for the recent decline in investment demand. Moreover, simulations of the Budget's proposals suggested that while a stimulus would have resulted from the temporary introduction of an ITC, it would have largely reflected the bringing forward of investment that would otherwise have been made.

I. Introduction

In recent years the apparent slowdown in U.S. investment and productivity growth has spurred interest in the adoption of tax measures that could stimulate investment. The interest in tax incentives stems in part from fears that tax changes, particularly aspects of the 1986 U.S. tax reform, have contributed to the decline in investment by removing incentives to invest.

This concern has led to a number of recent proposals to stimulate investment through the adoption of tax incentives. For example, the January 1992 Budget contained a number of investment tax incentives, including that to reduce the capital gains tax rate. Most recently, the February 1993 Budget also proposed a set of tax measures designed to promote investment, including the reintroduction of the investment tax credit that was eliminated as part of the 1986 tax reform. ^{1/}

Despite recent support for the introduction of investment incentives, questions remain regarding their effectiveness in stimulating investment. It is to this issue that this paper is primarily addressed. Following a review of recent investment trends, Section III describes the Administration's investment stimulus proposals. Section IV estimates the effect of such measures on the cost of capital. Section V reviews recent work on the effect of the 1986 Tax Reform on the cost of capital and investment demand, and Section VI simulates the effect of the Administration's proposals on investment and real GDP.

The results of the simulation exercise indicate that incentives of the type proposed in the February 1993 Budget would have had a positive effect on real GDP. However, this effect would have been mainly transitory owing to the fact that the principal proposal--the investment tax credit--was to be largely temporary. Congressional budget debate resulted in the withdrawal of a number of the more important incentives proposed in the February 1993 Budget, suggesting that the stimulus that may result from the remaining measures will be small.

II. Recent Trends in Investment

When measured on a gross basis--i.e., including purchases of capital equipment for replacement purposes--the aforementioned slowdown in investment demand is not apparent. For example, while the ratio of gross nonresidential fixed investment (measured in constant dollars) as a share of real GDP fell from 11 1/2 percent in the first half of the 1980s to just over 10 1/2 percent in 1990-92, it remained above levels recorded in the

^{1/} Note that the term February 1993 Budget refers to the proposals released in February following the President's State of Union address, rather than the budget documents that were issued in April.

