REPORT OF THE DEPARTMENT OF THE TREASURY ON THE ECONOMIC EFFECTS OF CUTTING DIVIDEND AND CAPITAL GAINS TAXES IN 2003

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EXECUTIVE SUMMARY

Corporate profits are subject to a double level of taxation in the United States, which discourages productive capital formation and ultimately reduces wages and the living standards of U.S. citizens. In January 2003, President Bush proposed to eliminate the double tax on corporate dividends. In May of 2003, Congress passed, and the President signed, the Jobs and Growth Tax Relief Reconciliation Act of 2003, which reduced the double tax on corporate profits by lowering the top individual tax rate on dividends and capital gains to 15 percent through 2008. This Act also accelerated the reduction in individual tax rates, and increased the amount of temporary bonus depreciation from 30 to 50 percent. This report examines the economic rationale for reducing the double tax on corporate profits and documents initial evidence on the economic effects.

- Reducing the tax rate on capital gains and dividends promotes economic growth and takes an important significant step toward removing taxes from important economic decisions. The reduction in the double tax:

    1. Increases capital in the corporate sector, and generally improves the allocation of capital throughout the economy by reducing the role played by taxes in investment decisions.
    2. Reduces tax-motivated reliance on debt finance for corporate investment.
    3. Increases corporate dividend payments by reducing the tax bias in favor of retained earnings.
    4. Increases investment, capital formation, and, ultimately, living standards, by lowering the cost of capital.

- The economy has performed strongly in the months since the passage of the 2003 Jobs and Growth Act.

    - Dividend payments by S&P 500 companies have increased by over 35 percent in 2005 as compared to 2002 and will likely increase more.
    - The S&P 500 has increased by approximately 40 percent since the President announced his dividend exclusion proposal.
    - Real private nonresidential investment increased by an average rate of 8.7 percent in the first 11 quarters after passage of the 2003 Jobs and Growth Act, after declining for nine consecutive quarters prior to the second quarter of 2003.
    - The growth rate in real GDP in the first 10 quarters after the passage of the 2003 Jobs and Growth Act averaged 3.9 percent.

- The tax relief provided over the past several years has increased employment substantially above what would have occurred otherwise.

    - The Treasury Department estimates that absent the tax relief from 2001 through 2004 the economy would have created as many as 1.5 million fewer jobs, by the second quarter of 2003 and as many as 3 million fewer jobs by the end of 2004 (assuming interest rates set by the Federal Reserve were unchanged from their actual levels).

The Economic Effects of Cutting Dividend and Capital Gains Taxes in 2003

Introduction

In January 2003, President Bush proposed to eliminate the double tax on corporate profits – the so-called dividend tax cut. In May of 2003, Congress passed, and the President signed, the Jobs and Growth Tax Relief Reconciliation Act of 2003, which lowered the top individual tax rates on capital gains and dividends to 15 percent through 2008, accelerated the reduction in individual tax rates, and increased the amount of temporary bonus depreciation from 30 to 50 percent.[1] This report examines the economic rationale for reducing the double tax on corporate profits through lower shareholder taxes and documents initial evidence of the economic effects.

The double tax on corporate profits discourages productive capital formation. First, by taxing corporate investments more heavily than investments elsewhere in the economy, the double tax leads to a misallocation of capital; productive corporate investments are passed over in favor of less productive investments elsewhere in the economy. Second, by contributing to the overall tax burden on capital income, the double tax on corporate profits reduces aggregate investment and capital formation, which eventually contributes to lower labor productivity. In short, by injecting tax considerations into investment decisions, the double tax reduces the productive capacity of the U.S. economy and serves, ultimately, to reduce the living standards of U.S. citizens.

Double Taxation of Corporate Income

The tax system imposes a heavy tax burden on equity-financed corporate investment through the double tax on corporate income. Corporate income from a newly equity-financed project is subject to two layers of tax. First, the corporate tax is paid on earnings at the firm level at a maximum rate of 35 percent. For income distributed as a dividend, the second layer of tax is paid by individual shareholders at a maximum rate of 15 percent. Alternatively, shareholders pay tax at a maximum statutory rate of 15 percent on the appreciation in stock value that arises from corporate earnings that are retained and reinvested in the firm. The total tax on corporate income is calculated by combining these two layers of tax. For corporate income distributed to shareholders as dividends, the combined tax can be nearly 45 percent (not counting state and local taxes).[2] For corporate income that is retained by the firm and realized by a shareholder as a capital gain, the combined tax rate can be nearly 40 percent, after accounting for deferral.[3] The double tax on corporate profits affects economic decisions in a number of important ways that

