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by William G. Gale

The President's Tax Proposal: First Impressions

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President Bush's new tax plan is an answer in search of a question. It would provide little short-term stimulus. It seems unlikely to provide much of a long-term boost to growth or jobs. It is an incomplete way to reform corporate taxes. It would not boost investor confidence. It would provide windfall gains for previous actions, rather than encouraging new activity. It would make taxes more complex. It does not fix the alternative minimum tax. It does not resolve uncertainty regarding the repeal of EGTRRA at the end of 2010. It is fiscally irresponsible and unduly weighted toward high-income households.

The plan has two main features: elimination of individual taxes on dividends and acceleration of many features of the 2001 tax cut. The repeal of dividend taxes is essentially a price support program for investors, which is consistent with earlier administration advocacy of price supports for farmers and the steel industry. Accelerating the tax cut — designed during boom times in 1999 to stave off a conservative political attack from Steve Forbes but never altered to address any changing economic circumstance since then — is also consistent with earlier administration positions. A consistent political agenda, however, does not always make good economics.

I. What's in the Proposal

The main features of the proposal include the following:[1]

- Accelerating to January 1, 2003, some, but not all, of the income tax cut provisions that were enacted in 2001 and scheduled to be implemented in the future. The accelerated items include the reduction in the top four income tax rates (from current levels of 27, 30, 35, and 38.6 percent to 25, 28, 33, and 35 percent, respectively); marriage penalty relief for middle- and upper-income households; an increase in the child credit to $1,000; and expansion and indexation of the 10 percent tax bracket.
- Increasing the individual alternative minimum tax (AMT) exemption through 2005, to hold taxpayers harmless for the other tax cuts they would receive in this package.
- Excluding all corporate dividends from taxation under the individual income tax provided that corporate taxes have been paid on the earnings generating the dividends. A related provision would allow companies to deem dividends without actually paying them, thus reducing eventual capital gains and capital gains taxes for shareholders.
- Increasing the small business expensing limits to $75,000 from $25,000 and increasing the income limit for expensing to $325,000 from $200,000.
- Establishing personal re-employment accounts — personal accounts that would finance up to $3,000 of job-search costs for each unemployed worker. Job seekers who found a job before the 13th unemployment insurance benefit payment would be able to keep any remaining funds.

II. What's Not in the Proposal

What is not in the proposal is at least as interesting as what is:

- Fixing the AMT: Under current law, the number of AMT taxpayers will rise from 3 million in 2003 to 20 million in 2006 and almost 36 million by 2010.
- Making EGTRRA permanent: Although the president has claimed repeatedly that making EGTRRA permanent would help resolve uncertainty today and would help boost the economy, the proposal contains no mention of this plan.
- Accelerating marriage penalty relief for EITC recipients, and the increase in the refundable portion of the child tax credit. The omission of these progressive elements of EGTRRA, given the extension of so many other EGTRRA income tax provisions, requires some explanation.
- Providing significant financial aid to the states.

[1]For further details, see Leonard Burman and Jeff Rohaly, "Tax Provisions in the President's Economic Stimulus Proposals," January 7, 2003, http://www.taxpolicycenter.org.

Table 1
Administration Stimulus Proposal:
Distribution of Income Tax Change by AGI Class, 2003[1]

AGI Class (thousands of 2001 dollars)[2]	Returns		Percent Change in After-Tax Income[3]	Percent of Total Income Tax Change	Average Tax Change ($)	Average Income Tax Rate[4]	
	Number (thousands)	Percent of Total				Current Law	Proposal
Less than 10	25,755	19.2	0.1	0.1	-5	-6.7	-6.9
10-20	23,602	17.6	0.4	1.3	-63	-3.0	-3.5
20-30	18,644	13.9	0.8	3.3	-204	3.8	3.0
30-40	13,534	10.1	1.0	4.1	-351	7.0	6.1
40-50	10,307	7.7	1.2	4.5	-500	9.0	8.0
50-75	17,874	13.4	1.4	12.7	-820	10.3	9.1
75-100	10,224	7.6	2.2	15.7	-1,776	12.3	10.4
100-200	9,906	7.4	2.3	23.2	-2,710	16.0	14.3
200-500	2,395	1.8	2.4	11.4	-5,527	23.0	21.6
500-1,000	418	0.3	3.5	6.4	-17,605	27.7	25.8
More than 1,000	226	0.2	3.9	17.4	-88,873	28.8	26.7
All	133,835	100.0	1.9	100.0	-865	13.9	12.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model.
[1]Calendar year. Includes the following provisions: accelerate 2006 rate cuts; exclude 100 percent of dividend income from taxation; accelerate marriage-penalty relief; accelerate child tax credit increase; accelerate expansion of 10 percent bracket; increase AMT exemption. Does not include any potential behavioral response.
[2]Returns with negative AGI are excluded from the lowest income class but are included in the totals.
[3]After-tax income is AGI less individual income tax net of refundable credits.
[4]Average income tax, net of refundable credits, as a percentage of average AGI.

