

**Testimony before the Subcommittee on Economic Policy of the Senate
Committee on Banking, Housing, and Urban Affairs.**

**PREPARED STATEMENT OF JAMES W. STUCKERT
Chairman, SIA Regional Firms Committee
Chairman and CEO, J.J.B. Hilliard and W.L. Lyons, Inc.**

May 22, 2003

Mr. Chairman and members of the Committee, my name is James W. Stuckert, and I am Chairman and CEO of Hilliard Lyons, based in the beautiful bluegrass state of Kentucky. Hilliard Lyons is a full-service investment firm with one goal: to help individuals reach their investment objectives. Since investment counseling is our only business, increasing investment in the equity markets is vital to us. I am also Chairman of the Securities Industry Association's SIA Regional Firms Committee, which represents the interests of regional firm members. I thank the Chairman and the Committee for the opportunity to present my views on how to jumpstart the economy and increase investment in the equity markets.

Established in 1854, Hilliard Lyons is a member firm of the New York, American and Chicago stock exchanges, National Association of Securities Dealers and Securities Investors Protection Corporation (SIPC). The firm offers one-on-one advice about stocks, bonds, options, retirement plans, money market funds, mutual funds, trust and estate planning and investment management. We also research the investment potential of various companies and industries and underwrite bonds for public improvements such as schools and highways. Hilliard Lyons, a PNC Advisors company, has 550 financial consultants in 85 branches in Arkansas, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, North Carolina, Ohio, South Carolina, Tennessee, Virginia and West Virginia.

Over the past 25 years, the securities industry has faced and overcome many challenges. These include processing ever-increasing volumes of trades, converting to a shorter settlement period, the development of many new investment vehicles, the globalization of markets, and a terrorist attack that affected our financial systems like no other seen in our time. While the transition to an era of fear and uncertainty is not a future we would have chosen for our country, that is the reality that faces us today. With a pragmatism that is uniquely American, we have tackled these new realities head on and have done everything feasible to mitigate loss and confusion. Regaining the public's trust and confidence in the greatest capital markets in the world is critical to jumpstarting our economy.

One of the most important things we can do to restore confidence is to get the economy and markets rolling again. Indeed, as the markets go, so goes public trust and confidence. The monthly UBS/Gallup Index of Investor Optimism hit an all-time low of 5 points in March 2003, but it surged 61 points in April, just as the markets began creeping upward. That increase represents the largest one-month jump in the Index's history (started in 1996). Some of the increase in confidence may be due to the tough new regulations, protections, and sanctions mandated by the Sarbanes-Oxley Act. We are unlikely to see a sustained restoration of investor

confidence, investment or economic growth, however, unless we as an industry continue to put the customer first.

Congress can also help boost the economy and the markets by passing President Bush's jobs and growth package. The elimination of the double tax on dividend income - the centerpiece of the plan - would enhance the long-term growth potential of the U.S. economy, promote job creation and higher wage growth, strengthen corporate governance, and put the United States on a more equal footing with our major trading partners.

Current tax policy encourages corporations to rely too heavily on debt rather than equity financing because interest is deductible but dividends are not. The bias favoring debt over equity financing, for example, led many companies to take on high levels of debt that left them vulnerable to the economic downturn. The President's proposal would improve the performance of our economy by relieving numerous distortions caused by the current corporate tax regime, including the income tax code's general bias against savings and investment. The President's economic package has undergone many revisions as it has worked its way through the legislative process, and even today a new version of the package is being discussed. Even so, the best route to renewed economic vitality is the complete elimination of the double taxation on dividends.

ELIMINATING DOUBLE TAXATION WOULD BENEFIT U.S. ECONOMY

Ending the double taxation of dividends would help move our tax system to one that taxes income only once. This, in turn, promotes savings and investment, increased capital formation, job creation, and economic expansion. The increased economic activity would generate additional tax revenues that could offset a significant percentage of the tax revenues foregone by the proposal.

The immediate impact of eliminating the tax on dividends would be an annual tax savings of approximately \$30 billion, or 0.3 percent of GDP. This savings would be distributed broadly and shared by the more than 50 percent of U.S. households that own stock. Moreover, in the case of the tax cut on dividends, there are additional factors that would help boost the economy in the long run.

Because the after-tax value of dividends would increase, investment in stocks would become more attractive. It has been estimated that the value of the equity market would increase by as much as 5-10 percent. This increase in equity values would provide further economic stimulus through the wealth effect (people spend more as their net worth increases). It is no accident that a rising stock market is a leading indicator of economic growth.

