

PUTTING THE ECONOMY BACK ON THE GROWTH TRACK: Six Steps To "Upsize" the Economy

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Executive Summary

"Downsizing" popularly describes steps taken by troubled American firms to become more competitive. Unfortunately, there are parallels to the larger American economy. While the economy has been in recovery since March of 1991, economic growth and job creation are only half to two-thirds of that experienced in other post World War II economic recoveries. More alarming, both private and government forecasts place long-term real growth prospects between 2 and 2.5 percent, well below the average 3.2 percent experienced between 1946 and 1988, and substantially slower than the 3.85 percent averaged from 1983-88.

While a one percent difference in growth over one, two, or three years may seem insignificant, measured over several decades the impact on America's standard of living is enormous:

- If the economy grows at a real rate of 3.5 percent while population grows at one percent, American living standards will double in 30 years. But if growth is held to 2.5 percent, it will take 50 years for the standard of living to double.

Slower growth since 1989 has already lowered potential GDP and government revenues, and American's living standards.

- Measured in today's dollars, real GDP is already \$1.3 trillion below what it would have been if the growth trend of the 1980s had been maintained. As a result, the average American is \$5,200 worse off since 1989 and could lose another \$10,000 during the rest of the decade.
- The federal government has lost some \$200 billion in revenue because of slower growth since 1989. The federal government will lose an additional \$600 billion if the slow growth trend continues until the end of the decade.

Recent tax policy which has significantly raised taxes on labor and capital—the key factors of production—bears considerable responsibility for slower economic growth. "Upsizing" the economy—that is putting it back on its historical growth track—should focus on reversing this counterproductive tax trend.

This study examines the economic and revenue implications of six tax changes. In varying degrees, all would lower the cost of capital or labor, and encourage new investment, job creation and higher wages, and additional revenues for government.

Collectively, by the end of the decade, adopting these six proposals would add 2 percentage points to the annual growth rate, and:

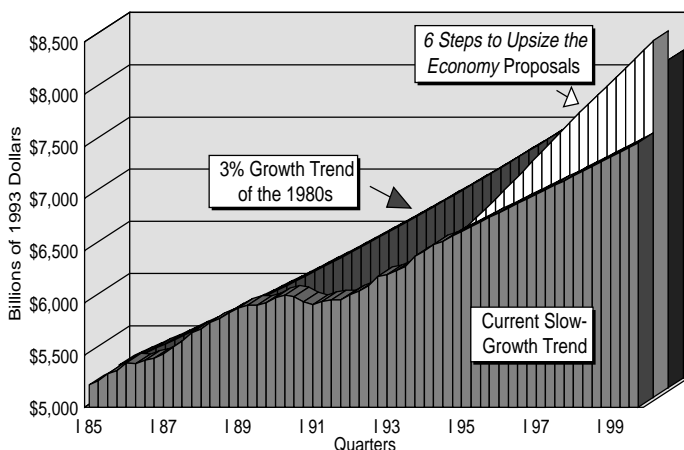
- Increase GDP by \$3.9 trillion;
- Create an additional 3.2 million jobs;
- Raise \$623 billion in additional federal revenues.

Lawmakers should seriously consider adopting these or other growth initiatives to put the American economy back on its historical growth track.

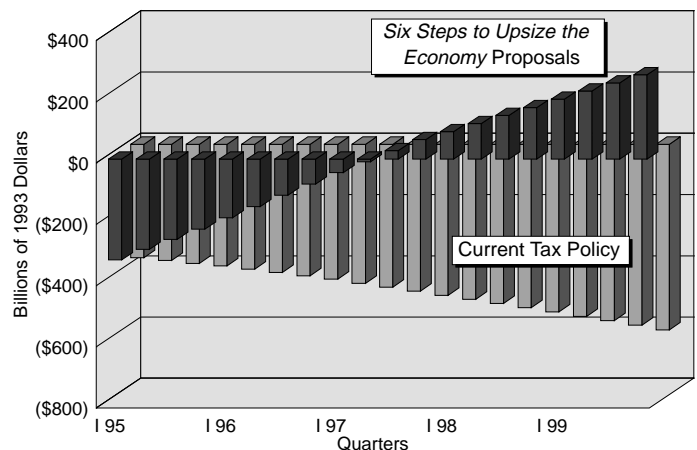
Six Steps to "Upsize" The Economy:

- Capital gains tax relief;
- Neutral Cost Recovery;
- Expanded IRAs;
- Restoration of the pre-1993 tax on Social Security benefits;
- Increasing the Social Security earnings test to \$30,000; and
- Increasing the estate tax exclusion to \$1.5 million.