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[1] The 2003 Jobs and Growth Act lowered the maximum tax rate on net capital gains for sales and exchange of capital assets after May 5, 2003 and before January 1, 2009 from 20 percent to 15 percent, and for lower income taxpayers, the rate dropped from 10 percent (8 percent on assets held over 5 years) to 5 percent (zero in 2008). Also, qualified dividends received by individual shareholders from domestic and foreign corporations would be taxed at the capital gains rates (5 and 15 percent) for taxable years beginning after December 31, 2002 and before January 1, 2009. The 2003 Jobs and Growth Act also accelerated into 2003 the individual rate cuts, bracket changes, and increase in the child tax credit that were to be phased in over time as a result of the Economic Growth and Tax Relief Reconciliation Act of 2001, so that individuals now face marginal rates of 10, 15, 25, 28, 33, and 35 percent. In addition, the 2003 Jobs and Growth Act increased the temporary bonus depreciation provided to certain property (mostly equipment) from 30 to 50 percent and extended the expiration date from September 11, 2004 to January 1, 2005. Finally, the 2003 Jobs and Growth Act also increased the limit for section 179 expensing allowed to small business from $25,000 to $100,000 for the years 2003, 2004, and 2005.

[2] The formula for computing the total tax equals $t_c + (1 - t_c)*t_d$, where t_c is the corporate rate (35 percent) and t_d is the dividend tax rate (15 percent). Without the dividend tax cut, the total rate could be as high as $0.35 + (1 – 0.35)*0.35 = 58$ percent.

[3] The effective tax rate on capital gains is lower than the effective rate on dividends because of the ability to defer the tax on capital gains until realized.

may reduce corporate investment, encourage debt finance over equity finance, discourage the payment of dividends, and discourage investment generally.

Economists often use marginal effective tax rates to measure the impact of taxes on investment decisions. Marginal effective tax rates summarize how various provisions in the tax code, including the statutory tax rate, depreciation deductions, interest deductions, deferral of tax liability, and both the individual and corporate levels of tax affect the after-tax rate of return to a new investment. In other words, marginal effective tax rates estimate the extra share of an investment's economic income needed to cover taxes over its lifetime. In addition to the double taxation of equity-financed corporate investment, many types investment face uneven tax treatment because of the various ways tax rates, depreciation deductions, deferral of tax, and inflation, interact and lead to different effective tax rates on different types of investment.

Table 1 shows the marginal effective tax rates on different types of investment by type of financing and economic sector for both current law and for the case with increased dividend and capital gains tax rates that would occur if the shareholder tax cuts enacted as part of the 2003 Jobs and Growth Act were allowed to expire.[4] Currently, the overall effective tax rate on an investment is 17.3 percent economy-wide, and 25.5 percent for investment within the business sector. The effective tax rate in the corporate sector is 29.4 percent, nearly 50 percent higher than the effective tax rate for the non-corporate sector because of the double tax on corporate profits. Equity-financed investment in the corporate sector faces an effective tax rate of 39.7 percent, while a debt-financed investment is effectively subsidized at a rate of 2.2 percent.

Table 1. Marginal Effective Tax Rates for Different Types of Investment

Effective Tax Rates (percent)	**Current Law***	**Without Lower Dividends and Capital Gains Tax Rates***
Economy wide	17.3	19.1
Business Sector	25.5	28.1
Corporate	29.4	33.5
Debt financed	-2.2	-2.2
Equity financed	39.7	44.2
Non-corporate	20.0	20.0
Owner-occupied housing	3.5	3.5

Source: Department of the Treasury, Office of Tax Analysis.

* The estimates of the effective marginal tax rates under current law and with the expiration of the lower tax rates on dividends and capital gains do not incorporate the deduction for certain production activities enacted as part of the American Jobs Creation Act of 2004.

Without the reduction in the double tax on corporate profits enacted as part of the 2003 Jobs and Growth Act, the overall effective marginal tax rate on investment economy wide would be 10 percent higher (i.e., 19.1 percent) than under current law. The effective marginal tax rate for investment in the business sector would also be about 10 percent higher (i.e., increasing to 28.1 percent) than under current law. This higher level of tax on investment, particularly investment

[4] In other words, the comparison is between current law marginal effective tax rates assuming that dividend and capital gains cuts are permanent, and the marginal effective tax rates that occur under current law if the dividend and capital gains rates were not in place.

in the business and corporate sectors, would discourage investment and would reduce labor productivity, and, ultimately, living standards.

The reduction in the double tax on corporate profits also results in a more even taxation of different types of investment by reducing the effective marginal tax rate of equity-financed investment in the corporate sector *relative* to investment elsewhere in the economy. More even or neutral taxation of investment improves the allocation of capital in the economy. That is, investment decisions will be based more on their underlying economic merits rather than their tax treatment. The improved allocation of capital from reducing the effect of taxes on investment decisions allows economic resources to be used more productively in the economy, thereby improving long-run economic growth and living standards.

