Jackie and I affirm Resolved: The United States should abolish the capital gains tax.

For clarification:
A capital gains tax is defined as a tax levied on profit from the sale of property or of an investment

Contention One: Lock-in Effect
Clemens 2014 explains

> **Capital gains** are taxed on a realization basis. This means that the **tax is only imposed when an investor opts to withdraw his or her investment from the market and realize the capital gain.** One of the most significant economic effects is the incentive this creates for **[this causes] owners of capital to retain their current investments even if more profitable** and productive **opportunities are available.** Economists refer to this result as t**[a phenomenon known as] the "lock-in" effect.** Capital that is locked into suboptimal investments and not reallocated to more profitable opportunities hinders economic output. Consider **[this happens because]** an investor who wishes to divest an asset and reinvest the proceedings in a new project. **The profit received from the sale of the asset is reduced by the capital gains tax.** [so] In order for the investor to reallocate his or her capital, the new investment must provide a rate of return high enough to recoup the funds paid in taxes plus yield a reasonable rate of return [which might never happen]

This is problematic because Auten from the Department of Treasury explains

> **Lock-in effects impose efficiency losses when investors are induced to hold suboptimal portfolios with inappropriate risk** or diversification, or forgo investment opportunities that may offer higher expected pre-tax returns.

The Economic Innovation Group quantifies in 2017

> **U.S. investors currently hold** an estimated **$2.3trillion in unrealized capital gains on stocks and mutual funds alone—a significant untapped resource for economic development.**

Circulating this money through the economy stimulates economic growth.
Mitchell 2014 quantifies

> **Reducing the capital gains tax by $1 would yield a $1.21 increase in the GDP.**

This is crucial because the IMF reports in 2017

> **a 1 percent increase in GDP is matched by an increase in employment of 0.6 percent or higher**

Contention Two: Start-ups
Long 2016 reports

> **New business creation in the U.S.** (a fancy way of saying "startups") **is at nearly a 40-year low**

Abolishing the Capital gains tax benefits start-ups in three ways

First, funding
Start-ups rely on funding from investors
Keuschnigg 2002 explains

Start-ups require considerable funds to pay for research and development as well as equipment investment which far exceed the entrepreneur's own wealth. They find it difficult, however, to raise outside finance. [However,] They cannot offer enough collateral to secure business debt, and they are unable to generate sufficient revenue to pay regular interest.
Assessing the prospects of such firms **[start ups] requires much business competence and own industry experience on the part of the investor which banks do not have For [this]** these **reason**s**, bank finance is difficult to obtain for innovative start-ups**

As a result, many start-ups turn to venture capitalists for funding which is extremely beneficial
Keuschnigg continues

Venture capitalists have money and industry experience. Their managerial know-how **and industry knowledge [that] establishes an** comparative **advantage over other financial intermediaries** in financing young, innovative firms.

Unfortunately, Laura Entis of the Entrepreneur Foundation finds that **only 0.05% of startups are funded with venture-capital funds.**
This is because the capital gains tax discourages investment

Saxton explains

Capital gains taxation effects entrepreneurship through its impact on venture capital, an important source of funding for entrepreneurial projects. **High capital gains tax rates lower the potential return from backing innovative companies, thus restricting the amount of venture capital available to new firms.** Some analysts argue that most venture capital comes from tax exempt sources such as pension funds and foreign investment; therefore, a capital gains tax reduction would not have much effect on venture capital. However, several studies indicate that[but] informal venture capitalists are extremely important sources of investment and are especially critical to the formation of new companies. Professors John Freear and William Wetzel, Jr. of the University of New Hampshire found that [and] private individuals are a crucial source of funding for new technology-based firms, accounting for 48 percent of seed capital funds..Their study states that "At the seed stage, private individuals invested more funds, in more rounds, for more firms than any other single source." 6 Formal venture capital becomes more important during later stages of development.

Thus, Paul Gompers of the Harvard Business School concludes that that every 1% decrease in the capital gains tax rate was associated with a 3.8% increase in venture capital funding.

Second, encouraging entrepreneurship
Gentry 2014 explains

Once the business has been established, **economic efficiency is enhanced by the entrepreneur selling the firm to professional managers and potentially starting another new business. By creating a transaction cost for selling the firm, the capital gains tax creates a lock-in effect by which entrepreneurs hold their businesses inefficiently long.**

Chari from the University of Minnesota quantifies in 2004, finding that

The second effect comes from a more efficient allocation of time of individuals as more households specialize in starting new businesses rather than self managing a business. In an benchmark economy where the capital gains tax is equal to 20%, **[currently,] only 10% of the entrepreneurs sell businesses they just started, while the rest of the entrepreneurs**

manage businesses until they become bankrupt. When the capital gains tax is decreased to zero, the number of individuals specializing in startups increases to 29 percent. To evaluate the size of the lock in effect we construct a system of type specific capital gains taxes. We retain capital gains taxes only on those individuals who, in the benchmark economy with taxes, start and immediately sell businesses.

Third, Managerial support

Clemens 2014 details

Start-up firms cannot typically **offer salaries that are competitive with established businesses and therefore** often **recruit managers using equity stakes. Capital gains taxes reduce the returns that these managers receive,** thereby **diminishing the likelihood that start-ups will be able to attract the talent that growth requires**

Managers are critical because Khan 2017 explains

Startups are created around product conceivers, engineers and technical experts. But **in order to grow,** they **[start-ups] need people who can help them effectively market their products,** build relationships with influencers, ensure that their work force is motivated **and increase profitability through effective financial planning.**

The impact of start-ups is two fold
First, innovation
Start-ups are more innovative than larger companies because
The Entrepreneur explains in 2016

A startup is small enough to act with freedom, they are agile and can be more responsive. **A larger business already has an established product**, and connected target audience. They have a system of departments and hierarchies built around this, product road maps, **and shareholder interests to contend with. All of this limits new innovations to R&D** teams, and shifting business focus is much harder, **whereas startups can jump full throttle into new projects**

Gornall of Stanford University explains that
This analysis changed the results dramatically. Of the currently public U.S. companies we have founding dates for, approximately 1,330 were founded between 1979 and 2013. Of those, 574, or 43%, are VC-backed. These companies comprise 57% of the market capitalization and 38% of the employees of all such “new” public companies. Moreover, **their R&D expenditure constitutes an overwhelming 82% of the total R&D of new public companies.** Given that the VC industry has been in large part spurred by the relaxation of the Prudent Man Rule, these results also provide an illustration of the impact that changes in government regulation can have on the overall economy.

This is critical because
The US Chamber Foundation reports

Economists have calculated that **approximately 50% of U.S. annual GDP growth is attributed to increases in innovation.**

Second, increasing employment
Mazerov 2016 quantifies
From 1980 to 2010, on-net 2.4 million jobs were made by startups

This impacts to more than just engineers as

Nichols 2007 corroborates

Low-income workers are disproportionately likely to work in smaller firms. Although 20 percent of all workers are employed in firms with fewer than 10 workers, such firms **[start ups] employ 42 percent of low-wage workers.**

Karnani 2011 explains
the best way to alleviate poverty is to increase the income of the poor by providing productive employment.

Thus we affirm.