



January 14, 2003

## President Bush's Economic Growth Plan Benefits All Americans Today and Into the Future

President Bush has proposed an economic growth and job creation plan that will benefit all Americans this year and well into the future. It will immediately help boost the economy through its acceleration of the 2001 tax reductions, and it will ensure long-term economic growth through its tax relief for small business and its elimination of the double taxation of dividends.

Like President Kennedy before him, President Bush understands that there aren't "winners and losers" when the government cuts taxes – everyone benefits. As President Kennedy noted in promoting his tax cut dramatically reducing the top marginal rate, "A rising tide lifts all boats."<sup>1</sup>

In 1965, the year immediately following passage of Kennedy's tax package, Gross Domestic Product (GDP) rose by 8 percent. Five years after passage of the Kennedy tax package, GDP had risen by 48 percent. Civilian unemployment fell from 5.2 percent in 1964 to 4.5 percent in 1965 and 3.5 percent five years later in 1969. Federal revenues also grew following the Kennedy tax cut. Five years after the Kennedy tax cut, federal revenues had risen 66 percent, from \$112 billion in 1964 to \$186 billion in 1969. During that same period the federal government moved from a \$5.9 billion deficit to a \$3.2 billion surplus.<sup>2</sup>

Further evidence of this phenomenon was provided by the Reagan tax cuts of 1981. In 1982, GDP had risen 4 percent, while five years after passage of the Reagan tax cuts, GDP had risen 42 percent. Meanwhile, civilian unemployment fell from 7.6 percent in 1981 to 7 percent in 1986. Finally,

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<sup>1</sup>Remarks made by President Kennedy August 17, 1962, Pueblo, CO, regarding his proposed tax cut which reduced the top marginal rate from 91 percent to 65 percent.

<sup>2</sup>Data on GDP, unemployment, and federal revenues from *Economic Report of the President*, January 2001.

federal revenues grew by 28 percent between 1981 and 1986. Deficits, too, grew during this time – not due to a dearth of revenues but rather to a 46-percent increase in federal outlays.<sup>3</sup>

## **Goals of the President’s Plan Will Be Realized**

President Bush’s economic growth package has three main objectives in addition to producing general economic gain for all. His plan will encourage consumer spending, thus boosting the economic recovery. It will further promote investment by individuals and businesses, leading to economic growth and job creation. Finally, it will provide critical help to America’s unemployed citizens by helping displaced workers get back on the job.

As an example of how these tax cuts will affect the average American, a typical family of four with two earners making a combined \$39,000 in income will receive a total of \$1,100 in tax relief under President Bush’s plan.<sup>4</sup> This evidence refutes claims that his plan will only benefit the so-called rich.

The President’s plan has been constructed in a such a manner as to ensure that both short-term and long-term economic growth will result from its passage.

As Magda Kandil of the International Monetary Fund notes,

The President’s plan is directly targeting consumer spending and investment incentives. The reduction of marriage penalty, the increase in child tax credit, the extension of unemployment benefits and speeding up tax relief will help revive consumer spending, increase confidence and boost aggregate demand in the short-run. The end of double taxation of dividends and increasing incentives for small businesses should help sustain momentum in favor of job creation and long-term growth.<sup>5</sup>

## **Specific Provisions of the President’s Growth Package**

### **1. Accelerated 10-Percent Bracket Expansion:**

#### **Immediate Beneficiaries**

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<sup>3</sup>Ibid.

<sup>4</sup>Data taken from White House talking points, “Taking Action to Strengthen America’s Economy” and Treasury Department distribution tables.

<sup>5</sup>Department of Treasury, Office of Public Affairs.

According to the materials released by the Bush Administration, the President's proposal accelerates from 2008 to 2003 the expansion of the 10-percent bracket and indexes it for inflation beginning in 2004. This provision expands the amount of income taxed at 10 percent from \$12,000 to \$14,000 for married couples and from \$6,000 to \$7,000 for single taxpayers. Accelerating the expansion of the 10-percent bracket would reduce taxes for 69 million taxpayers.

## **Overall Economic Benefits**

This provision would immediately put money into the pockets of all income taxpayers, allowing them to spend it or invest it in whatever manner best suits their economic needs. This benefits America's short-term economic needs by injecting millions of dollars into today's economy. Indexing the tax cut ensures that it will continue to allow all taxpayers to keep more of their hard-earned money, thus benefitting our long-term economic growth as well.