Reducing the double tax on corporate profits reduces the distortionary impact of the high level of tax on a number of important economic decisions:

1. **The decision to invest in the corporate or noncorporate sectors.** The double tax on corporate investment implies that the before-tax rate of return on corporate capital is larger than the before-tax rate of return on noncorporate capital, assuming that after-tax risk adjusted rates of return are equal. This tax bias against investment in the corporate sector means that there is too little investment in the corporate sector. This misallocation of investment and capital translates into lower national income than would occur absent the distorting effects of the double tax. The greater tax burden on corporations encourages business owners to choose organizational forms, such as partnerships and other pass-through entities, that enjoy a single level of taxation, but do not have the benefits of limited liability or centralized management found in the corporate structure. Also, investment in inherently corporate industries is discouraged by the double tax.

2. **The decision to finance new investment with debt or equity.** The greater taxation of equity investments leads to an over-reliance on debt finance for corporate investment. Higher debt burdens increase a firm's risk of bankruptcy during temporary industry or economy-wide downturns. Business failures generate losses to both shareholders and employees, and the heightened bankruptcy risk can make the entire economy more volatile. Over-reliance on debt also leads to misallocation of resources in the economy and, by extension, lower economic performance and lower living standards.

3. **The decision to retain or distribute earnings through dividends or share repurchases.** Corporations are discouraged from paying out earnings through dividends to the extent that dividends are more heavily taxed than capital gains generated through share repurchases or retained earnings. This distortion in dividend payout policy may lead to an over investment in established firms that are able to finance investment through retained earnings and a less efficient allocation of investment among firms in the economy. The payment of dividends also may improve corporate governance by providing a signal to investors of a company's underlying financial health and profitability, as a firm cannot pay dividends for a long period of time unless the company has earnings to support such payments. Regular dividend payments also limit funds over

which corporate managers have discretion and may be one way for shareholders to ensure that managers invest only in projects that raise shareholder value.[5]

4. **The decision whether to consume today or invest and consume in the future.** Table 1 indicates that the 2003 Jobs and Growth Act lowered the overall tax burden on capital income. Taxing capital income increases the price of future consumption (i.e., savings) compared to consuming today, as income consumed today will be taxed once, while income saved for consumption in the future will be taxed today and again in the future as the return to saving is included in income. Lowering the price of future consumption should increase savings and capital accumulation, which raises living standards over time as the larger stock of capital increases worker productivity.

The effects of these economic distortions and options to reduce them through integrating the corporate and individual income tax systems are discussed in detail in a 1992 report of the U.S. Department of the Treasury titled, *Integration of the Individual and Corporate Tax Systems*. That study suggested that eliminating the double taxation of corporate profits could eventually raise economic welfare in the United States by about 0.5 percent of national consumption, or about $43 billion per year (in 2005 dollars), not including the economic gains from reducing the distortion between present and future consumption. Put differently, the reduced distortion of business decisions would be equivalent to receiving additional income of $43 billion every year in perpetuity.

The lower dividend and capital gains tax rates passed in 2003 reduced, but did not eliminate the double tax on corporate profits. Thus, the economic gains are likely smaller than estimated in the 1992 Treasury Integration Study.

The reduction in the double tax on corporate profits not only improves the allocation of capital, but also reduces the overall level of tax on capital income. As shown in Table 1, the overall effective marginal tax rate on investment would be 10 percent higher economy-wide without the reduction in the double tax on corporate profits under the 2003 Jobs and Growth Act.

[5] For a review of research on dividends and corporate governance issues, see Randall Morck and Bernard Yeung. 2005. "Dividend Taxation and Corporate Governance." *Journal of Economic Perspectives* Vol. 19, No. 3, pp. 163-180.

International Comparisons

All of our major trading partners provide relief from the double tax on corporate profits. As shown in Table 2, in 2004, all countries in the G-7 provide relief at the shareholder level through either an imputation credit system, in which shareholders receive a credit for taxes paid at the corporate level, a dividend exclusion, or lower tax rates. With a 15 percent rate on dividends, the dividend tax rate for the United States is 50.6 percent (including state and local taxes), just below the average of the other G-7 countries (54.0 percent).[6] Without the 15 percent rate, the United States would have an effective dividend tax rate of 56.7 percent, higher than all other G-7 countries except Japan and roughly 10 percentage points higher than both Italy and the United Kingdom.[7]

Table 2: Tax Rates on Corporate Income Paid Out as Dividends in G-7 Countries, 2004 1/

Country	Type of dividend treatment	Corporate Tax Rate on Distributed Profits	Net Personal Tax Rate	Combined Corporate and Personal Tax Rate
Japan	Partial imputation	40.9	40.0	64.5
France 2/	Partial exclusion	35.4	33.9	57.3 (52.5)
Canada	Partial imputation	36.1	31.3	56.1
Germany	Partial exclusion	38.9	23.7	53.4
United Kingdom	Partial imputation	30.0	25.0	47.5
Italy	Partial exclusion	33.0	18.4	45.4
Average of other G-7 Countries		35.7	28.7	54.0
United States:				
Current Law	Lower rate	39.3	18.7	50.6
Without lower tax rates on dividends and capital gains	Lower rate	39.3	28.6	56.7

Source: OECD Tax Database, www.oecd.org.
Notes:
1/ Tax rates reflect statutory tax rates on corporate income paid out as dividends and include taxes of subnational governments. The net personal rate incorporates any exclusions or imputation credits for taxes paid by corporations.
2/ France implemented a 50 percent dividend exclusion starting in 2005 that lowered the combined maximum rate on corporate dividends to 52.5 percent. This would also reduce the average for the other G-7 countries to 53.2 percent.