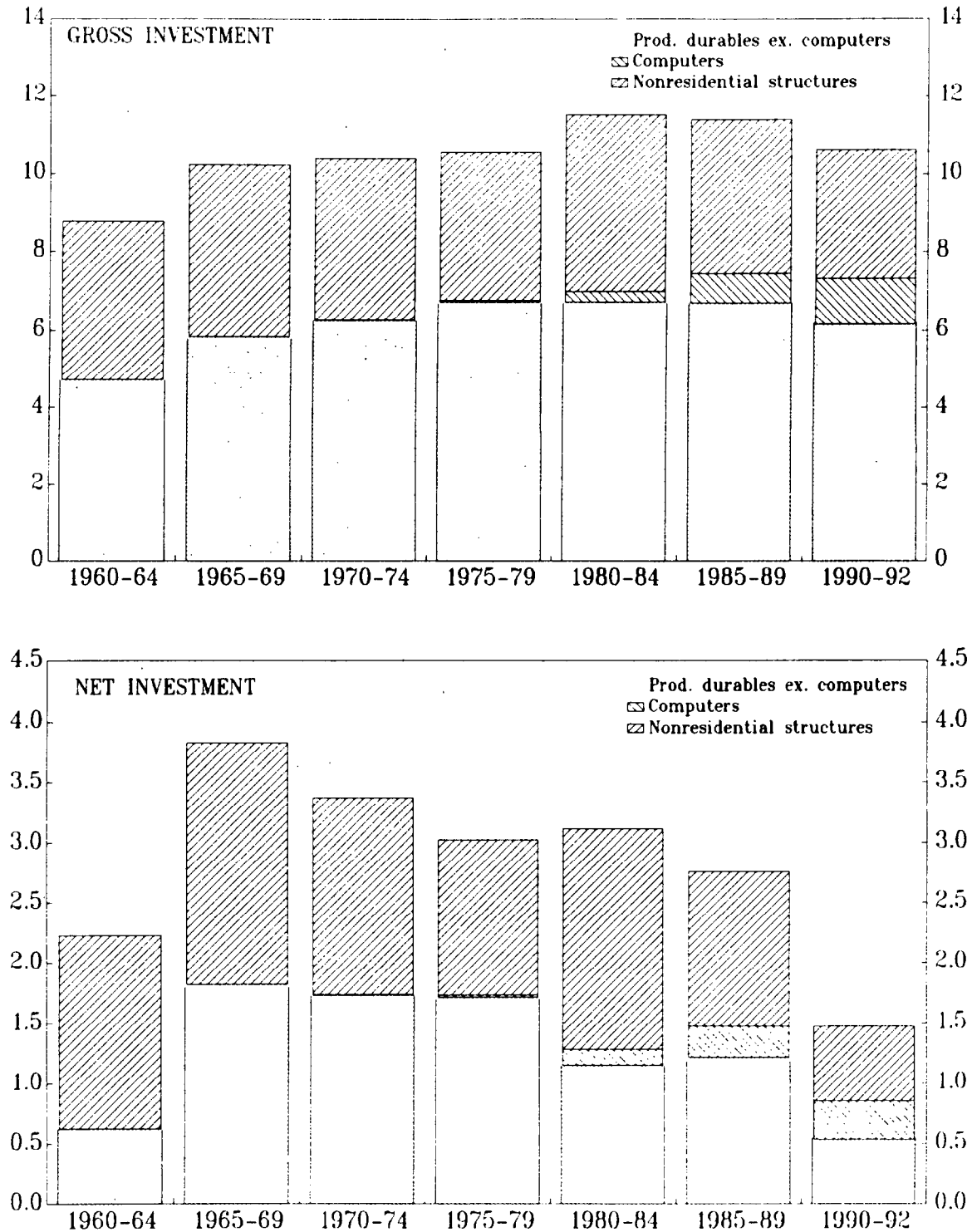
1960s (Chart 1). The fall in gross investment over this period has been attributed to two special factors that affected investment in nonresidential structures. In particular, the decline in oil prices in the latter half of the 1980s sharply reduced purchases of drilling rigs and other oil-related structures. In addition, the elimination of "passive loss" provisions for investment in real estate, including nonresidential structures, by the Tax Reform Act of 1986 limited investors' ability to deduct losses in real estate against other income and significantly decreased the attractiveness of such investment (see Appendix I for details of recent tax legislation affecting investment). Gross investment in producer durable equipment rose consistently in the latter half of the 1980s, and fell only marginally in 1990-92, despite the cyclical downturn. However, within this category a substantial shift in the share devoted to computers and related equipment is evident.

While gross investment is an important component of aggregate demand, it is also useful to consider the trend in net investment, i.e., in purchases of capital less the amount required to offset depreciation, since it represents the net addition to the capital stock that contributes to changes in the productive capacity of the economy. Moreover, it is firms' decisions regarding net changes to their capital stock, rather than the depreciation of assets, which is considered to be most responsive to other economic variables, including tax policy. ^{1/}

When measured on a net-of-depreciation basis, a secular decline in investment since the latter half of the 1960s is more apparent. From a peak of 3 3/4 percent of GDP in the last half of the 1960s, total net investment fell steadily to 2 3/4 percent in the last half of the 1980s, and dropped sharply to 1 1/2 percent in 1990-92. This reflects the increasing share of gross investment that has been devoted to offsetting depreciation rather than increasing the capital stock, in turn related to the increasing share of investment in high technology equipment that depreciates at a substantially faster rate. However, the downward trend in net investment is most evident for nonresidential structures and noncomputer producer durables. In contrast, net investment in computers has shown strong growth since the early 1980s, likely owing in part to rapidly falling prices of such equipment.

^{1/} Of course, tax policies can affect the choice between capital goods with high versus low rates of depreciation. Moreover, replacing capital with newer and more productive equipment improves the economy's potential output. Note also that net investment data is calculated on the basis of estimated depreciation and is subject to measurement error.

CHART 1
UNITED STATES
FIXED NONRESIDENTIAL INVESTMENT
(In Percent of GDP)



III. Recent Investment Stimulus Proposals ^{1/}

Recent proposals for investment tax incentives include the January 1992 Budget's "growth agenda," which called for the adoption of a number of investment incentive measures, including the reduction in the tax on capital gains from 28 percent to 15.4 percent. ^{2/} It also included the proposed provision of passive loss relief on real estate transactions, ^{3/} the introduction of a 15 percent investment tax allowance, simplification of Alternative Minimum Tax depreciation schedules, the establishment of enterprise zones, and the adoption of incentives for research and development. In the event, however, legislative support for these initiatives was not forthcoming.