Growth Projections Including 6-Steps Proposals



Change in GDP Relative to 3% Growth Trend, 1946-1988

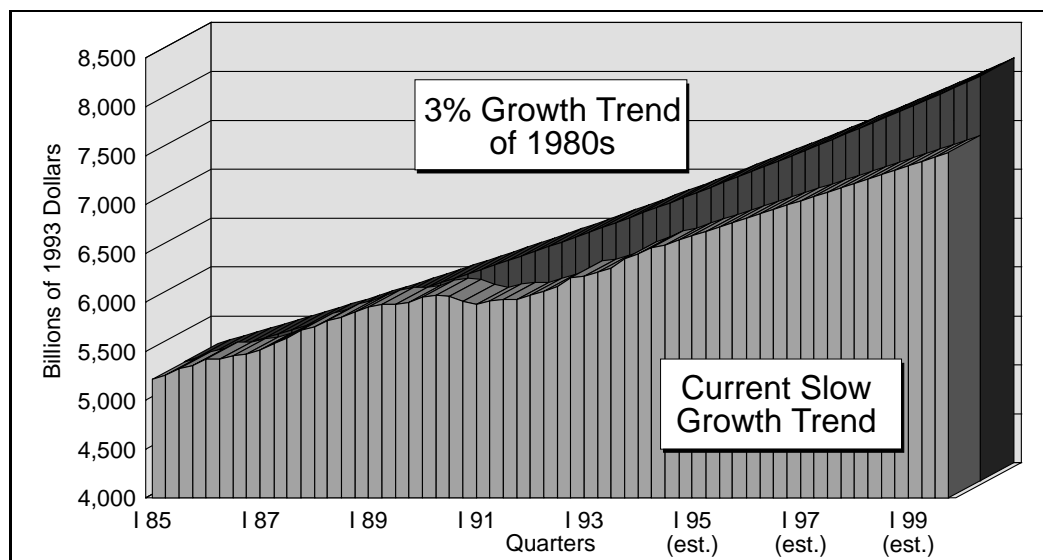


PUTTING THE ECONOMY BACK ON THE GROWTH TRACK:

Six Steps To "Upsize" the Economy

The American economy has seen better times. While the economy has been expanding since the latest recession ended in March of 1991, it is growing considerably slower than in the past. Economic output and investment are two-thirds of where they should be at this point in a recovery. Job creation is less than half of where it should be. Equally alarming, private and government forecasts place long-term real growth prospects between 2 to 2.5 percent, well below the average 3.2 percent experienced between 1946 and 1988.

While a one percentage point difference in economic growth over one, two or three years may seem insignificant, over several decades the impact on America's standard of living is enormous. For example, if the economy grows at a real rate of three-and-one-half percent while population grows at one percent, Americans would see their standard of living double in 30 years. But if growth is held to two-and-one-half percent, it will take 50 years for the standard of living to double.



Introduction

Figure 1
Lost GDP Due to Slower Growth Relative to 3% Growth Trend of the 1980s

The U.S. economy has lost almost \$1.3 trillion in real GDP since 1989 because the growth trend of the 1980s has not been maintained. If long-term economic growth is in the 2.5% range, as private and government economists forecast, it will lose another \$2.6 trillion between now and the end of the decade.

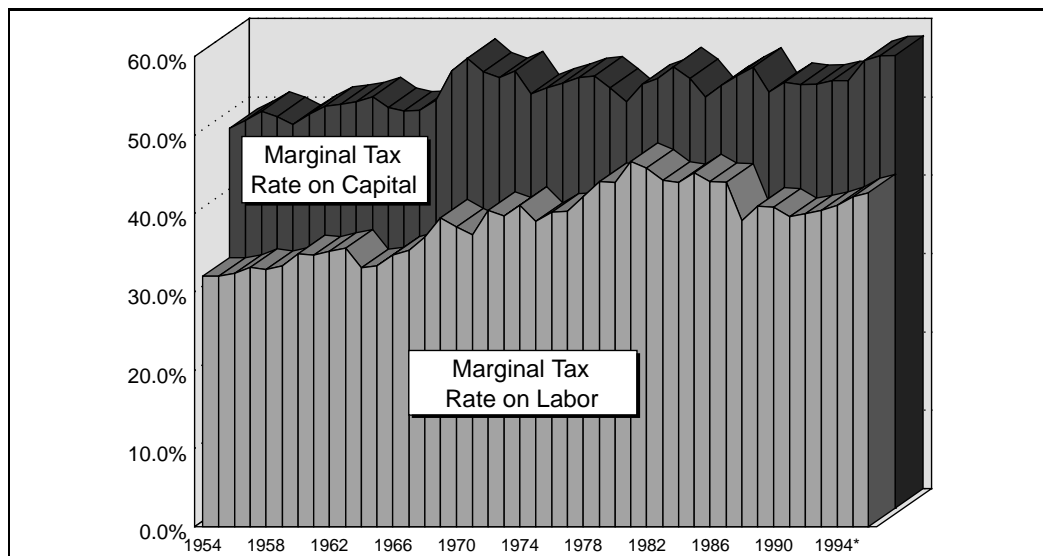
Slower growth since 1989 has already robbed Americans of higher living standards. Measured in today's dollars, real GDP is \$1.3 trillion below what it would have been if the growth trend of the 1980s had been maintained. As a result, the average American is \$5,200 worse off since 1989 and could lose another \$10,000 during the rest of the decade.

Economic performance affects government fortunes as well. The rate of growth helps determine the tax revenues used to pay for government services, the size of the deficit and the national debt. For instance, the federal government has lost some \$200 billion in revenue because of lower-than-average growth since 1989 and could lose another \$600 billion if the trend continues until the end of the decade. Assuming that spending is kept the same, higher budget deficits will have added over one-half trillion dollars to the national debt in just over a decade.

Recent tax policy bears considerable responsibility for the significant downsizing in long-run U.S. growth prospects. Despite the dramatic reduction in statutory personal income tax rates made in the Tax Reform Act of 1986, tax rates

Figure 3
Marginal Tax Rates on Labor and Capital, 1954 - 1996 (projected)

**Projected*



on labor and capital have been rising and are near historic highs. The marginal tax rate on labor should hit 41.1 percent in 1994, compared to 32 percent in 1954. Tax rates on capital are even higher. The marginal tax rate on private business capital should reach 65.8 percent in 1994, compared to 53.6 percent in 1954.

