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Obama's Dividend and Capital Gains Tax Hike Would Hurt Seniors

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President Obama's "Budget Blueprint" proposes to raise the tax rate on dividends and capital gains from 15 percent to 20 percent.[1] This tax hike would hit senior citizens particularly hard, as it would depress the value of stocks held in many types of retirement savings plans they rely on for income to supplement their Social Security benefits.

These plans include 401(k)s, 403(b)s, IRAs, and self-directed state, local, and federal government employee retirement funds. As of December 31, 2008, these plans invested $4.4 trillion in stocks—just over of 54 percent of all their assets.[2]

A Steep Decline. Capital gains and dividends taxes decrease stock prices in two ways: They reduce the after-tax value of the dividends and capital gains earned by stocks, and they increase the cost of capital for businesses, thereby reducing future business profitability.

To determine how much Obama's proposed tax hike would reduce the value of retirement savings plans, the value in current dollars of the yearly revenue raised by the tax increase (as shown in the Budget Blueprint) is discounted by the latest available price-to-earning ratio of the S&P 500 to calculate the aggregate decline in stock prices. This is a widely accepted methodology.[3]

According to this calculation, the tax hike would cause stock prices to drop almost $93 billion. As the percentage of all stocks held in retirement savings plans is approximately 30 percent,[4] nearly one-third of the decline in stock prices would fall on stocks owned through these plans. This works out to $27 billion of lost value for current and future retirees unnecessarily redistributed to Congress. That works out to $434 of lost retirement savings for each family.

Seniors' Income Would Fall. The $27 billion of lost wealth would lower the incomes of seniors dependent on retirement savings plans. Seniors sell stocks held in these funds after they retire to pay for their living expenses, including basics such as housing, food and medical care. When the stocks they sell decline in value, seniors have less money to pay their bills, and their budgets are squeezed tighter.

Seniors dependent on retirement savings plans already experienced a precipitous decline in purchasing power due to the current recession. From the end of 2007 to the end of 2008, they lost more than $2.6 trillion of value—more than 24 percent of their total worth—because of the decline in stock prices.[5]

Seniors may not see these values return to near previous highs any time soon because of the ongoing economic and financial crisis. These seniors are forced to live on less for the foreseeable future as a result. A tax hike on dividends and capital gains would fur-

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ther depress retirement savings plan values and the purchasing power of seniors' money.

Unlike the decline in stock values due to the recession, the stock price decline caused by the dividend and capital gains tax hike is irrecoverable because the additional tax lowers stock prices permanently—or at least until the tax hike is reversed. On the other hand, the lost value from the stock market decline will reverse as economic conditions improve.

Do Not Punish Seniors. Seniors have already paid a steep price in their retirement income during this recession. Rather than causing further damage, Congress and the President should leave the tax rate on dividends and capital gains at current levels. Even better, they should follow the opposite course and lower these taxes. Cutting the dividend and capital gains taxes would raise stock prices, thereby raising the incomes of seniors, and it would reduce the tax disincentive facing business investment, thereby accelerating the recovery—a double bonus for the ailing economy.

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1. U.S. Office of Management and Budget, *A New Era of Responsibility: Renewing America's Promise* (Washington, D.C.: U.S. Government Printing Office, 2009), p. 123, Table S-6, at *http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf* (April 8, 2009).
2. Federal Reserve Board, "Flow of Funds Accounts of the United States," March 12, 2009, pp. 75–76, at *http://www.federalreserve.gov/releases/z1/Current/z1.pdf* (March 12, 2009).
3. See James Poterba, "Corporate Payout Policy," *American Economic Review*, Vol. 94, No.2 (May 2004), pp.171–175, at *http://jstor.org/stable/3592877* (March 6, 2009); United States Department of Treasury, "Report of the Department of the Treasury on the Economic Effects of Cutting Dividend and Capital Gains Taxes in 2003," March 14, 2006, p. 9, at *http://www.treas.gov/press/releases/reports/report%20on%20econ%20of%20cap%20gains%20%20dividends%203.14.06.pdf* (March 6, 2009).
4. Federal Reserve Board, "Flow of Funds Accounts of the United States," pp. 75–76.
5. *Ibid.*