In February 1993 the current Administration introduced a similarly broad-ranging set of proposals to stimulate private sector investment, the principal component being the reintroduction of the investment tax credit (ITC) that was repealed in 1986. A permanent small business investment tax credit would provide a 7 percent credit for property placed in service during 1993-94, and a 5 percent credit for property put in place thereafter. ^{4/} A small business would be defined as a business with gross receipts of less than \$5 million in the preceding three years.

For other businesses a temporary incremental tax credit of 7 percent was proposed for property placed in service during 1993-94. This would permit tax credits for 50 percent of investments in excess of a fixed base, which would be defined as the average level of investment during 1987-91 (indexed by GDP growth and multiplied by 0.7 in 1993 and 0.8 in 1994).

In addition, the Administration proposed a number of other investment incentives. First, the Alternative Minimum Tax (AMT) depreciation schedules would be modified in order to match those used to calculate regular tax liabilities. ^{5/} Specifically, a 120 percent declining balance depreciation schedule would be adopted under the AMT, the same formula used

^{1/} For details see U.S. Department of the Treasury (1993).

^{2/} Specifically, the proposal provided for the exclusion of up to 45 percent of capital gains from the 28 percent tax.

^{3/} Losses from real estate activities in which taxpayers do not "materially participate" are treated as passive.

^{4/} The ITC would have applied to tangible property (excluding buildings or their structural components) used for manufacturing, and extraction, or for furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services. For property with a three-year tax life, the rate would be one third the regular rate, property with a five-year tax life would receive two thirds the regular rate, property with a seven-year tax life would receive four fifths the regular rate, and property with a tax life beyond seven years would receive the full rate.

^{5/} For corporations AMT is calculated as 20 percent of taxable income defined to include tax preferences and adjusted for the tax treatment of certain items. A 24 percent AMT rate applies to individuals.

under the regular tax system. 1/ This would simplify the system and would imply an investment incentive, since the calculation for businesses under the AMT generally utilizes less advantageous depreciation schedules (straight line) than the regular tax system.

Second, a targeted capital gains exclusion was proposed to enable investors to exclude from tax 50 percent of the capital gains from holdings of stocks of small businesses held for at least five years. 2/ Additional incentives included the adoption of enterprise zones--economically distressed areas in which tax incentives would apply--and the provision of passive loss relief for certain real estate transactions.

In order to offset the revenue losses associated with the above, an increase in the top marginal corporate tax rate from 34 percent to 36 percent also was proposed. An increase in the recovery period for nonresidential property from 31 1/2 years to 36 years also was proposed in order to bring tax lives more in line with economic depreciation rates. (The specific measures that were included in the budget bill passed by the Congress in August are detailed in Appendix II.)

IV. Incentives and the Cost of Capital

The measures described above would be expected to have an effect on the cost of capital and thus on investment. In particular, in the standard neoclassical model profit maximization results in firms investing until the real marginal product of capital is reduced to the marginal user cost of capital C . The desired capital stock, and therefore investment demand, is inversely related to the cost of capital. In the absence of corporate taxes, the cost of capital is simply the product of the relative price of capital and the real interest rate, i.e., $C = q(i + \delta - \pi)$, where the real interest rate is defined as the nominal rate (i) plus the depreciation rate (δ) less the inflation rate (π).

The existence of corporate and personal income tax systems complicates the derivation of the cost of capital. For example, in the presence of income and capital gains taxes, as well as depreciation allowances, the cost of capital would be:

$$C = q([i + \delta - \pi](1 - k - uz) - i_l g) / (1 - u)$$

1/ Note that residential and nonresidential property would utilize the straight line method, as under the regular tax system.

2/ For the purpose of this proposal a small business was defined as a corporation with less than \$25 million of aggregate capitalization on January 1, 1993 excluding businesses engaged in personal service, banking, leasing, real estate, farming, mineral extraction, and hospitality services.

where τ is the tax rate on capital gains, u is marginal corporate income tax rate, i is the cost of funds, δ is the economic depreciation rate, z is the present value of depreciation allowances, π is the expected rate of increase of asset prices, k is the investment tax credit per dollar of new investment, ℓ is the share of investment financed by debt, g is the gain from debt financing, $\frac{1}{q}$ and q is the price of capital relative to the price of output.

Income taxes (at the rate u) increase the effective cost of capital by reducing the revenue accruing from capital investment. An investment tax credit, which permits k percent of the cost of new investment to be deducted from corporate income tax, reduces the effective corporate tax rate and the cost of capital. Taxes on capital gains at the rate τ increase the effective cost of capital to the extent that asset prices increase at the rate π . Finally, corporate tax systems typically permit firms to deduct some measure of depreciation against income as implicit compensation for the cost of "wear and tear." In this formulation, the present value of depreciation allowances per dollar of investment (z) reduces the cost of capital, depending on the corporate tax rate.