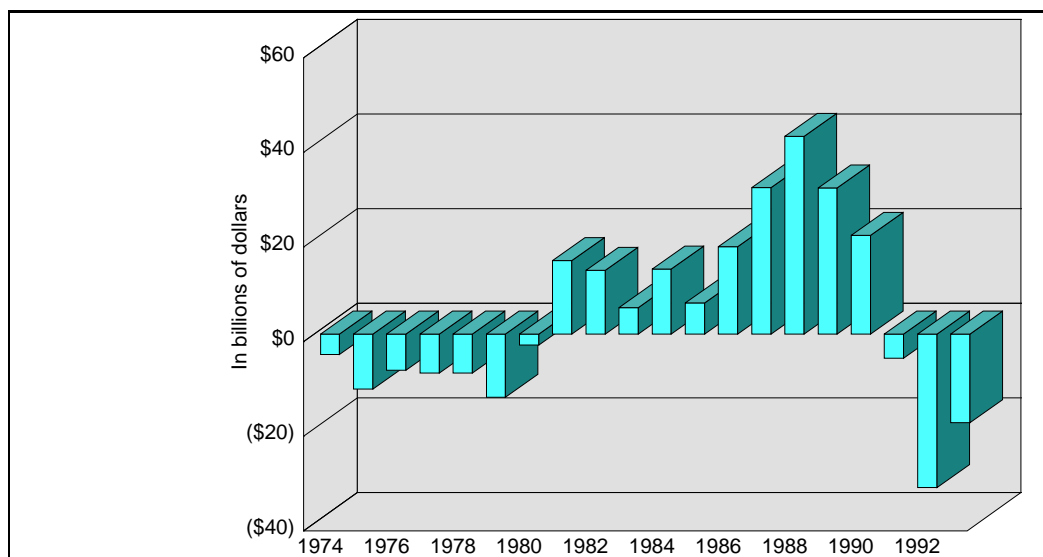
Rising tax rates on the factors of production were a major cause of the 1990-91 recession and are a key contributor to current anemic growth. High tax rates on capital also are a major contributor to two disturbing trends with respect to U.S. capital formation. First, investment remains low by historical standards. Net investment (after depreciation) in fixed capital has averaged only 3.4 percent of GDP since 1990, compared to 5.3 percent from 1974 through 1989, and 5 percent from 1983 through 1989. And although investment has picked up recently, it is still weak, running at 4.8 percent for the first half of 1994.

The second disturbing trend concerns capital flows into and out of the United States. During the 1970s, direct investment (plant and equipment) by Americans in other countries outweighed direct investment by foreigners in the U.S. by \$10 to \$20 billion a year. This pattern reversed during the 1980s with foreign direct investment in the U.S. exceeding American investment abroad by as much as \$42 billion in 1988. Since 1990, these capital flows have reversed yet again. The *Wall Street Journal* recently reported that even Treasury Secretary Lloyd Bentsen is investing abroad, putting between one-quarter and one-half million dollars of his own money into Asian stocks.

In a recent study, we examined tax policy over the last forty years and found that it does affect the economy, although not always in the way policymakers

Figure 2
Net Direct Investment in the U.S.

Source: U.S. Dept. of Commerce, U.S. International Transactions



envision.¹ For example, the U.S. economy experienced sustained periods of robust growth after the tax cuts of 1964 and 1981 which significantly lowered marginal tax rates. Tax bills which raised taxes, as in 1968, 1977 and 1990, or tried to redistribute the tax burden, as in 1969, 1976 and 1986, were often followed by recession or periods of slower growth.

¹See "Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy," *TaxAction Analysis Policy Report No. 127*, Sept. 1994. Institute for Policy Innovation.

The study concludes that attention should be focused on how taxes affect the costs of labor and capital. Taxes, after all, must be paid out of incomes that people earn in their capacity as either workers or investors. Because those taxes affect incentives to work and save, they ultimately affect economic activity. Further, taxes affect incentives at the margin, that is, on the next dollar earned. Measures to lower tax rates or increase investment incentives lower marginal tax rates on labor and capital and stimulate growth. Measures aimed at providing tax relief on the first dollar of income, such as raising the personal exemption or standard deduction, have almost no effect on marginal rates. Based on these observations, a pro-growth tax policy should pursue the following goals:

- Labor and capital should be taxed more equally. Because capital is currently taxed at a much higher rate than labor, tax rates on capital need to be lowered.
- Marginal tax rates of labor and capital should be brought closer to their average rates. Policies that focus on the last dollar, such as lower tax rates or investment incentives, are preferable to ones that focus on the first dollar.
- Tax rates on labor and capital are too high and both should be lowered. Although the previous two principles could be accomplished while holding the total tax take the same, additional growth benefits would result by lowering the total tax burden through reducing the size of government.

Currently, tax rates on capital are roughly 50 percent higher than they are on labor. The first step to stimulating growth, therefore, is to reduce tax rates on capital. Bringing tax rates on capital more in line with those on labor can be accomplished in numerous ways. The proposals estimated as part of the package presented here would:

- Reduce the amount of capital gains included in taxable income;
- Increase the availability of Individual Retirement Accounts which lowers the tax rate on capital because earnings on capital held in these plans is taxed only once;
- Liberalize tax depreciation rules to lower the effective tax rate on both corporate and noncorporate capital.