Partial imputation: dividend tax credit at shareholder level for part of underlying corporate profits tax.
Partial exclusion: part of received dividends is excluded from taxable income at the shareholder level.

[6] This only reflects statutory rates and ignores the effect of accelerated depreciation deductions and other items that enter into the marginal effective tax rates shown in Table 1.
[7] The tax rate in France recently dropped to 52.5 percent.

Economic Effects of the Dividend Tax Cuts

Effect on Dividend Payouts

The economics literature suggests dividend payments are sensitive to the difference between the effective tax rates on dividends and capital gains. By reducing the distortion in the treatment of dividends and capital gains, the 2003 Jobs and Growth Act should increase dividend payments. One study estimates that dividends will eventually increase by approximately 30 percent.[8] The empirical evidence on actual dividend payments has found that dividend payments have increased significantly as a result of the tax cut.

Several studies indicate that prior to the recent dividend tax cuts, corporations were steadily reducing dividend payments over the past two decades. One study documented that the portion of firms paying cash dividends in their sample fell from 66.5 percent in 1978 to 20.8 percent in 1999.[9] Other studies have found that aggregate payout ratios have been more stable, as the remaining dividend paying firms are large and profitable, but these ratios also declined in the decade preceding the 2003 tax cut.[10] These trends of declining dividends reversed beginning in 2003 at the time the dividend tax cuts were enacted. One study found that the dividend tax cut increased regular dividend payments by publicly traded corporations by approximately 20 percent by the end of the second quarter in 2004.[11] The same study found that the portion of firms paying dividends increased from under 20 percent in 2002 to almost 25 percent by the middle of 2004. Similarly, as shown in Figure 1, the percent of firms in the S&P 500 paying dividends declined from 94 percent in 1980 to 70 percent in 2002, but has since increased to 77 percent.

Recent data from Standard and Poor's (S&P) indicate that these dividend increases have continued through 2004 and 2005. Among the approximately 7,000 publicly owned companies that report dividends to S&P, 1,745 reported an increase in dividends in 2004, a 7.2 percent increase over 2003. For the first 9 months of 2005, 1,446 firms reported dividend increases, a 12.4 percent increase from the same period in 2004. In 2004, dividends paid by S&P 500 companies reached a record level of $181 billion (not counting Microsoft's special one-time payout of $32.6 billion), an increase of 13 percent over 2003. In 2005, dividend payments set another record of $203 billion, an increase of 12.4 percent over 2004. Dividend payment by S&P 500 companies were up 36.5 percent in 2005 as compared to 2002.

It is too early to know whether these dividend increases represent a long-term change in corporate payout policies. An important factor is whether firm managers and shareholders believe that the lower tax rate on dividends will remain in place in the future.

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[8] Poterba, James. 2004. "Taxation and Corporate Payout Policy." *American Economic Review* Vol. 94, No. 2, pp. 171-175.
[9] Fama, Eugene F. and Kenneth R. French. 2001. "Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay." *Journal of Financial Economics*, 60:3-43.
[10] For example, see Gustavo Grullon and Roni Michealy. 2002. "Dividends, Share Repurchases, and the Substitution Hypothesis." *The Journal of Finance*, Vol. LVII, No. 4, pp. 1649-1684.
[11] Chetty, Raj and Emmanuel Saez. 2005. "Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut." *Quarterly Journal of Economics*, Vol. CXX, No. 3, pp. 791-833. As with the previous two studies, financial and utility companies are excluded from the sample. The 20 percent figure is likely to increase over time and suggests a faster adjustment that previously estimated by Poterba (2004).

Effect on Stock Market

With the bursting of the tech bubble in late 2000, the terrorist attacks in 2001, and revelations of numerous high profile corporate accounting scandals during 2000 through 2002, the S&P 500 stock price index declined nearly 50 percent, from a high of 1527 in March 2000 to just under 777 October 2002. In the months from October 2002, through the passage of the 2003 Jobs and Growth Act in May 2003, the S&P 500 traded in a range between that level and 962 with a series of rises and falls. However, as shown in Figure 2, equity prices rose steadily in the months after the tax cut was passed and in the almost three years since the time the President announced his proposal to repeal the double taxation of corporate profits, the S&P 500 index has increased by approximately 40 percent.