The tabulation below simulates the static effect on the cost of capital of the three principal proposals that were included in the February 1993 Budget: the introduction of an ITC, the increase in the marginal corporate tax rate, and the extension of the service life of nonresidential structures. The net effect of these three measures is estimated to reduce the cost of capital for computers and other producer durable equipment by 10 1/2 and 12 1/4 percent, respectively. As can be seen, this reduction largely results from the ITC; the increase in the corporate tax rate has a relatively modest effect. As the ITC would not apply to structures, the cost of capital for this category would rise by 2 1/2 percent owing to the extension of service lives.

$\frac{1}{q}$ The gain from debt financing results from the deductibility of interest payments from taxable income and any differential between market rates of return on debt (i) versus equity (r). Also the gain from debt financing increases to the extent that there is a wedge between personal tax rates on dividend income and capital gains. Thus, g is defined as

$$g = 1 - (1-u)(r/i)[(1-\tau_g)/(1-\tau_d)]$$

where τ_g is the tax rate on capital gains and τ_d is the tax rate on dividend income.

Static Effect of the February 1993 Budget Investment Incentive
Proposals on the User Cost of Capital 1/

(In percent of the baseline value)

	<u>Producer Durables</u>		<u>Nonresidential</u>
	<u>Computers</u>	<u>Other</u>	<u>Structures</u>
7 percent ITC	-10.4	-11.5	--
Increase in corporate tax rate to 36 percent <u>2/</u>	0.2	-0.5	0.7
Increase in service life of nonresidential structures	--	--	2.0
Total measures <u>3/</u>	-10.6	-12.3	2.6

The effects of the measures on the cost of capital likely would be mitigated over time by a number of factors. First, as investment demand responded to the incentives, the price of capital equipment and interest rates would tend to rise, diminishing the reduction in the cost of capital. Second, the full 7 percent ITC rate would apply only to property with a service life of seven or more years; a lower rate would apply to other investments. Moreover, the 7 percent ITC was intended to be a temporary measure, expiring after two years. The permanent ITC would be only 5 percent and would only apply to small businesses. Thus, for larger businesses the investment incentive would be relatively short lived.

1/ The static estimates were calculated using the Washington University Macroeconometric Model of the United States, assuming no change in prices or interest rates. For details regarding the calculations of the components of the cost of capital, see Laurence H. Meyer (1989). Note that the estimates do not consider the impact of proposed changes to the personal tax system on the gain from debt financing (g).

2/ Note that the decline in the cost of capital for "other" producer durables as the corporate tax rate rises results from the effect of higher tax rates on the net benefit of depreciation allowances.

3/ Note that the total effect of the measures is not sum of the individual effects owing to the nonlinear nature of the cost of capital formula.

V. Recent Evidence on the Effect of Investment Tax Incentives

During the 1980s relatively frequent legislative changes were made to investment incentives. Legislation was adopted in 1981 to extend the Investment Tax Credit (ITC) and enhance depreciation allowances, in response to economic slowdown that began in 1979 (see Appendix I for details). These incentives were scaled back somewhat by legislative changes adopted in 1983 and 1984. As the economy entered a prolonged period of expansion, the Tax Reform Act (TRA) was adopted in 1986, which severely limited tax-related investment incentives. Most significantly, the ITC was eliminated and depreciation periods were lengthened.

Estimates of the incentive effect of the TRA vary widely, but generally suggest that its effect was to increase the cost of capital substantially. For example, the Council of Economic Advisers (1987) estimated that the static impact of the TRA was to raise the cost of capital for machinery and equipment by 62 percent and to raise the cost of investment in nonresidential structures by 17 percent. Evans and Kenward (1988) estimated increases of 27 percent and 43 percent, respectively. Prakken, et al. (1991) estimated that the effect of the TRA was to increase the user cost by 19 percent and 12 percent, respectively. ^{1/} Moreover, these estimates do not measure the impact of the TRA's elimination of the deductibility of passive losses of business and real estate transactions against other income, and so may underestimate the impact of the TRA.

Despite the magnitude of these changes, most researchers have concluded that they did not exert a substantial effect on business investment. ^{2/} For example, Bosworth and Burtless (1992) surveyed recent efforts to isolate the impact of investment tax incentives on investment and concluded that they played a "relatively minor role in explaining the pattern of aggregate investment over the decade." ^{3/} Prakken et al. (1991) estimated investment demand functions that suggested that the TRA's effect was to lower gross durable equipment demand by only 4 percent and to lower purchases of nonresidential structures by 2 percent, by 1990. Evans and Kenward (1988) obtained similar results, implying a reduction of 4 percent and 3 percent, respectively, by 1990. Corker, Evans, and Kenward (1993) examined the effect of tax legislation during 1980-87 and found that the

^{1/} Differences between the estimates described above partly reflect differences in the way in which the personal tax system is assumed to interact with the cost of capital.