### **2. Accelerated Reduction in Income Tax Rates:**

#### **Immediate Beneficiaries**

In addition to those who benefit from the expansion of the 10-percent bracket, the President realizes that all wage earners deserve tax relief, and so his plan accelerates the reduction of the remaining income-tax rates. According to the Administration, the reductions in income-tax rates in excess of 15-percent scheduled for 2004 and 2006 are accelerated to 2003, resulting in new rates of 25 percent, 28 percent, 33 percent and 35 percent (from 27 percent, 30 percent, 35 percent and 38.6 percent). These reductions benefit married couples with taxable income greater than \$47,450 and single taxpayers with taxable income greater than \$28,400. Accelerating the 2004 and 2006 rate cuts in 2003 would provide 28 million taxpayers with an average tax cut of \$1,100.

#### **Overall Economic Benefits**

Like the expansion of the 10-percent bracket, accelerating the marginal rate reductions will benefit almost all taxpayers and inject millions of dollars into the economy. This will provide a short-term boost for the economy by allowing millions of Americans to keep more of their hard-earned money to spend or invest. Once again, this infusion of cash into the economy will positively impact the economy's immediate health.

At the same time, the reduction of all marginal rates benefits our long-term economic outlook by allowing upper-income earners to also keep more of their earnings. These are the very people who create new jobs and new businesses, and provide a large amount of investment in the stock market. Allowing these members of society to be more productive as they create more new jobs and invest even more in the markets will benefit our long-term economic prospects – a rising tide helping all Americans.

#### **The Fallacy of an Unfair Tax Cut for the Rich**

Many opponents of tax relief object to the marginal rate reductions because they claim that the majority of the tax cuts benefit the “rich.” This argument, however, ignores the obvious. If a certain segment of the population pays the vast majority of the income taxes, then any equitable reduction in income taxes will – by definition – benefit that segment the most. As the following chart from the National Taxpayers Union demonstrates, a small segment of Americans pays the vast majority of income taxes, and therefore will receive a larger overall portion of the tax reduction.

Yet despite the mathematical truism displayed in the chart, the Bush tax package provides the **greatest percentage reduction** in income tax burden to lower-income families. According to the Department of Treasury, the average income-tax reduction ranges from 17 percent for taxpayers with income under \$30,000 to just over 11 percent for taxpayers with income over \$100,000.

**Who Pays Income Taxes?<sup>6</sup>**

Fiscal Year 2000

<b>Percentiles Ranked by AGI</b>	<b>AGI Threshold on Percentiles</b>	<b>Percentage of Federal Personal Income Tax Paid</b>
Top 1%	\$313,469	37.42%
Top 5%	\$128,336	56.47%
Top 10%	\$92,144	67.33%
Top 25%	\$55,225	84.01%
Top 50%	\$27,682	96.09%
Bottom 50%	<\$27,682	3.91%

Note: AGI is Adjusted Gross Income  
Source: Internal Revenue Service

Because the percentage reduction in income taxes is greatest for families with income under \$50,000, ***these families will pay a smaller share of the total income tax burden under the President’s proposal than they do under current law.***

Conversely, families with income of \$100,000 or more receive a smaller than average percentage reduction in income taxes so they will pay a larger share of the total income tax burden under the

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<sup>6</sup>“Who Pays Income Taxes?” *National Taxpayers Union*, [www.ntu.org](http://www.ntu.org).

President's proposal than they do under current law. Under his proposal, the share of income taxes paid by families with incomes of \$100,000 or more will rise to 73.3 percent.<sup>7</sup>

## **Benefits for Small Businesses**

Another way to boost economic growth in both the short-term and for the future is to decrease the onerous burden placed on small businesses by the current tax code. Small businesses are vitally important to the health of America's economy, creating two-thirds of the new jobs in the United States. Of the new businesses in America, 98 percent are created as small businesses; further, 40 percent of America's GDP is supplied by small businesses.<sup>8</sup> Clearly, their economic health is inextricably linked to the health of the American economy.