III. Revenue and Distributional Effects

A. Revenue Effects

The Treasury Department estimates a 10-year revenue loss of $674 billion from the plan.[2] Estimates suggest the debt service costs would add $250 billion, implying a total reduction in surplus of $925 billion over the next decade.[3]

If accelerating the tax cut was not affordable in 2001, it is hard to see how it should be considered affordable now.

At $674 billion in tax cuts, the proposal is half as large as EGTRRA, which cut taxes by $1.35 trillion over 10 years. Of course, the fiscal situation is quite different now than it was in 2001. First, in January 2001, Congress faced a projected 10-year surplus of $5.6 trillion, including more than $3 trillion outside of Social Security. Even so, Congress was willing to finance only a $1.35 trillion tax cut. The most recent CBO estimate, from last August, projects a surplus of about $336 billion for the same 10-year period, with almost all of the surplus occurring in 2011. If accelerating the tax cut was not affordable in 2001, it is hard to see how it should be considered affordable now.

The second way that the fiscal situation is far worse today than in 2001 has to do with the alternative minimum tax and the possibility of extending EGTRRA. Because the administration is not currently proposing to extend EGTRRA or to fix the underlying AMT problem, we know that those items will be on the table in the future. Each will cost at least $600 billion over the 10-year period, and much, much greater amounts over the longer-term (see Auerbach, et al. 2002, Burman, et al. 2002). In addition, the president appears intent on fighting a war with Iraq, which would add further to costs. As a result, the sheer magnitude of the president's proposal seems wildly incommensurate with either available resources or the relative importance of the proposed changes.

B. Distributional Estimates for 2003

Tables 1 and 2 show estimates from the Tax Policy Center (TPC) simulation model of the distributional impact of the first three proposals listed above for 2003 (the tables omit the provisions for small business expensing and re-employment accounts). Table 1 reports several measures of the distributional burden of the tax cut, each of which demonstrates that the tax cut is regressive and provides disproportionate benefits to the highest-income households. The most useful distributional measure is the percentage change in after-tax income. A tax cut that gives each household the same percentage change in after-tax income leaves the distribution of income unchanged. Table 1 shows that after-tax income would rise by almost 4 percent for the

[2]Departments of Treasury and Labor, "President's Proposal for Economic Growth and Job Creation" (undated).
[3]Richard Kogan, private communication, January 9, 2003.

Table 2
Administration Stimulus Proposal:
Distribution of Income Tax Change by Percentiles, 2003[1]

AGI Class[2]	Percent Change in After-Tax Income[3]	Percent of Total Income Tax Change	Average Tax Change ($)	Average Income Tax Rate[4]	
				Current Law	Proposal
Lowest Quintile	0.1	0.1	-5	-6.7	-6.8
Second Quintile	0.4	1.7	-74	-2.4	-2.8
Middle Quintile	0.9	6.1	-265	5.5	4.6
Fourth Quintile	1.2	14.1	-611	9.6	8.4
Next 10 Percent	2.1	18.7	-1,616	12.0	10.1
Next 5 Percent	2.4	14.0	-2,418	14.8	12.7
Next 4 Percent	2.3	16.9	-3,661	19.2	17.4
Top 1 Percent	3.5	28.3	-24,428	27.8	25.3
All	1.9	100.0	-865	13.9	12.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model.
[1]Calendar year. Includes the following provisions: accelerate 2006 rate cuts; exclude 100 percent of dividend income from taxation; accelerate marriage-penalty relief; accelerate child tax credit increase; accelerate expansion of 10-percent bracket; increase AMT exemption. Does not include any potential behavioral response.
[2]Returns with negative AGI are excluded from the lowest quintile but are included in the totals. The income thresholds are (in 2001 dollars): second quintile, $9,965; middle quintile, $21,350; fourth quintile, $37,835; next 10 percent, $68,330; next 5 percent, $98,054; next 4 percent, $133,859; and top 1 percent, $316,895.
[3]After-tax income is AGI less individual income tax net of refundable credits.
[4]Average income tax, net of refundable credits, as a percentage of average AGI.