A second way to stimulate growth is to bring average and marginal tax rates closer together. Currently, the weighted-average marginal tax rate on labor and capital is over one-fourth higher than the average tax rate. Narrowing this differential could be addressed in many ways. This package contains proposals to liberalize the Social Security retirement earnings test and reduce the extremely high marginal tax rates caused by the way Social Security benefits are taxed.

The specific elements of the pro-growth tax policy package are:

- Capital Gains Tax Relief;
- Neutral Cost Recovery;
- Expanded IRAs;
- Restoration of Prior Social Security Benefit Tax (with 5 year phase-in);
- Increased Social Security Earnings Test to \$30,000 with Indexing; and
- Increased Estate Tax Exclusion to \$1.5 Million with Indexing.

Pro-Growth Tax Initiatives

... the U.S. economy experienced sustained periods of robust growth after the tax cuts of 1964 and 1981 which significantly lowered marginal tax rates.

1) Capital Gains Tax Relief

The Tax Reform Act of 1986 eliminated the 60-percent exclusion for capital gains, effectively raising the maximum tax rate on capital gains income from 20 percent to 28 percent. This change was supposed to help raise revenue to pay for the individual and corporate tax rate reductions. As a revenue raiser, however, it has failed miserably. Despite rosy forecasts by CBO and Treasury, *instead of raising new federal revenue, capital gains receipts have been declining since 1988*. Capital gains realizations in 1992 — the latest year for which data is available — were less than they were almost a decade ago when the economy was about half the size it is today.

This proposal offers a 50-percent exclusion, indexing capital gains for inflation, and a deduction for capital loss on sale of a principal residence.² The proposal would reduce the economy-wide marginal tax rate on capital by 6 percent and lower the cost of capital by 5 percent. By the year 2000:

²This proposal follows the specifications of H.R. 3739 introduced by Representative Bill Archer (R-TX).

- Higher investment would increase capital formation in the U.S. by \$2 trillion.
- This larger stock of U.S. capital would lead to 618,000 additional jobs.
- More capital and labor would yield an extra \$750 billion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$242 billion higher than otherwise.
- This greater economic activity would boost the near-term annual growth rate by 0.4 percentage points.

The federal static revenue loss would be small. Realizations from unlocking would increase capital gains tax revenues by \$14.1 billion over the first two years. The annual static loss would be \$9.3 billion by the year 2000. Additional income, payroll and excise tax revenues from added economic growth, however, would lead to a sizable net gain for the federal government:

- Ignoring economic effects, the proposal would lose \$3.8 billion in capital gains tax revenues between 1995 and 2000. This estimate does allow for substantial unlocking effects.
- However, federal payroll, corporate and personal income, and excise taxes would be \$130.2 billion higher than otherwise due to greater economic activity generated by the proposal.
- As a result, the net effect on federal revenues would be a gain of \$126.4 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would net \$216.4 billion between now and the end of the decade.

Table 1
CHANGES IN THE ECONOMY
50% Capital Gains Exclusion and Prospective Indexing, Housing Losses Allowed

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-3.2%	-3.1%	0.3%	0.0%	0.7%	0.3%
1996	-4.1%	-3.8%	0.8%	0.1%	2.0%	0.4%
1997	-4.6%	-4.1%	1.3%	0.2%	3.4%	0.4%
1998	-5.1%	-4.4%	1.8%	0.3%	4.7%	0.5%
1999	-5.5%	-4.7%	2.3%	0.4%	5.9%	0.5%
2000	-5.8%	-4.9%	2.7%	0.5%	6.8%	0.4%

*The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.

Change from Baseline in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	16.7	0.023	158.4
1996	52.0	0.095	477.8
1997	97.2	0.208	868.5
1998	145.3	0.344	1,263.4
1999	196.7	0.492	1,670.7

Table 2

CHANGES IN THE ECONOMY
50% Capital Gains
Exclusion and
Prospective Indexing,
Housing Losses Allowed

***Each job represents 2,040 labor hours annually.*

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	1.4	0.1	2.6	0.3	4.3	2.6	6.9
1996	4.4	0.3	4.6	0.8	10.0	6.7	16.7
1997	8.2	0.7	6.6	1.4	16.9	11.7	28.6
1998	12.3	1.3	9.2	2.0	24.8	17.3	42.1
1999	16.6	2.0	11.9	2.7	33.2	23.2	56.4
2000	20.4	2.7	14.4	3.4	40.9	28.5	69.4

Table 3

DYNAMIC REVENUE CHANGES
50% Capital Gains
Exclusion and
Prospective Indexing,
Housing Losses Allowed
(\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	8.5	4.3	12.8	15.4
1996	5.6	10.0	15.6	22.2
1997	-0.2	16.9	16.7	28.4
1998	-2.7	24.8	22.1	39.4
1999	-5.7	33.2	27.6	50.8
2000	-9.3	40.9	31.6	60.2

Table 4

REVENUE CHANGES
50% Capital Gains
Exclusion and
Prospective Indexing,
Housing Losses Allowed
(\$bil. Nom.)