While numerous factors contributed to the rise in stock prices during the past three years, the dividend and capital gains tax cuts likely played an important role. One study estimated that the likely increase in aggregate equity values due to capitalizing the annual flow of permanent dividend and capital gains tax cuts would be 6 percent. [12] Given the forward looking nature of the markets, it is not clear exactly when the effects of the dividend tax cut were capitalized into share prices or what the expected duration of the tax cut was. Assuming that the increase in equity values due to the tax cut occurred entirely in 2003, then as much as one-quarter of the 26 percent increase in the S&P 500 index for 2003 could be attributed to the capitalized value of the dividend and capital gains tax cut. This estimate is rough and ignores the influence of the tax cut on future investment behavior.[13]

Effect on Investment and Economic Growth

The turnaround in private investment is more strongly correlated with the passage of the 2003 Jobs and Growth Act than is the stock market turnaround. As shown in Figure 3, real private nonresidential investment declined for 9 consecutive quarters prior to the second quarter of 2003. Investment has surged in the 11 quarters since then, with the percentage increases over 10 percent in several quarters and an average rate increase of 8.7 percent. Of course, separating the independent effects of the dividend tax cut from other factors that might influence investment is difficult, especially in view of other tax changes included in the 2003 Jobs and Growth Act, such as the increase in bonus depreciation to 50 percent that would be expected to affect investment.[14]

The extent to which dividend taxation influences corporate investment is an unsettled issue. Economists generally agree that investment financed with issuing new shares of stock is made more costly when dividends are taxed. However, dividend taxation may play a less significant role for determining investment financed through retained earnings where dividend taxes are primarily reflected through share prices.[15] Some recent evidence suggests that for some firms

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[12] Poterba, James. 2004. "Taxation and Corporate Payout Policy." *American Economic Review* Vol. 94, No. 2, pp. 171-175.
[13] For some firms, economy theory suggests that the decrease in dividend taxes would have only a temporary effect on share prices, although stock market capitalization for these firms would increase in the long-run as the corporate capital stock would increase with greater investment financed by new share issues.
[14] Preliminary research suggests that the bonus depreciation provision increased investment. See Christopher L. House and Matthew D. Shapiro. 2005. "Temporary Investment Tax Incentives: Theory with Evidence from Bonus Depreciation." Working Paper.
[15] In other words, firms that face a permanent increase in share prices would not alter investment behavior due to the dividend tax cut; for firms where the dividend tax cut lowers the cost of capital and encourages investment, share prices would not increase in the long-run.

dividend taxation reduces investment so that the recent dividend tax cut would be expected to increase corporate investment.[16]

Since the passage of the 2003 Jobs and Growth Act, national output has increased dramatically. The recovery from the economic downturn of 2001 had been sluggish up through the first quarter in 2003, as shown in Figure 4. The real growth rate in GDP in the nine quarters preceding the dividend tax cut averaged 1.1 percent, while the growth rate in the 10 quarters since the passage of the tax cut has averaged 3.9 percent. The increase in national output results from both the increase in capital use as indicated by the investment figures cited above and the increase in labor inputs as evidenced by growing employment during this time period. For example, approximately 4.7 million jobs have been created since the 2003 Jobs and Growth Act became law. Economic growth since the tax cut easily exceeds historical averages. For example, since 1970 real economic growth has averaged 3.2 percent. These output gains reflect the combination of many factors, including the resilience of the American economy, and do not solely reflect the effect of the 2003 Jobs and Growth tax cuts. However, the benefit of less distorting tax system resulting from cutting dividend and capital gains taxes likely contributed to these gains.

The effect on employment of the dividends and capital gains tax cuts made as part of JGTRRA are difficult to quantify. In the shorter run, when the economy was away from its long-run GDP growth and unemployment rates, factors such as the stance of monetary policy and the state of consumer and business confidence can affect how a tax cut influences the economy. In the longer run, a tax cut could result in small job gains, but sizable output gains and increases in living standards. For example, dividend and capital gains tax cuts make the economy more efficient by improving the allocation of resources within the economy and increasing the capital stock. The ultimate effect on the level of employment itself would be very small unless the tax cuts significantly raised the incentive to participate in the labor market. The level of employment in the long run is largely set by labor-leisure choices and the growth in the population – factors that determine the supply of labor. If the long-run “equilibrium” unemployment rate, for example, were not much affected by the lower tax rates on dividends and capital gains, then the level of employment in the long run would likely be, to a large extent, unaffected. However, the productivity of labor would certainly be enhanced, and the higher level of labor productivity would translate into a higher standard of living.

In the shorter term, however, and when the economy is below full employment, as it was when the 2003 Jobs and Growth Act was enacted, employment increases along with the level of economic activity. There can be little doubt that 2003 Jobs and Growth Act played a key role in stimulating the economy in mid-2003. The short-run effect of the 2003 Jobs and Growth Act on (the President’s proposals made in early 2003) could be substantial.

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[16] For further discussion of these issues, see Alan Auerbach and Kevin Hasset. 2003. “On the Marginal Source of Investment Funds.” *Journal of Public Economics*. Vol. 87, pp. 205-232, and Robert Carroll, Kevin A. Hasset and James B. Mackie III. 2003. “The Effect of Dividend Tax Relief on Investment Incentives.” *National Tax Journal* Vol. LVI, No. 3, pp. 629-651.