0.2 percent of households with income above $1 million. In contrast, after-tax income rises by much smaller percentages, ranging from 0.1 to 1.4 percent, for the 80 percent of households with income below $75,000.

A second measure is the distribution of the tax cut across income classes. Table 1 shows that households with income above $200,000 receive more than one-third of the entire tax cut in 2003. A third measure reports the tax cuts in dollar terms, and is often the most striking. Returns with income above $1 million would receive an average tax cut of almost $89,000. Those with income below $40,000 would receive an average tax cut of $125 and those with income between $40,000 and $75,000 receive an average tax cut of $703.

Table 2 shows similar results by income percentile. The bottom 60 percent of the population would receive less than 8 percent of the tax cut. The top 1 percent would obtain 28 percent, and the top 10 percent would get 59 percent of the benefits.

C. Distributional Estimates for 2010

The distributional estimates for 2003 suggest a tax cut heavily weighted toward high-income households. In fact, however, the long-term effect of the tax cut is even more skewed toward high-income households than the 2003 figures suggest. The reason is that the main benefits for lower- and middle-class taxpayers in 2003 represent acceleration of benefits they would have received in the long term anyway. The major new program — the dividend tax cut — overwhelmingly benefits high-income households. As a result, the proposal is even more regressive in the long term than in the short term.

Table 3 shows the distributional effects of the tax cuts in 2010, relative to current law. Households with income above $100,000 (in constant dollars) receive 69 percent of the tax cut in 2010, compared to "just" 59 percent in 2003. The difference is made up by households with income between $50,000 and $100,000, who receive only 17 percent of the tax cut in 2010, down from 28 percent in 2003. As the program becomes permanent, middle-class households would lose much of their share of the tax cut with the resources transferred to high-income groups.

D. Other Distributional Issues

The administration continues to report distributional estimates in controversial and misleading ways, when it bothers to report them at all (Burman, 2001). The administration notes that after the tax cut, high-income households will pay a greater share of the income tax. Readers may be confused as to how that claim can be correct when all of the data show that by any reasonable standard the tax cut is sharply regressive (Tables 1 and 2). The answer is twofold. First, when the level of revenue is changing, looking at the share of tax burden owed by a group is not a meaningful indicator of whether the tax cut is regressive. For example, suppose that A earns $10,000 and pays $1 in tax and B earns $10 million and pays $1 million in taxes. Then we cut taxes, so that A pays zero and B pays $500,000. After the tax cut B pays a greater share of the tax (100 percent) than before the tax cut. But by any reasonable standard — percentage change in after-tax income, share of income tax received, dollar tax cut received — B got a bigger tax cut and the tax cut is regressive. Second, the administration ignores other federal taxes. If these were included in the analysis, high-income households would be shown to pay a smaller share of the overall tax burden after the tax cut than before.

The Department of the Treasury reports that the tax cut will give 92 million taxpayers an average benefit of $1,083 in 2003.[4] This gives the impression that large benefits are widely dispersed across the population, but Table 4 suggests the benefits will be highly skewed. The table shows that the 68 percent of returns that are least affected will get an average tax cut of about $102, while the top 0.1 percent of returns will obtain average tax cuts of $142,000.[5]

The administration justifies the dividend tax cut in part by noting that almost half of the benefits of the dividend tax cut go to the elderly. But these are not the destitute elderly.

The administration justifies the dividend tax cut in part by noting that almost half of the benefits of the dividend tax cut go to the elderly. The TPC model finds similar results, estimating that people over age 65 would obtain 41 percent of the benefits of the dividend tax cut. But these are not the destitute elderly. Only 5.5 percent of the total dividend tax cut goes to households whose numbers are aged 65 or older and have less than $50,000 in income.

IV. Growth and Jobs

The president claims the package is mainly about "growth and jobs," but the effects here are not likely to be large.

A. Deficits, National Saving, and Future Income

The increase in expected future budget deficits will reduce national saving and likely reduce saving. The reduction in national saving in turn will reduce the capital stock and hence reduce future national income (Gale and Orszag 2002). Davis (2002) notes that the administration estimates that a $200 billion reduction in tax revenues reduces the capital stock by $100 billion. That implies that the $674 billion decline in revenues would reduce the capital stock in 10 years by about $337 billion. Applying a 6 percent rate of return to such capital implies that annual national income will be reduced by $21 billion in 2012. This translates into about $190 per household in 2012. Obviously, not a cataclysmic event, but note that more than 50 percent of households are likely to have tax cuts less than that (Table 3), and thus would be made worse off by the proposal in the absence of other growth effects.

