

Mihir A. Desai and Austan D. Goolsbee  
“Investment, Overhang, and Tax Policy”

*Brookings Papers on Economic Activity*, no. 2 (Fall 2004), pp. 275-328

Did a capital overhang from the 1990s contribute to the investment collapse of the early 2000s? And why have several major tax cuts failed to revive investment? We find little correlation between investment growth during the boom and investment decline during the bust, whether across industries, asset classes, or firms. We also modify the standard tax-adjusted  $q$  model to allow for clearer identification of tax effects in the presence of mismeasured  $q$ . The resulting estimates are larger and more precisely measured, suggesting that the model explains investment patterns reasonably well. Consistent with the “new” view of dividend taxation, we find evidence that dividend taxes do not influence marginal investment incentives. The recent dividend tax cut would have had little impact on investment. The effect of partial expensing of equipment was too small to counteract the large aggregate investment declines. We estimate the investment increases resulting from the 2002-04 tax cuts at 1 to 2 percent.

JEL classification codes: E22, E62, H25.