- The Council of Economic Advisers estimated that the Act would increase the number of jobs:

  "Stronger GDP growth would lead to an estimated 510,000 new jobs expected to be created as a result of the proposal over the course of 2003. Another 891,000 new jobs would be created in 2004. On average, the level of employment in 2003 would be 192,000 higher than without the proposal and 900,000 higher in 2004 than in 2003."(Strengthening America's Economy, February 4, 2003)

- Simulations done by the Congressional Budget Office (CBO) with two macroeconomic models also suggested that there would be significant employment gains associated with the President's proposal. Both the Macroeconomic Advisers (MA) model and the Global Insight model predicted that the proposals would raise the level of employment in 2004 about 1 percent above the baseline level (a little more than 1 million jobs). (An Analysis of the President's Budgetary Proposals for Fiscal Year 2004, March 2003, page 53.)

The effect of all of the fiscal stimulus measures together – including the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, June 2001), the Job Creation and Worker Assistance Act of 2002 (JCWAA, March 2002), and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA, May 2003) – has been to increase employment substantially above what would have occurred otherwise.

- The Treasury Department used the MA macro-econometric model to estimate how the economy would have performed had there been no fiscal stimulus from 2001 through 2004. This analysis found that: (1) by the second quarter in 2003,the economy would have created as many as 1.5 million fewer jobs, and (2) by the end of 2004, the economy would have created as many as 3 million fewer jobs (interest rates set by the Federal Reserve were taken as unchanged from their actual levels),

Effects on Taxpayers

In 2004, the latest year for which tax return data are available, over 24 million taxpayers (18.5 percent of all taxpayers) reported $110 billion of dividend income eligible for the new preferential tax rates.[17] In addition, 25 million taxpayers reported capital gains totaling $471 billion, up from $323 billion in 2003.

Reflecting the widespread holding of corporate stock, dividends were received by taxpayers in all income groups. For example, 23.2 percent of taxpayers with incomes of $50,000 to $75,000 received eligible dividends as did 10.3 percent of taxpayers with incomes $20,000 to $30,000. Also, about 43 percent of taxpayers who reported dividends eligible for the lower tax rate had incomes below $50,000 and 73 percent had incomes below $100,000.

Older taxpayers were particularly likely to benefit from the lower tax rates on dividends. In 2003, nearly 7 million taxpayers age 65 and over – 40 percent of all elderly taxpayers and 30 percent of all taxpayers with dividends – reported dividends eligible for the lower tax rate in 2003.

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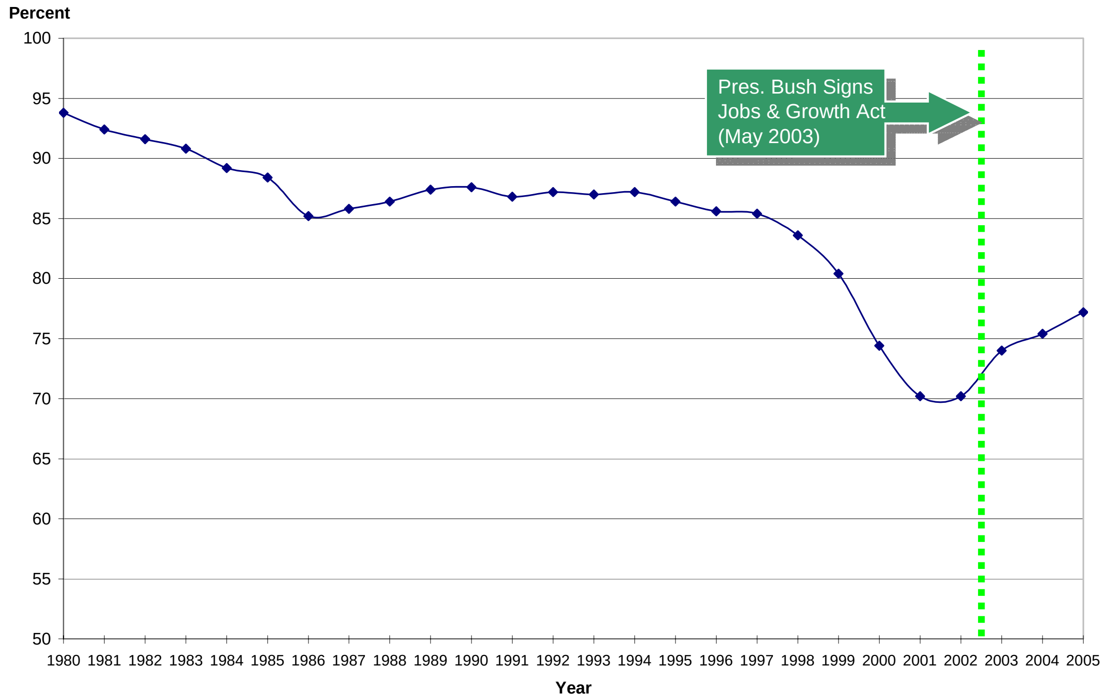
[17] This percentage is likely to increase in future years as taxpayers become more familiar with the provision.