[4]"Effects of Major Individual Income Tax Relief Provisions in the Economic Growth Plan," Department of the Treasury, January 7, 2003.

[5]The administration provides similar claims — focusing on the mean tax cut — for married couples, couples with children, and single parents with children and the same pattern holds — namely, that the benefits are highly skewed. For example, the administration claims that the average tax cut among 6 million single women with children is $541. That may be true, but it is a misleading guide to who benefits: 85 percent of those women would get tax cuts less than $500, including 49 percent who would receive nothing, while a select few would receive enormous tax breaks. The full set of information is at http://www.taxpolicycenter.org.

B. Interest Rate Effects

The proposals are likely to raise interest rates for two reasons. First, the increase in the budget deficit is likely to raise interest rates. Davis (2002) reports that the administration believes that a $200 billion reduction in the surplus raises interest rates by 3-5 basis points. By that measure, a $900 billion package would reduce rates by between 13 and 22 basis points. Gale and Orszag (2002) review macroeconometric models and research that relates expected future deficits to interest rates and find that a sustained 1 percent of GDP increase in the deficit raises interest rates by about 50 basis points in the first year and up to 100 basis points in the 10th year. Calculations using this measure suggest that the increase in the deficit due to the tax cut will raise interest rates by 20 basis points in the first year and 40 basis points later on.

Second, the dividend tax cut should raise equilibrium after-tax interest rates even if there were no increase in the deficit. The easiest way to see why is to note that exempting dividends from individual taxation will tempt some marginal investors to shift from tax-free municipal bonds into equities. This will drive down municipal bond prices, hence drive up municipal bond interest rates. That will encourage holders of other bonds to buy munis and sell their existing bonds, which will drive up interest rates for those bonds. This will spill over into other bonds, reducing yields and raising interest rates. It is difficult to estimate the magnitude of the interest rate effect from this channel, but its presence will surely be felt.

C. The Stock Market and Investment

The administration claims the dividend tax cut will boost the stock market, raise investment, and create jobs.[6] These effects are related. Under the traditional view of corporate taxation, a cut in dividend taxes will have little effect on firms' market value but it will reduce the cost of new investments. Under the "new view," the tax cut will have a bigger effect on the market, but a smaller or nonexistent effect on investment.

Is it a good idea to use tax policy to give the stock market a one-time boost?

The administration estimates the market would rise by 10 percent under a dividend exclusion. Macro-Advisers, an economic consulting group, estimates the change at 8 percent. MIT economist James Poterba is cited in *The Wall Street Journal* as suggesting a 5-6 percent increase. (Davis and Ip, 2003). All of these estimates are uncertain. I take an average of 8 percent, but note that none of these estimates assumes an increase in interest rates. A 20-basis-point increase in interest rates would reduce stock market values by about 3 percent (if the current required return is 8

[6]"Eliminating the Double Tax on Corporate Income," Council of Economic Advisers, January 7, 2003.

Table 3
Administration Stimulus Proposal:
Distribution of Income Tax Change by AGI Class, 2010[1]

AGI Class (thousands of 2001 dollars)[2]	Returns		Percent Change in After-Tax Income[3]	Percent of Total Income Tax Change	Average Tax Change ($)	Average Income Tax Rate[4]	
	Number (thousands)	Percent of Total				Current Law	Proposal
Less than 10	28,558	19.4	0.1	0.4	-4	-8.0	-8.2
10-20	25,545	17.4	0.1	2.0	-28	-4.2	-4.4
20-30	19,338	13.1	0.2	3.4	-62	3.4	3.3
30-40	14,425	9.8	0.2	4.1	-100	7.1	6.9
40-50	10,975	7.5	0.3	4.6	-146	9.1	8.9
50-75	18,082	12.3	0.3	9.5	-185	10.8	10.7
75-100	11,364	7.7	0.2	7.3	-225	13.0	12.9
100-200	13,861	9.4	0.4	21.5	-545	16.9	16.8
200-500	3,157	2.1	0.7	18.0	-1,998	23.4	23.3
500-1,000	531	0.4	0.9	8.1	-5,373	25.5	25.4
More than 1,000	267	0.2	1.0	20.9	-27,468	26.5	26.4
All	147,114	100.0	0.4	100.0	-238	14.5	14.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model.
[1]Calendar year. Table measures the impact of the elements of the stimulus proposal that differ from current law in 2010: the exclusion of 100 percent of dividend income from taxation; width of the 10-percent bracket. Does not include any potential behavioral response.
[2]Returns with negative AGI are excluded from the lowest income class but are included in the totals.
[3]After-tax income is AGI less individual income tax net of refundable credits.
[4]Average income tax, net of refundable credits, as a percentage of average AGI.

percent and the growth rate is 2 percent) and thus reduce the stock market gain to 5 percent, roughly.