According to the National Federation of Independent Business, 85 percent of America's small businesses pay personal income taxes rather than corporate taxes.<sup>9</sup> (This is inherently unfair because the top personal income tax rate is currently 38.6 percent, while the top corporate tax rate is only 35 percent.) Small business owners would receive 79 percent (about \$10.4 billion) of the \$13.3 billion in tax relief from accelerating the reduction in the top tax bracket to 35 percent from 2006 to 2003.<sup>10</sup> Further emphasizing that the Bush tax-relief proposal benefits all segments of society, 15 percent of small businesses are minority owned and 26 percent are owned by women.<sup>11</sup>

Reducing their overall tax burden will allow these businesses to keep more of their hard-earned profits and use them in a manner that most benefits their company – and in the end, America's economy. Whether this entails utilizing the increased profits in hiring new employees, expanding the business, or investing in new businesses is irrelevant. What is relevant is that this economic activity will boost the economy in the short-term while providing for the long-term health of the economy. It will benefit the millions of small business owners across the country and the millions more whose lives they affect. Once again we see that a rising tide will lift all boats.

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<sup>7</sup>“Distribution Table for the President's Growth Package,” Department of Treasury, Office of Tax Analysis.

<sup>8</sup>“Who We Represent,” National Federation of Independent Business website (found at [www.nfib.com](http://www.nfib.com)).

<sup>9</sup>“NFIB Says Bush Tax-Relief Package Will Help Small Business Rev Economy's Engine,” National Federation of Independent Business, January 1, 2003.

<sup>10</sup>“Effects of Major Individual Income Tax Relief Provisions in Economic Growth Plan,” Department of Treasury, January 7, 2003.

<sup>11</sup>“1997 Economic Census Minority-and Women-Owned Businesses,” U.S. Census Bureau, [www.census.gov](http://www.census.gov).

### **3. Accelerated Reduction of the Marriage Penalty:**

#### **Immediate Beneficiaries**

The President's plan recognizes the importance of family and immediately removes the unfair treatment of marriage currently in the tax code. The standard deduction for married couples is increased to double the amount of the standard deduction for single taxpayers in 2003. The salary range at which couples are taxed in the 15-percent tax bracket is increased to twice the range for single taxpayers in 2003. These provisions were scheduled to phase-in over the period between 2005 and 2009. Enacting marriage penalty relief in 2003 would reduce taxes for 35 million married couples by an average of \$574.

#### **Overall Economic Benefits**

Again, allowing families to keep more of their hard-earned money will permit that money to be spent, or invested, in the free market rather than allowing an inefficient government bureaucracy to "spend" it. The more efficient use of this money will help provide a much needed boost to our current economy, while benefitting our long-term prospects as families continue to enjoy marriage penalty relief throughout the decade.

### **4. Accelerated Increase in Child Tax Credit:**

#### **Immediate Beneficiaries**

The President's plan would immediately implement the new child tax credit. The amount of the child tax credit is increased to \$1,000 in 2003 (from \$600), accelerating a scheduled phase-in over the period between 2005 and 2010. In 2003, the increased amount of the child tax credit will be paid in advance beginning in July 2003 on the basis of information on the taxpayer's 2002 tax return filed in 2003. Advanced payments will be made in a manner similar to the advance payment checks that were issued in 2001 to reflect the new 10-percent tax bracket. Increasing the child tax credit to \$1,000 in 2003 would provide 26 million families with an average tax cut of \$623.

#### **Overall Economic Benefits**

As with the elimination of the Marriage Penalty, accelerating the full implementation of the Child Tax Credit will immediately allow American families to keep more of their income to spend or invest in a more efficient manner in the free market, rather than it being spent inefficiently by the federal government. Like the elimination of the marriage penalty, the increased child tax credit would provide an immediate boost to the economy by allowing more Americans to keep more of their income today, while continuing to benefit economic growth as these families enjoy the Child Tax Credit throughout the decade.

### **5. Exclusion of Corporate Dividend from Taxable Income:**

## The Importance of This Dividend Exclusion

One key way to help ensure the long-term economic growth of America is to eliminate the double taxation of dividends. Under current law, a corporation pays taxes on its earnings at a maximum rate of 35 percent – thus reducing the amount the corporation can use to distribute to shareholders as dividends, reinvest, hire new employees, or engage in any other business activity. When the corporation does distribute these after-tax earnings to its shareholders via dividends, the shareholder is forced to pay taxes on those same earnings, this time at a maximum rate of 38.6 percent.

The double taxation of dividends is particularly detrimental to our nation's economy because it distorts the free market and retards economic growth. By eliminating the dividend tax paid by individuals, the President's proposal would ensure that the government taxes all income – but only once.