In addition, it is estimated that for 2006, the lower tax rates on dividends and capital gains in the 2003 Jobs and Growth Act will benefit 28 million taxpayers who will receive an average tax cut of $989 from the provision. Among those benefiting are 8.5 million elderly taxpayers who will receive an average tax cut of $1,144.

Conclusion

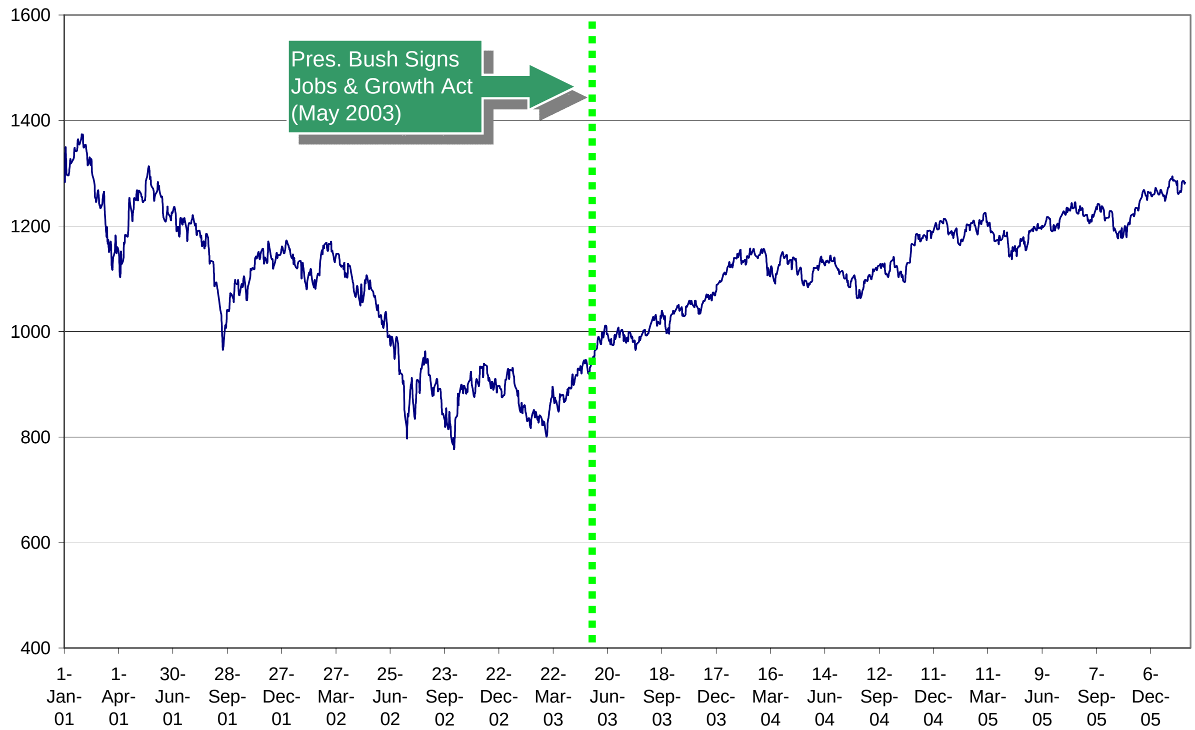
The economy has performed strongly since the passage of the lower tax rates on dividends and capital gains: stock market valuations, dividend payments, investment, employment and GDP have increased noticeably since early 2003. These gains are the result of a combination of many factors that include the benefits from reducing the double tax on corporate profits and the ways in which this double tax distorts economic decisions.