Is it a good idea to use tax policy to give the stock market a one-time boost? When we say that cutting dividend taxes would boost the stock market, it means that it would give windfall gains to existing taxable investors. These investors voluntarily bought their stock at prices reflecting the current taxation of dividends, and so already earn the after-tax market rate of return on their stock investments, despite so-called double taxation. Lower taxes on dividends, to the extent they raised stock prices, would give them an undeserved and unnecessary benefit.

In addition, in the current environment, cutting taxes on dividends could easily be viewed as an attempt to manipulate stock prices with the tax code to bail out investors who have suffered losses. Such a precedent would be unfortunate and dangerous, not to mention hypocritical for an administration that wants to privatize Social Security.

Furthermore, a dividend tax cut is a poorly targeted way of boosting the market. The cut would have the biggest effect on firms that pay the most dividends, not on those whose price has fallen the most. But Brown (2003) shows that non-dividend-paying stocks have fallen substantially more in value than dividend-paying stocks. Tech stocks, for example, generally pay low dividends and have experienced the largest price drops, so the change would hurt tech stocks relative to the rest of the market.

It is not clear — to me at least — that bolstering investor confidence and mechanically boosting the stock market are the same thing. Put differently, I wonder whether a stock market increase that is due solely to a change in the tax law — and has nothing to do with any underlying change in the marginal product of capital or labor — would really do anything to boost investor confidence. Suppose the government said that it would match, 1:1, any dividend payment that firms made. That would boost the market because it raises the value of receiving a dividend, but it seems unlikely to change anyone's fundamental views about the economy. Thus, it is not clear to me that a mechanical tax-induced asset price boost will build confidence.

> ***Capacity use rates are very low. It is unclear why firms would want to build new plant and equipment while they are not using what they already have.***

The impact on investment is likely to be miniscule, regardless of whether the new view or old view holds, for three reasons. First, firms have already seen significant drops in the cost of capital over the last few years because of lower inflation and interest rates. The 2002 stimulus act further reduced the cost of new investments by providing partial first-year expensing. Yet investment has remained flat or falling. The reason is not hard to see. Currently, capacity use rates are very low. It is unclear why firms would want to build new plant and equipment while they are not using what they already have. Second, dividend tax cuts subsidize the return to old capital as well as the return to new

Table 4
Administration Stimulus Proposal:
Percent of Returns by Size of Income Tax Cut, 2003[1]

Income Tax Cut ($)	All Filers	
	Percent of Total	Average Tax Cut ($)
0	29.4	0
1-100	19.5	-52
101-500	19.3	-307
501-1,000	9.9	-743
1,001-1,200	2.9	-1,119
1,201-2,000	7.9	-1,599
2,001-5,000	9.6	-2,718
5,001-10,000	0.9	-6,744
10,001-50,000	0.6	-19,469
Over 50,000	0.1	-142,009
All	100.0	-865

Source: Urban-Brookings Tax Policy Center Microsimulation Model.
[1]Calendar year. Includes the following provisions: accelerate 2006 rate cuts; exclude 100 percent of dividend income from taxation; accelerate marriage-penalty relief; accelerate child tax credit increase; accelerate expansion of 10 percent bracket; increase AMT exemption. Does not include any potential behavioral response.

share issues. Thus, most of the cost of the dividend tax cut would go to providing windfall gains to old investments that would do nothing to generate new investment. Third, to the extent that firms pay more dividends, they will have fewer internal funds available to finance investment and will have to face outside scrutiny, and typically higher financing costs, to borrow funds to finance investment projects.

It's also important to note that the effects above would adversely impact interest-sensitive sectors of the economy, such as housing, durables, and net exports. It could, for example, hurt families with adjustable-rate home mortgages or car payments. The proposed change could also hurt small businesses, because they do not currently face double taxation of dividends. Thus, the change would make large corporations a more attractive investment relative to small businesses.