The initial approximately \$30 billion in tax savings is actually a very conservative estimate because it assumes no change in the current dividend policies of U.S. companies. But it is likely that more companies would issue dividends. Now that a tax cut on dividends has been proposed, companies that have previously retained large amounts of cash have said they may distribute some of that cash to shareholders.

As useful as a tax cut on dividends would be in reviving the current sluggish economy, the main benefits would be long term. The double taxation of corporate earnings reduces companies'

return on capital and therefore increases the cost of capital. Lowering the cost of capital by eliminating taxes on dividends would encourage companies to invest more in plants, equipment and other capital stock, enhancing long-term growth and leading to more jobs and higher wages.

U.S. POLICY LAGS OUR MAJOR TRADING PARTNERS

Importantly, eliminating the double tax on equity-financed investments would bring United States tax policy more in line with our major trading partners. With the exception of the United States, all G-7 countries provide protection against the double tax on dividends. In addition, the United States has the second highest dividend tax rate among the 30 OECD nations. Twenty-seven of the 30

OECD countries have adopted one or more ways of alleviating the double tax.

Whether competing at home or abroad, the double tax makes it more difficult for a U.S. company to compete successfully against a foreign competitor.

DIVIDENDS BENEFIT TAXPAYERS ACROSS THE INCOME SPECTRUM

According to the most recent IRS data, 34.1 million tax returns (or 26.4 percent of total tax returns, representing 71 million people) reported some dividend income in 2000. Of all taxpayers that claimed some dividend income in 2000, nearly half (45.8 percent) earned less than \$50,000 in adjusted gross income (including dividends). This proposal would also benefit more than 13.1 million small business owners or self-employed taxpayers. Importantly, almost half of all savings from the dividend exclusion would go to taxpayers 65 and older, thereby giving retirees an additional reliable, long-term source of income to supplement their social security earnings and other retirement savings. The average annual tax savings for the 9.8 million seniors receiving dividends would be \$936.

IMPROVING CORPORATE GOVERNANCE WILL BOOST INVESTOR CONFIDENCE.

Perhaps the greatest long-term benefit from the elimination of the double taxation of dividends would be the incentives for companies to return to the principles of sound financial management. With half of American families invested in the market, nothing is more important to the securities industry than restoring the public's trust in the strongest capital markets in the world. While we cannot blame the bubble of the late 1990s and its painful aftermath on the tax system, the current system did little to reign in the excesses and in some cases contributed to them. From the standpoint of both shareholders and the health of our economy, companies should be encouraged to concentrate on real earnings.

In that vein, encouraging companies to pay dividends would limit excesses because dividends offer proof of real profits. The payment of dividends by a company may give investors a strong signal of the company's underlying financial health and profitability. Indeed, a firm cannot pay dividends for any length of time unless the company has the earnings to support such payments. In an environment where reported earnings are viewed with some skepticism, cash dividends will bolster the credibility of earnings reports. Moreover, the payment of dividends would better align the interests of shareholders and managers by allowing shareholders to participate in decisions

regarding corporate investment. Finally, because dividends serve as a stronger foundation for long-term value, companies that pay them will have fewer motives to artificially inflate profits just to cause temporary increases in stock prices.

CURRENT ECONOMIC DATA

SIA correctly forecast the sub-par performance of the U.S. economy in the first quarter of 2003 as well as the further weakening in the current quarter. The depth and length of the downturn is uncertain, and will be determined by several interrelated variables. Among them are the expense of the reconstruction in Iraq; the direction of oil prices; how quickly consumer and investor sentiment rebounds; and, whether the recent resumption of growth in business fixed investment will continue. SIA's view is that it is critical that we focus on stimulating business fixed investment, which contradicted traditional recessionary patterns by leading the economy into the downturn while consumption remained relatively strong.

In this vein, not all fiscal stimuli are created equal, and the tax measures that are focused on investment are much more important than those that provide a short term, transient boost to consumption. President Bush has focused on the dividend proposal as key to job creation. Capital formation, spending on machinery and equipment, plant and facilities will stimulate job creation more than spurring incremental consumption.

CONCLUSION.

Mr. Chairman, I commend you for holding a hearing to review the economic situation on how to "jumpstart" the equity markets. Our number one goal is regaining the public's trust and confidence in our industry and our capital markets, and we are doing everything we can to ensure that our customers' interests always come first. Sound economic policy, as embodied in the President's jobs and growth package, is also critical to reinvigorating our economy. I urge Congress to pass it quickly.