^{2/} Note, however, that a number of previous studies argued that such tax legislation would have a large impact, e.g., Feldstein (1982) and Summers (1981).

^{3/} Fazzari, Hubbard, and Petersen (1988) argued that one reason for this small role may be the fact that liquidity constraints prevent many firms from funding investment in capital markets. Thus, tax policies would have the greatest effect on investment through their impact on firms' cash flows.

cumulative effect of tax changes over the period was to lower total business fixed investment by no more than 2 percent by 1991.

Auerbach and Hassett (1990) suggested that the TRA had been relatively unimportant in explaining the level and variation in business fixed investment in the late 1980s. However, the same authors (1992) concluded that tax policy had been a significant determinant of investment demand, and that the effect of a permanent increase in the cost of capital of 10 percentage points would be to lower gross equipment investment by 1 1/2 percent. ^{1/}

Thus, the evidence from the 1980s indicates that the legislative changes that occurred during this period had a relatively modest medium-term effect on investment demand. Nonetheless, empirical estimates of investment demand, including those described above, generally do suggest that changes to the cost of capital ultimately will have a large effect on investment, but only with a long lag. This, and the fact that many of the tax measures that were adopted in the early 1980s were reversed by the TRA, may explain the difficulty in identifying an effect on recent investment trends of investment tax incentives.

VI. Simulated Macroeconomic Impact of the Administration's Proposals ^{2/}

In order to provide an indication of the possible effect of the February 1993 Budget's investment incentive proposals on investment and output, they were simulated using the Washington University Macroeconomic Model. ^{3/} The model utilizes the standard neoclassical approach to investment demand, in which changes in the cost of capital would tend to have significant long-run effects. In particular, it assumes that investment demand results from CES production functions, where the

^{1/} One of the few papers suggesting a major impact of the TRA is that by Auerbach and Hassett (1991). They used cross sectional time series data to fit investment equations for the pre-1986 data and examine the prediction errors for the post-1986 data to determine the extent to which they resulted from tax changes. Auerbach and Hassett concluded that equipment investment was roughly 20 percent lower in 1987-89 than would have been predicted by a model that excluded tax variables, and that as much as half the underprediction could be explained by tax factors. They were unable to assign a significant role for tax changes to the similar overprediction of investment in nonresidential structures.

^{2/} The simulations below draw heavily on the analysis presented by Laurence H. Meyer & Associates in their March 10, 1993 memorandum.

^{3/} The Washington University Macroeconomic Model (WUMM) is a quarterly simulation model with over 350 equations and 137 exogenous variables. It is characterized by neoclassical long-run demands for fixed investment and labor, an expectations-augmented Phillips curve which is vertical in the long-run, and adaptive expectations. For details see Meyer (1989).

elasticity of substitution is 0.6 and capital is "putty-clay" (i.e., responds with a long lag), so that a 1 percentage point increase in the user cost of capital would reduce investment by 0.6 percent in the long run.

A baseline projection was simulated and compared to an alternative projection in which the three elements of the Administration's tax measures were included. In particular, the alternative scenario assumed that the top marginal corporate tax rate was increased from 34 to 36 percent, that the service life for structures was increased from 31 1/2 years to 36 years, and that an ITC of 7 percent was implemented for two years, followed by a permanent ITC of 5 percent for small businesses. 1/

The results of the simulation are shown in Chart 2. As can be seen, the effect of the tax measures on gross investment is substantial in the near term. In particular, gross purchases of computers and other producer durables rise to 9 percent and 5 percent above their baseline values, respectively, by the seventh quarter. However, this increase is largely owing to the assumption that the ITC is transitory for most firms, which serves to bring forward investment that would otherwise have been made.

Thus, purchases of producer durables fall below their baseline levels in the eighth quarter after the tax change and return to baseline by the fourth year. Investment in nonresidential structures is boosted initially by the increase in overall activity, despite the disincentive associated with the lengthened tax life, rising to 2 percent above baseline by the seventh quarter. However, as overall activity begins to wane, the effect of the increased cost of capital begins to dominate, and gross investment in nonresidential structures falls below baseline in the fifth year of the simulation. 2/

The tax measures have a relatively large effect on the stock of producer durables, which increase to just over 1 percent above the baseline by the seventh quarter. However, after the expiration of the temporary ITC, the effect on producer durable stocks declines to roughly 1/2 percent of the baseline value. The stock of nonresidential structures increases somewhat initially, relative to the baseline, but falls below baseline by the end of the simulation period. Real GDP is boosted by as much as 1/2 percent during the second year, owing to the surge in investment. However, this gain is temporary, and as investment falls below baseline, real GDP also is depressed during the remainder of the simulation period.