Year	Change in Jobs (mil.)	Percentage Change in Jobs	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate (annual)	Change in Pretax Wage Rate (annual)
1995	0.023	0.2%	0.02%	\$ 61	\$ 89
1996	0.095	0.7%	0.08%	\$ 205	\$ 299
1997	0.208	1.1%	0.18%	\$ 368	\$ 536
1998	0.344	1.5%	0.29%	\$ 529	\$ 768
1999	0.492	1.9%	0.42%	\$ 690	\$ 1,002

Table 5

LABOR MARKET EFFECTS
50% Capital Gains
Exclusion and
Prospective Indexing,
Housing Losses Allowed

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	16.7	5.7	11.0	7.0	15.4	-11.4
1996	52.0	17.3	34.7	21.9	22.2	-9.4
1997	97.2	31.7	65.6	40.9	28.4	-3.8
1998	145.3	46.4	98.9	61.3	39.4	-1.7
1999	196.7	61.7	135.0	83.0	50.8	1.2
2000	242.1	74.9	167.2	102.4	60.2	4.7
1995-2000	749.9	237.5	512.4	316.5	216.4	-20.5

Table 6

COMPOSITION OF NET CHANGES IN INCOME FLOWS
50% Capital Gains
Exclusion, Indexing,
Housing Losses Allowed
(\$bil. Nom.)

**Replacement of capital assets that have worn out or become obsolete.*

***Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.*

2) Neutral Cost Recovery

Tax depreciation specifies how much of the original cost of an asset a business can deduct from income in a particular year. The current tax depreciation system adversely affects the mix of assets and the level of the U.S. stock of capital because of its inherent time bias; tax life errors; and potential for political influence. And depreciation deductions are not indexed for inflation. This shortcoming magnifies the bias generated by the other three problems. For example, at a 10 percent inflation rate, the total loss in the value of depreciation deductions ranges from 19.4 percent for a 5-year asset to 80.3 percent for a 39-year asset.

This proposal would allow businesses to index depreciation for investments in plant and equipment based on the GDP deflator and an annual rate of return of 3.5 percent.³ To assure that the revenue effects of the change will be positive in the near term, the new write-off pattern would be based on a slower method — 150 percent declining balance versus current law’s 200 percent declining balance — for most assets. To help small business, the proposal would increase the expensing limit from \$17,500 to \$25,000.

³This proposal follows the specifications of H.R. 539 introduced by Representative Nick Smith (R-MI).

The proposal would reduce the economy-wide marginal tax rate on capital by 24 percent and lower the cost of capital by 16 percent. By the year 2000:

- Higher investment would increase capital formation in the U.S. by \$8.9 trillion.
- This larger stock of U.S. capital would lead to the creation of 2.7 million new jobs.
- More capital and labor would yield an extra \$3.5 trillion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$1 trillion higher than otherwise.
- This greater economic activity would boost the near-term annual growth rate by 1.8 percentage points.

Even on a static basis the proposal would pick up revenue during the early years. This is because the switch from the double-declining method to 150-percent declining balance initially reduces depreciation deductions. Higher depreciation deductions in later years due to indexing adjustments start producing static revenue losses by the fifth year. By that time, however, added revenues from almost two additional percentage points in the rate of near-term U.S. growth would continue to far outweigh any static losses.

- Ignoring economic effects, the proposal would lose \$3.6 billion in federal tax revenues between 1995 and 2000.
- Higher growth, however, would generate an extra \$596.1 billion to federal payroll, corporate and personal income, and excise taxes
- As a result, federal revenues would gain \$592.5 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would pick up \$1 trillion between now and the end of the decade.

Table 7
CHANGES IN THE ECONOMY
Neutral Cost Recovery with \$25,000 Expensing

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-21.6%	-16.1%	1.6%	0.1%	4.2%	1.6%
1996	-22.1%	-16.1%	4.2%	0.5%	11.1%	2.1%
1997	-22.6%	-16.1%	6.7%	0.9%	18.0%	2.2%
1998	-23.0%	-16.1%	8.7%	1.4%	23.3%	2.1%
1999	-23.4%	-16.2%	10.5%	1.9%	27.8%	2.0%
2000	-23.8%	-16.2%	11.4%	2.3%	30.0%	1.8%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	101.6	0.157	968.7
1996	286.7	0.539	2,697.5
1997	493.4	1.078	4,571.8
1998	687.4	1.675	6,246.0
1999	878.4	2.252	7,847.0

Table 8

CHANGES IN THE ECONOMY Neutral Cost Recovery with \$25,000 Expensing

***Each job represents 2,040 labor hours annually.*

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	8.6	0.4	15.8	1.7	26.4	15.9	42.3
1996	24.2	1.1	23.8	4.2	53.3	36.0	89.4
1997	41.7	2.3	33.3	7.0	84.2	58.9	143.1
1998	58.1	3.8	43.6	9.6	115.2	81.1	196.3
1999	74.2	5.6	53.9	12.3	146.0	103.0	249.0
2000	86.3	7.7	62.5	14.3	170.9	120.1	291.0

Table 9

DYNAMIC REVENUE CHANGES Neutral Cost Recovery with \$25,000 Expensing (\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	-1.3	26.4	25.1	41.2
1996	6.6	53.3	60.0	97.9
1997	8.5	84.2	92.7	153.8
1998	3.9	115.2	119.2	201.3
1999	-5.8	146.0	140.2	241.8
2000	-15.5	170.9	155.4	271.7

Table 10

REVENUE CHANGES Neutral Cost Recovery with \$25,000 Expensing (\$bil. Nom.)