As the President notes, this elimination of double taxation would reduce the bias against capital income in the current tax system, encourage investment, promote corporate fiscal responsibility, and enhance the long-term growth potential of the U.S. economy. In turn, higher investment promotes job creation and higher wage growth. Finally, elimination of the double taxation of dividends would help simplify the tax code while making it more equitable – both key requirements for moving toward fundamental tax reform.

## Overall Economic Benefits

Steve Entin, President of the Institute for Research on the Economics of Taxation, points out:

Dividend relief . . . would move the tax system in the direction of fundamental tax reform.

[It] would reduce or remove artificial barriers to growth in the current tax system, and [it] would promote capital formation, productivity, employment, and higher wages. As a side effect, [it] would indeed boost the stock market. [This proposal is] not radical or extreme. Any tax system that sought to be completely unbiased in its treatment of savings versus consumption would go even further than the proposals under discussion.<sup>12</sup>

Not only do noted economists agree that the double taxation of dividends is economically destructive and unfair, so too do many politicians from *both* sides of the aisle. During an interview with *Fortune* magazine in May of 1976, then Presidential candidate Jimmy Carter noted, “[W]e presently tax corporate income when it's earned and we also tax the dividends paid to stockholders. I would favor taxing income only once . . . I don't favor taxing the same income twice.”

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<sup>12</sup>“Dividend Tax Relief and Other Measures Aimed at Boosting the Stock Market – Methods and Consequences,” Steve Entin, *Institute for Research on the Economics of Taxation*, August 30, 2002.

Meanwhile, current Democratic Presidential hopeful Senator John Kerry (D-MA), speaking at the City Club of Cleveland on December 3, 2002, declared that the United States “should encourage the measurement of the real value of companies by ending the double taxation of dividends.”<sup>13</sup>

### **Immediate Beneficiaries**

While some will claim that the elimination of the double taxation of dividends will benefit only the richest of Americans who own stock, this ignores a significant trend in stock ownership in America over the past few decades.

Nearly one-half of Americans own stocks and will benefit from elimination of the double taxation of dividends: In fact, according to the American Shareholders Association (ASA), the percentage of share-holding households increased from 18 percent of households in 1960 to 48.2 percent of households in 1999. More importantly, this increase in shareholdings was not limited to the most wealthy Americans. The ASA also notes that between 1989 and 1995, the rate of stock ownership among laborers and farmers increased a staggering 107 percent, while families with incomes under \$25,000 saw the rate of ownership increase by 80 percent.<sup>14</sup>

Given these statistics, it is ironic that many of the same people who, not too long ago, were correctly noting that the shareholders of bankrupt companies were just average Americans working paycheck to paycheck are now attempting to portray these same Americans as members of the highest income brackets simply because Republicans wish to provide them with some much-needed tax relief.

Eliminating the dividend tax would provide much-needed tax relief to many average Americans who, as stockholders, have suffered through a roughly \$7-trillion reduction in the value of the stock market since March of 2000.<sup>15</sup>

### **Encouraging Corporate Responsibility**

Another benefit of eliminating the double taxation of dividends would be the salutary effect on corporate responsibility and governance. Because of the bias against dividends in the current tax code, corporations rely too much on borrowing, creating fiscally unsound environments susceptible to bankruptcy. The current bias against dividends also induces corporations to retain or reinvest profits rather than issue a dividend.

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<sup>13</sup>[http://www.johnkerry.com/site/PageServer?pagename=spc\\_2002\\_1](http://www.johnkerry.com/site/PageServer?pagename=spc_2002_1)

<sup>14</sup>Investor Class Fact Sheet, American Shareholders Association.

<sup>15</sup>Entin, Steve.

Referring to the former problem, the Heritage Foundation's Dan Mitchell notes, "[S]ubjecting dividend income to an extra layer of tax creates a bias for corporate debt. The White House growth package will put debt and equity on a level playing field, encouraging companies to restructure their finances and improve their balance sheets, reducing bankruptcies."<sup>16</sup>

Commenting on the later distortion, former Chairman of the Council of Economic Advisers and current Cato Institute chairman William Niskanen explains,

The tax rate on dividend income is much higher than the rate on long-term capital gains. This leads corporations to rely more on capital gains than on dividends as the return to equity. This bias also leads to several other adverse effects – reducing the cash-flow discipline to meet dividend payments, increasing the incentive to inflate the stock price, and increasing the role of corporate managers relative to investors in the allocation of capital.<sup>17</sup>