1/ Allowance was made for the fact that the temporary ITC would have applied only to investment above a prespecified base level, as well as for the fact that the permanent portion would have affected only a small proportion of business activity.

2/ The CBO (1993) also suggested that the effect of the ITC would have been relatively modest.

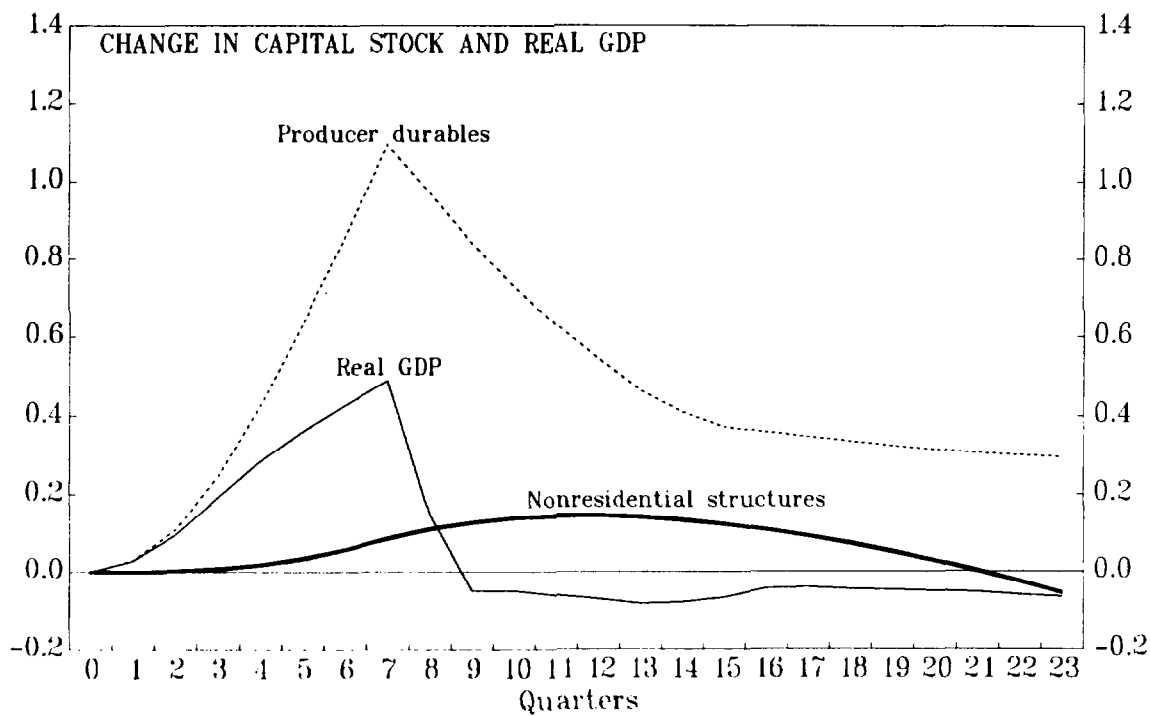
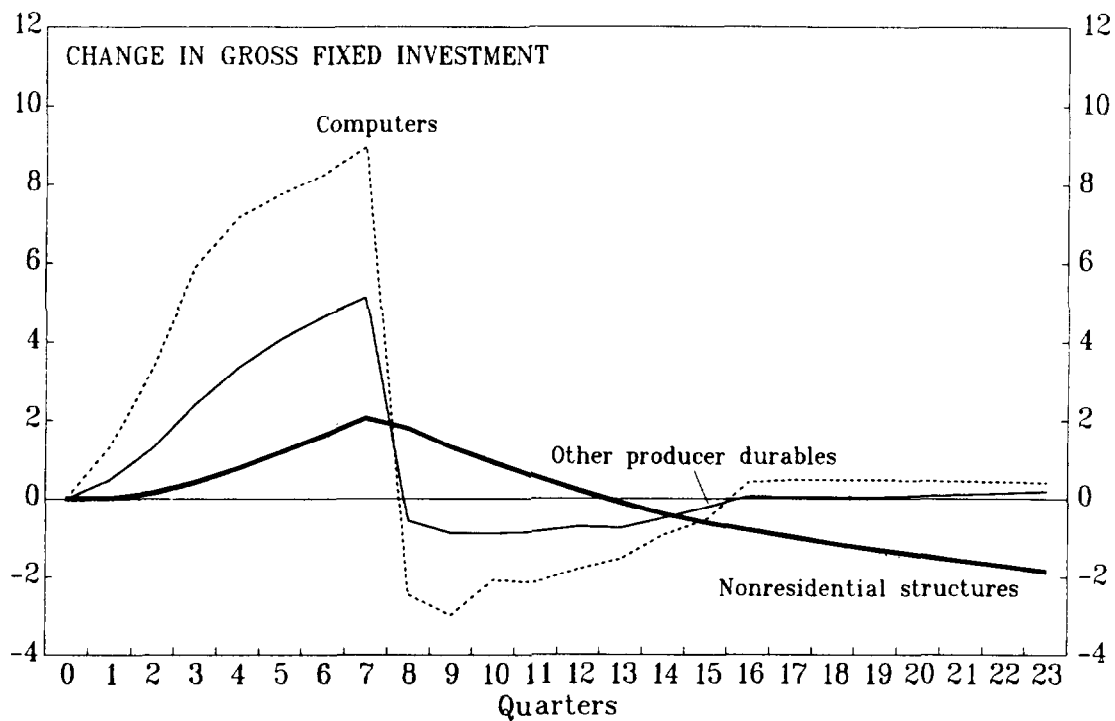
The Congress' emphasis on deficit reduction resulted in a much-reduced package of investment incentives than was included in the February 1993 Budget (see Appendix II for details). In particular, the proposed ITC was abandoned, the increase in the top marginal tax rate was reduced to 1 percentage point, and an increase in the amount of new capital spending that small businesses could write off was proposed. Simulations of this modified package were performed, but are not reported since, unsurprisingly, the effects on investment and real GDP were virtually zero.