Year	Change in Jobs (mil.)	Percentage Change in Jobs	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate (annual)	Change in Pretax Wage Rate (annual)
1995	0.157	1.4%	0.14%	\$ 408	\$ 596
1996	0.539	3.6%	0.47%	\$ 1,110	\$ 1,618
1997	1.078	5.6%	0.93%	\$ 1,816	\$ 2,264
1998	1.675	7.1%	1.43%	\$ 2,425	\$ 3,521
1999	2.252	8.2%	1.90%	\$ 2,953	\$ 4,285

Table 11

LABOR MARKET EFFECTS Neutral Cost Recovery with \$25,000 Expensing

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	101.6	34.8	66.8	42.6	41.2	-17.1
1996	286.7	97.6	189.0	120.5	97.9	-29.4
1997	493.4	166.6	326.8	207.9	153.8	-34.9
1998	687.4	229.2	458.3	290.0	201.3	-33.1
1999	878.4	289.8	588.7	370.8	241.8	-24.0
2000	1,022.1	332.0	690.1	432.2	271.7	-13.8
1995-2000	3,469.7	1,150.0	2,319.7	1,464.1	1,007.8	-152.2

Table 12

COMPOSITION OF NET CHANGES IN INCOME FLOWS Neutral Cost Recovery with \$25,000 Expensing (\$bil. Nom.)

**Replacement of capital assets that have worn out or become obsolete.*

***Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.*

3) Expanded IRAs

The Tax Reform Act of 1986 changed Individual Retirement Accounts (IRA) in two significant ways. First, it limited the tax-free IRA contribution to only those not covered by any other pension arrangement or to those with income under \$25,000 for individuals and \$40,000 for married couples.

Second, the Act dramatically reduced marginal tax rates. The marginal rate reductions cut the tax advantage of IRA's relative to a regular savings plan by about 40 percent. The combination of lower rates and reduced eligibility for the initial deduction has reduced IRA participation to about one-fourth of its previous high.

This proposal would eliminate the income test for participation in an IRA. It also would end the current IRA tax deduction for the initial contribution and in its place allow withdrawals at retirement to be made tax free. Earnings inside the IRA would continue to accumulate free of tax. This new, "backended" IRA conveys the same level of tax benefits as the former IRA (in present value terms) but reduces the immediate tax revenue loss. The \$2,000 contribution limit would be indexed for inflation beginning in 1996 and the nonworking spousal contribution would be increased from \$250 to \$2,000.

IRAs and Keogh plans currently hold about \$1 trillion in assets. People with these accounts would have the option of converting their assets to a backended IRA by paying taxes on whatever is rolled over into the new account at their current marginal rate. This option must be exercised during 1995 or 1996. Any funds not rolled over would continue to accumulate tax free and be taxed at the time of withdrawal. We estimate that about 20 percent of current IRA holdings would be converted (\$80 billion in conversions in 1995 and \$120 billion in 1996).

The proposal would reduce the economy-wide marginal tax rate on capital by 0.6 percent and lower the cost of capital by 0.5 percent. By the year 2000:

- Higher investment would increase capital formation in the U.S. by \$146 billion.
- This larger stock of U.S. capital would lead to the creation of 42,000 new jobs.
- More capital and labor would yield an extra \$44 billion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$18 billion higher than otherwise.

Because of the conversion option, the proposal would pick up substantial revenue on a static basis for the first several years.

- Ignoring economic effects, the proposal would increase federal tax revenues by \$50 billion between 1995 and 2000.
- Higher growth would generate an extra \$8 billion to federal payroll, corporate and personal income, and excise taxes
- As a result, federal revenues would gain \$58 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would pick up \$75 billion between now and the end of the decade.

Table 13
CHANGES IN THE
ECONOMY
Expanded IRAs

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-0.09%	-0.09%	0.01%	0.00%	0.02%	0.01%
1996	-0.18%	-0.17%	0.03%	0.00%	0.07%	0.01%
1997	-0.28%	-0.27%	0.06%	0.01%	0.15%	0.02%
1998	-0.36%	-0.34%	0.10%	0.02%	0.25%	0.02%
1999	-0.46%	-0.42%	0.15%	0.02%	0.37%	0.03%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	0.5	0.001	4.2
1996	1.8	0.003	16.2
1997	4.4	0.012	37.4
1998	7.8	0.019	66.5
1999	12.3	0.029	103.3

Table 14
CHANGES IN THE
ECONOMY
Expanded IRAs

***Each job represents 2,040 labor hours annually.*

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	0.0	0.0	0.1	0.0	0.1	3.9	4.0
1996	0.1	0.0	0.2	0.0	0.4	6.1	6.4
1997	0.4	0.0	0.4	0.1	0.9	1.0	1.8
1998	0.7	0.1	0.6	0.1	1.4	1.4	2.8
1999	1.0	0.1	0.8	0.2	2.2	1.9	4.1
2000	1.5	0.2	1.2	0.2	3.1	2.6	5.7

Table 15
DYNAMIC REVENUE
CHANGES
Expanded IRAs
(\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	19.8	0.1	20.0	23.9
1996	29.6	0.4	30.0	36.1
1997	1.0	0.9	1.9	2.9
1998	0.5	1.4	1.9	3.3
1999	-0.1	2.2	2.1	4.0
2000	-0.8	3.1	2.3	4.9

Table 16
REVENUE CHANGES
Expanded IRAs
(\$bil. Nom.)