D. Stimulus

CEA Chair R. Glenn Hubbard has expressed the view that "In terms of bang for the buck, it [a dividend tax cut] is really the biggest" (*Financial Post*, January 7, 2003). In my view, the stimulus effects are likely to be small. A 5 percent gain in the stock market, with a current aggregate market value of about $8.5 trillion, according to the Wilshire 5000 Index, implies a boost of $425 billion in market value. Households' marginal propensity to consume out of wealth is typically estimated at 3-5 percent. Using 4 percent, aggregate consumer spending ought to rise by $18 billion from this effect. That amounts to less than 0.2 percent of GDP, which is less than half the size of the rebate offered in the summer of 2001, but at a cost of hundreds of billions of dollars over the next decade.

Moreover, the direct effect of market wealth in raising consumption may not occur. In the last few years, we have seen significant declines in stock market wealth without large changes in consumption expenditures. Indeed, consumption has held strong over the period. This suggests that consumption is not likely to rise by very much in response to any change in stock market wealth.

> ***If the administration took one-tenth of what it proposes for dividend tax cuts in 2003 and instead gave it to the Security and Exchange Commission, it would multiply the SEC's budget several times over.***

And the stock market effect, whatever it is, will be offset to some extent by the contraction in interest-sensitive sectors of the economy. Moreover, the dividend tax cut will hurt the states directly, by reducing revenue, and indirectly, by raising municipal bond rates. These factors suggest that the dividend tax cut would generate a net stimulus that is smaller than that generated by the rebate in 2001, even under pessimistic assumptions about how well the rebate operated (Shapiro and Slemrod, 2002).

The acceleration of EGTRRA provisions will provide some additional stimulus, but it is important to note that the upper income tax rate cuts are skewed substantially toward higher-income households. Almost none of the rate cuts will go to households in the bottom 60 percent of the distribution, although these are the households most likely to spend any additional funds they receive. As a result of all these provisions, the administration's Council of Economic Advisers estimates the plan will create just 190,000 new jobs in 2003.[7]

V. Corporate Tax Reform

Taxing all corporate income once, and only once, and at the same full rate, would be a significant improvement in the structure of tax policy. But, contrary to what may be popular belief, it is decidedly not the case that the current system taxes all corporate income twice. Robert McIntyre of Citizens for Tax Justice has calculated that on average, about half or more of corporate income is not taxed at the corporate level. Similarly, more than half of dividends in recent years have gone to investors who would be unaffected by the change in taxation — pension funds, 401(k) plans, nonprofits, etc. (Gale, 2002). As a result, in the current system, some corporate income is not taxed at all, some

[7]Council of Economic Advisers, "Strengthening America's Economy: The President's Jobs and Growth Proposals," January 7, 2003.

is taxed once — at either the individual or firm level — and some is taxed twice.

The president's proposal to change the taxation of dividend income would be welcome as part of a revenue- and distributionally-neutral package that broadens the corporate tax base. This includes closing corporate shelters, reducing or eliminating the myriad forms of corporate welfare and targeted subsidies, and limiting corporate inversions and taxes all corporate income once at the same full rate. This is particularly important because the current administration is opposed to tax increases of any kind. Thus, if any sort of corporate reform is to be enacted, it needs to be done at the same time that a dividend tax cut is introduced. The administration's proposal would not eliminate incentives to sheltered funds. In addition, the proposal to cut dividend taxes could create significant problems of avoidance, abuse, or complexity that are beyond the scope of these comments. Moreover, dividend tax relief may not be the best way to obtain integration of the corporate and individual tax systems. Dividend tax relief provides windfall gains to investors who purchased shares in firms under the previous dividend tax regime, rather than focusing its incentives on new investment.

VI. Conclusion

The features of a good plan depend on the goal. A plan for long-term reform and growth could usefully begin by fixing the AMT, creating revenue-neutral corporate tax reform that aims to tax all corporate income once and only once, and paying for the AMT fix by freezing the 2001 tax cut at its current levels while making the already-implemented provisions permanent. This would be an equitable way to raise growth, reduce uncertainty, shore up fiscal prospects, and make taxes simpler. Better corporate oversight would also help. If the administration took one-tenth of what it proposes for dividend tax cuts in 2003 and instead gave it to the Security and Exchange Commission, it would multiply the SEC's budget several times over. A well-designed stimulus package would get funds to low- and middle-income households, help out the states, and extend unemployment insurance. It would focus on boosting activity now, keeping a lid on long-term costs, and getting money into the hands of people who need it and would spend it. Either approach would be an improvement over the president's plan.

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