VII. Concluding Remarks

As discussed above, the secular decline in net investment in the United States has contributed to interest by both the previous and current Administrations in the adoption of investment tax incentives. This interest was manifested in proposals in the January 1992 Budget that included a reduction in the capital gains tax, and proposals in the February 1993 Budget that included the reintroduction of an investment tax credit. The measures proposed in the February 1993 Budget would have had a significant effect on the cost of capital. Estimates reported above suggest that a decline of roughly 10 percent in the user cost of producer durables could be expected to result from the Administration's proposals.

However, empirical study of the 1980s, a period in which changes to the tax code had even larger effects on the cost of capital, has not supported the conclusion that tax policy has been responsible for the recent decline in investment demand. Moreover, simulations of the Budget's proposals suggested that while a stimulus would have resulted from the temporary introduction of an ITC, it would have largely reflected the bringing forward of investment that would otherwise have been made.

CHART 2
UNITED STATES
SIMULATED CHANGE IN CAPITAL STOCK AND REAL GDP
(In percent deviations from baseline)



Recent U.S. Investment Incentive Initiatives 1/

Besides reducing marginal personal income tax rates, the Economic Recovery and Tax Act (ERTA) of 1981 also contained a number of provisions that increased the incentives to invest. In particular, the tax burden on income from new investment was reduced through the introduction of the Accelerated Cost Recovery System, which reduced the number of depreciation classes and substantially reduced the average tax life for assets, with effect from January 1, 1981. In addition, depreciation schedules were amended, in some cases partially offsetting the shortened tax lives. ERTA also contained a provision for further accelerating depreciation schedules over 1983-86. In addition, ERTA extended the investment tax credit (ITC) to some short-term assets that had not been previously covered. 2/

The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1983 amended some of the provisions of the ERTA, reducing investment incentives with effect January 1, 1983. The acceleration of depreciation schedules proposed under the ERTA was canceled, and the depreciable base of assets--that is, the amount of the asset upon which depreciation allowances were calculated--was reduced by half the amount of the value of the ITC. The Deficit Reduction Act (DEFRA) increased the top depreciation tax life from 15 to 19 years, with effect from March 16, 1984.

The Tax Reform Act (TRA) of 1986 included the abolition of the ITC effective at the beginning of 1986. The TRA increased the depreciation life of various assets significantly, offset in part by more generous depreciation schedules. 3/ In addition, the maximum tax rate on capital gains was raised to 28 percent, while the maximum corporate tax rate was cut from 46 percent to 40 percent in 1987, and to 34 percent thereafter.

1/ For additional details, see Bosworth and Burtless (1992) or Corker, et al (1993).