Year	Percentage Change in Jobs	Change in Jobs (mil.)	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate (annual)	Change in Pretax Wage Rate (annual)
1995	0.00%	0.001	0.0%	\$ 2	\$ 3
1996	0.00%	0.003	0.0%	\$ 7	\$ 10
1997	0.01%	0.012	0.1%	\$ 27	\$ 39
1998	0.02%	0.019	0.1%	\$ 28	\$ 41
1999	0.02%	0.029	0.1%	\$ 44	\$ 63

Table 17
LABOR MARKET
EFFECTS
Expanded IRAs

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	0.5	0.2	0.3	0.2	23.9	-23.8
1996	1.8	0.6	1.2	0.7	36.1	-35.6
1997	4.4	1.4	3.0	1.8	2.9	-1.7
1998	7.8	2.4	5.3	3.3	3.3	-1.2
1999	12.3	3.8	8.5	5.2	4.0	-0.7
2000	17.6	6.4	12.2	7.5	4.9	-0.1

Table 18
COMPOSITION OF NET
CHANGES IN
INCOME FLOWS
Expanded IRAs
(\$bil. Nom.)

**Replacement of capital assets that have worn out or become obsolete.*

***Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.*

4) Restore Prior Social Security Benefit Tax, 5 Year Phase-In

The Omnibus Reconciliation Act of 1993 increased the taxation of Social Security benefits. Previously, singles with \$25,000 in income and married couples with \$32,000 in income had to include in adjusted gross income (AGI) 50 cents in Social Security benefits for every dollar of income over those threshold amounts. (Income here is defined as AGI plus tax-exempt interest plus one-half of Social Security benefits). The maximum amount of benefits that could be included in AGI, and therefore subject to tax, was 50 percent.

This method of taxing benefits substantially increases the marginal tax rate for people who pay tax on less than one-half of their benefits. For example, someone normally in the 15% tax bracket would face an effective marginal rate of 22.5%; someone in the 28% bracket would face an effective rate of 42%.

The 1993 tax bill raised the amount of Social Security benefits subject to tax to 85 percent for singles with income over \$34,000 and married couples with income over \$44,000. This further increases the effective marginal tax for people including less than 85 percent of their benefits in AGI. For example, someone in the 28% bracket faces an effective rate of 51.8%.

This proposal would phase out the changes made in the 1993 tax bill. Specifically, it would reduce the maximum 85 percent inclusion rate by 7 percentage points each year. By 1999, the maximum amount of benefits included would be back at 50 percent.

Doing so would reduce the economy-wide marginal tax rate on capital by 1.2 percent and lower the cost of capital by 1.1 percent. By the year 2000:

- Higher investment would increase capital formation in the U.S. by \$332 billion.
- This larger stock of U.S. capital would lead to the creation of 91,000 new jobs.
- More capital and labor would yield an extra \$97 billion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$40 billion higher than otherwise.
- Ignoring economic effects, the proposal would decrease federal tax revenues by \$27 billion between 1995 and 2000.
- Higher growth would generate an extra \$17 billion to federal payroll, corporate and personal income, and excise taxes.
- On net, federal revenues would lose only \$9 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would pick up \$2.5 billion between now and the end of the decade.

Table 19
CHANGES IN THE ECONOMY
Restore Prior Social Security Benefit Tax, 5 Year Phase-In

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-0.2%	-0.2%	0.01%	0.00%	0.03%	0.01%
1996	-0.4%	-0.3%	0.05%	0.01%	0.13%	0.02%
1997	-0.6%	-0.6%	0.12%	0.02%	0.30%	0.04%
1998	-0.9%	-0.8%	0.21%	0.03%	0.53%	0.05%
1999	-1.2%	-1.0%	0.33%	0.05%	0.82%	0.07%
2000	-1.2%	-1.1%	0.45%	0.08%	1.12%	0.07%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	0.8	0.001	7.8
1996	3.4	0.006	31.3
1997	8.6	0.020	75.7
1998	16.4	0.037	142.1
1999	27.4	0.061	232.7

Table 20

CHANGES IN THE ECONOMY

Restore Prior Social Security Benefit Tax, 5 Year Phase-In

**Each job represents 2,040 labor hours annually.

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	0.1	0.0	0.1	0.0	0.2	0.1	0.3
1996	0.3	0.0	0.4	0.1	0.7	0.5	1.2
1997	0.7	0.1	0.8	0.1	1.7	1.1	2.8
1998	1.4	0.2	1.2	0.2	3.0	2.0	5.1
1999	2.3	0.3	1.9	0.4	4.9	3.3	8.2
2000	3.4	0.4	2.5	0.6	6.9	4.8	11.7

Table 21

DYNAMIC REVENUE CHANGES

Restore Prior Social Security Benefit Tax, 5 Year Phase-In (\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	-0.9	0.2	-0.7	-0.5
1996	-2.1	0.7	-1.3	-0.9
1997	-3.5	1.7	-1.8	-0.7
1998	-5.2	3.0	-2.2	-0.2
1999	-7.2	4.9	-2.3	1.0
2000	-7.9	6.9	-1.0	3.8

Table 22

REVENUE CHANGES

Restore Prior Social Security Benefit Tax, 5 Year Phase-In (\$bil. Nom.)

Year	Percentage Change in Jobs	Change in Jobs (mil.)	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate	Change in Pretax Wage Rate (annual)
1995	0.0%	0.001	0.0%	\$ 3	\$ 5
1996	0.0%	0.006	0.0%	\$ 14	\$ 20
1997	0.0%	0.020	0.1%	\$ 44	\$ 64
1998	0.0%	0.037	0.2%	\$ 61	\$ 88
1999	0.1%	0.061	0.3%	\$ 99	\$ 143

Table 23

LABOR MARKET EFFECTS

Restore Prior Social Security Benefit Tax, 5 Year Phase-In

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	0.8	0.3	0.5	0.3	-0.5	0.7
1996	3.4	1.1	2.3	1.4	-0.9	1.7
1997	8.6	2.8	5.9	3.6	-0.7	2.9
1998	16.4	5.2	11.2	6.9	-0.2	4.4
1999	27.4	8.6	18.8	11.6	1.0	6.2
2000	39.9	12.3	27.6	16.9	3.8	6.9
1995-2000	96.7	30.3	66.3	40.8	2.5	23.0

Table 24

COMPOSITION OF NET CHANGES IN INCOME FLOWS

Restore Prior Social Security Benefit Tax, 5 Year Phase-In (\$bil. Nom.)