Figure 1. Percent of Firms in the S&P 500 Paying Dividends, 1980-2005



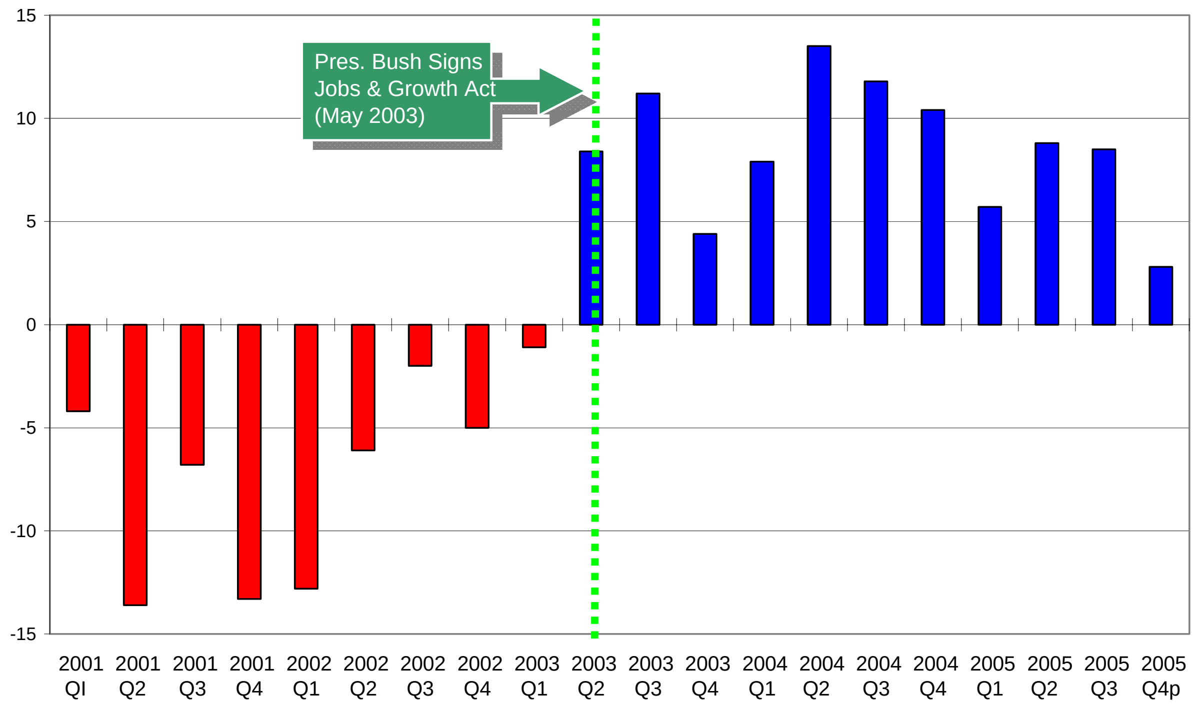
Source: Standard & Poor's

Figure 2. S&P 500 Index Closing Prices



Source: Standard & Poor's

Figure 3. Percent Change in Real Private Nonresidential Investment Over the Previous Period



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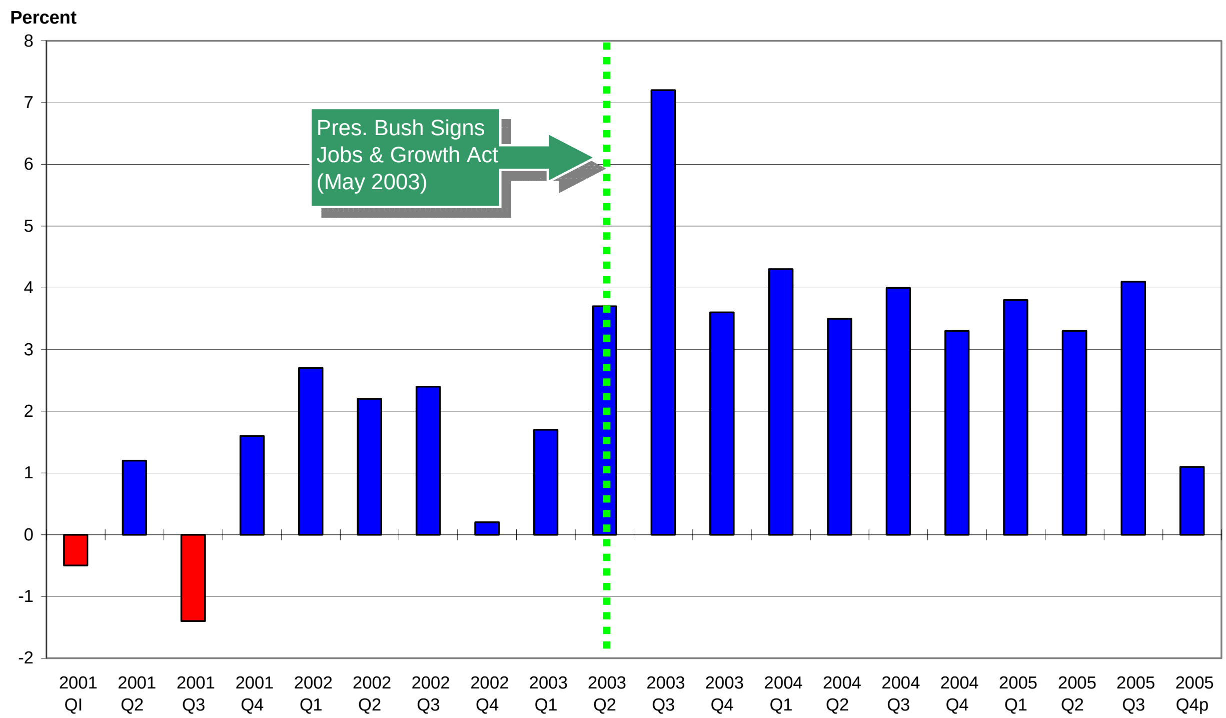
Source: Bureau of Economic Analysis

Figure 4. Percentage Change in Real GDP Over the Previous Period



p: Preliminary
Source: Bureau of Economic Analysis