2/ The ITC had been introduced in 1962 during the Kennedy Administration.

3/ In particular, under the Accelerated Cost Recovery System of 1981 most equipment was depreciated by a 150 percent declining balance schedule, which included an allowance for the "half-year convention," an offset against the depreciable base equal to 50 percent of the ITC, and a recovery period that averaged 4.6 years. The TRA raised the recovery period to 6 years, but allowed the use of the double-declining balance formula for the depreciation of most classes of equipment. For structures, the TRA mandated the use of straight line depreciation schedules and lengthened the recovery period. See Prakken, Varvares, and Meyer (1991) for details.

Investment Incentives in the February 1993 Budget
and Omnibus Budget Reconciliation Act of 1993 ^{1/}

	February 1993 Budget	The Omnibus Budget Reconciliation Act of 1993
1. Extension of research tax credit	Budget proposed a permanent extension of the 20 percent research tax credit, which expired June 30, 1992.	OBRA93 extended the research tax credit for three years (to July 1, 1995).
2. Capital gains exclusion for small business stock	None.	OBRA93 allowed taxpayers to postpone the capital gains realized on publicly trade stock provided that the proceeds of the sale are used to purchase small business investment companies. The amount of capital gain eligible for rollover by individuals is the lessor of \$50,000 or \$500,000 reduced by the gain previously excluded under this provision. For corporations the limits are \$250,000 and \$1 million.
3. Investment tax credit	The Budget proposed an incremental investment tax credit of 7 percent for property placed in service during 1993 and 1994 over and above a historical base. A small business investment tax credit of 7 percent during 1993 and 1994, and 5 percent thereafter, would apply to businesses with annual receipts below \$5 million.	None.
4. Targeted capital gains exclusion	The Budget would permit individuals to postpone 50 percent of the capital gains realized on qualified small business stock held for at least 5 years. Qualified stock had to have been purchased after 1992, and the amount eligible for exclusion was limited to the greater of ten times the investor's basis or \$1 million.	Same, except that the limit on the exclusion was increased to \$10 million.
5. Modification of alternative minimum tax (AMT) depreciation rules	The Budget proposed adopting the 120 percent declining balance method for calculation of AMT depreciation.	OBRA93 adopted a 150 percent declining balance method under the AMT.
6. Increase expensing deductions for small businesses	None.	OBRA93 increased the limit on small businesses' investment deduction from \$10,000 to \$17,500.
7. Bonds for high-speed intercity rail facilities	The Budget provided for tax exempt bond financing of high-speed (above 150 miles per hour) intercity rail projects (either public or private).	Same, except that would apply only to projects that were government owned.

^{1/} Source was Department of the Treasury (1993) and House of Representatives (1993).

Investment Incentives in the February 1993 Budget
and Omnibus Budget Reconciliation Act of 1993

	February 1993 Budget	The Omnibus Budget Reconciliation Act of 1993
8. Extension of qualified small-issue bonds	The Budget proposed the permanent extension of the provision to exclude the interest on qualified small issue bonds issues (e.g., less than \$1 million and at least 95 percent of the bond issue is used to fund manufacturing or first time farm purchases).	Same.
9. Extension of tax credits for orphan drug testing expenses	None.	OBRA93 extended the 50 percent tax credit for 30 months.
10. Extension of qualified mortgage bonds and mortgage credit certificates	The Budget would have permanently extended (with some modification) the authority to issue qualified mortgage bonds, which provides subsidized credit for taxpayers' purchase of homes, subject to income and other eligibility criteria.	Same, with some reduction in eligibility requirements.
11. Extension of tax credit for low-income rental housing	The Budget proposed permanently extending the tax credit for the construction of low-income rental housing, which expired after June 30, 1992.	Same, with some modification.
12. Modification of passive loss rules for real estate transactions	The Budget proposed elimination of passive loss restrictions on certain rental real estate transactions for those taxpayers for whom more than half of their personal services are in real property trades.	Same.
13. Increase in recovery period for depreciation of nonresidential real property	The Budget proposed an increase in the recovery period for nonresidential real property from 31.5 years (straight line method) to 36 years.	Same, except that OBRA93 increased the recovery period to 39 years.
14. Empowerment zones and enterprise communities	The Budget proposed the designation of 50 federal enterprise zones, which would receive targeted employment and investment incentives.	OBRA93 provided for nine empowerment zones and 95 enterprise communities. Tax credits of up to \$3,000 per employee and up to \$20,000 in investment allowances were provided for empowerment zones. Tax exempt bond financing of investment in empowerment zones and enterprise communities was also provided for.

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