## Deficit Dichotomy

Others argue that eliminating the double taxation of dividends will be too costly and will increase deficits. In fact, some are even proposing tax increases to eliminate budget deficits. Even most Keynesian economists agree that it is economically unsound to raise taxes during economic slowdowns.<sup>18</sup> ***This interpretation misinterprets the relationship between the economy and deficits, however. The best way to eliminate deficits is for the economy to grow and the best way for that to occur is to reduce the disincentive to production – in other words, reduce taxes.***

However, it is not even certain that the elimination of the double taxation of dividends will increase future deficits. "Eliminating the Double Taxation of Corporate Income," a report released by the White House's Council of Economic Advisers, estimates that federal revenues would be reduced by

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<sup>16</sup>"President Bush's Tax Package: Pro-Growth and Pro-Tax Reform," Daniel J. Mitchell, *The Heritage Foundation*, January 8, 2003.

<sup>17</sup>"Two Simple Cures for What Ails American Corporations," William Niskanen, *Cato Institute*, January 7, 2003.

<sup>18</sup>"Nor shall the argument seem strange, that taxation would be so high as to defeat its object and that given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget. To take the opposite view today is to resemble a manufacturer who, running at a loss, decides to raise his price. And when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more. And who, when at last his account is balanced when naught on both sides is still found righteously declaring that it would have been the act of a gamble to reduce the price when you were already making a loss." *The Collected Writings of John Maynard Keynes*, vol. 9, *Essays in Persuasion* (London: MacMillan, 1972). p. 338.

approximately \$364 billion over 10 years should the double taxation of dividends be eliminated. However, it also notes that a Treasury study from a 1992 suggests that – even ignoring the increased investment created by the elimination of the double taxation of dividends – such a tax cut would raise economic welfare in the United States by about 0.4 percent of consumption – equal to about \$36 billion per year (in 2003 dollars), or \$360 billion over 10 years.

Even these assumptions ignore the influence on revenues of increased investment in the stock market. By reducing the cost of investing in the market, it can reasonably be predicted that more people will invest. This increased economic activity will result in more revenues.

The capital gains tax cut of 1997 provides an example of how reducing the punishment on work and investment can spur economic activity and increase revenues. By reducing the amount of gains the government confiscated, the new rate increased the incentive for individuals to conduct business transactions (taxed under the capital gains tax) that they would not otherwise have conducted. In other words, the government collects more revenues taxing 20 percent (rather than 28 percent) of a transaction than it would if the transaction never took place because the market found rates too confiscatory. As a result of this, realized capital gains as a percentage of GDP grew from 3.34 percent in 1996 when the maximum capital gains tax rate was 28 percent, to 6.27 percent in 2000. Over the same period, capital gains revenues grew from \$66 billion in 1996 to \$126 billion in 2000.<sup>19</sup>

## **Dividend Tax Cuts and the Market**

It is reasonable to predict that the reduced costs associated with receiving a dividend (thanks to the elimination of the second level of taxation) will promote greater activity in the stock market. In fact, Massachusetts Institute of Technology economist James Poterba estimates that “the value of the stock market [will] rise between \$500 billion and \$650 billion, or 5 percent to 6 percent of the U.S. market’s current value. . .”<sup>20</sup> This increase in the value of the stock market will stimulate new revenues and help generate economic growth. Furthermore, the increase in value of the market will benefit those – including seniors – who hold stocks that don’t pay dividends but whose value will increase as the market’s value increases.

## **Conclusion**

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<sup>19</sup>“Capital Gains Tax Rates and Revenues,” Gregg A. Eesenwein, *CRS Report for Congress*, March 25, 2002.

<sup>20</sup>Davis, Bob and Greg Ip, “The ‘If’ Factor: Bush Stimulus Package Needs Many Assumptions to Pan Out,” *The Wall Street Journal*, Wednesday, January 8, 2003.

By providing short and long-term economic growth – growth that benefits all Americans by increasing the value of the market, creating new businesses and jobs, increasing take-home pay, increasing savings and investment, and countless other economic benefits – the Bush proposal promises to be the rising tide that will lift all boats.

*This RPC paper is meant to serve as an overview of the President's economic growth plan. The Republican Policy Committee will be releasing further analysis of the President's plan as warranted.*

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