*Replacement of capital assets that have worn out or become obsolete.

**Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.

5) Increase Social Security Earnings Test to \$30,000 and Index

Currently, people between the ages of 65 and 70 who receive Social Security benefits are subject to an earnings test. They are permitted to earn \$11,160 in a year without penalty. For every three dollars above that earnings limit, however, they lose one dollar in Social Security benefits. This effectively adds 33 percentage points to the marginal tax rate on wages and salaries. Considering payroll taxes, federal and state income taxes, and the taxation of Social Security benefits, some older workers can face marginal tax rates of over 100 percent.

This proposal would raise the earnings limit to \$30,000 in 1995 and index it to wages thereafter. This indexing would be the same as the current method.

This proposal would reduce the economy-wide marginal tax rate on labor by 0.4 percentage points. By the year 2000:

- A lower cost of labor would lead to the labor hour, full-time equivalent of 198,000 more jobs and \$34 billion more in capital.
- More capital and labor would yield an extra \$44 billion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$13 billion higher than otherwise.
- Ignoring economic effects, the proposal would increase federal outlays for Social Security benefits by \$13 billion between 1995 and 2000.
- Higher growth, however, would generate an extra \$15 billion to federal payroll, corporate and personal income, and excise taxes
- On net, federal revenues would pick up \$2.5 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would pick up \$11 billion between now and the end of the decade.

Table 25
CHANGES IN THE ECONOMY
Increase Social Security Earnings Test to \$30,000 and Index

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	0.00%	0.00%	0.02%	0.04%	0.00%	0.02%
1996	0.00%	0.00%	0.05%	0.07%	0.02%	0.03%
1997	0.00%	0.00%	0.08%	0.11%	0.04%	0.03%
1998	0.00%	0.00%	0.11%	0.14%	0.06%	0.03%
1999	0.00%	0.00%	0.13%	0.16%	0.09%	0.03%
2000	0.00%	0.00%	0.15%	0.16%	0.11%	0.02%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	1.6	0.040	1.1
1996	3.7	0.084	4.4
1997	6.1	0.124	9.9
1998	8.7	0.159	17.2
1999	11.1	0.184	25.6

Table 26

CHANGES IN THE ECONOMY

Increase Social Security Earnings Test to \$30,000 and Index

**Each job represents 2,040 labor hours annually.

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	0.1	0.1	0.3	0.0	0.6	0.3	0.9
1996	0.3	0.3	0.8	0.1	1.4	0.7	2.1
1997	0.5	0.4	1.2	0.1	2.2	1.2	3.4
1998	0.7	0.6	1.6	0.1	3.0	1.6	4.6
1999	0.9	0.7	1.9	0.2	3.7	2.0	5.7
2000	1.1	0.8	2.2	0.2	4.3	2.3	6.6

Table 27

DYNAMIC REVENUE CHANGES

Increase Social Security Earnings Test to \$30,000 and Index (\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	-1.3	0.6	-0.6	-0.3
1996	-1.7	1.4	-0.3	0.4
1997	-2.1	2.2	0.2	1.3
1998	-2.3	3.0	0.7	2.3
1999	-2.6	3.7	1.1	3.1
2000	-2.8	4.3	1.5	3.8

Table 28

REVENUE CHANGES

Increase Social Security Earnings Test to \$30,000 and Index (\$bil. Nom.)

Year	Percentage Change in Jobs	Change in Jobs (mil.)	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate	Change in Pretax Wage Rate (annual)
1995	0.04%	0.040	0.4%	\$ 103	\$ 1,150
1996	0.07%	0.084	0.5%	\$ 1,140	\$ 1,204
1997	0.11%	0.124	0.5%	\$ 1,163	\$ 1,237
1998	0.14%	0.159	0.5%	\$ 1,184	\$ 1,267
1999	0.16%	0.184	0.6%	\$ 1,203	\$ 1,295

Table 29

LABOR MARKET EFFECTS

Increase Social Security Earnings Test to \$30,000 and Index

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	1.6	0.0	1.5	0.7	-0.3	1.2
1996	3.7	0.2	3.6	1.6	0.4	1.6
1997	6.1	0.4	5.8	2.6	1.3	1.9
1998	8.7	0.6	8.0	3.7	2.3	2.1
1999	11.1	0.9	10.1	4.7	3.1	2.3
2000	13.1	1.3	11.9	5.5	3.8	2.5
1995-2000	44.3	3.4	40.9	18.7	10.6	11.6

Table 30

COMPOSITION OF NET CHANGES IN INCOME FLOWS

Increase Social Security Earnings Test to \$30,000 and Index (\$bil. Nom.)

*Replacement of capital assets that have worn out or become obsolete.

**Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.

6) Increase Estate Tax Unified Tax Credit to \$750,000 and Index

Under current estate tax rules, all estates receive a unified credit of \$192,800. This credit effectively excludes the first \$600,000 of gross estate from tax. The purpose of the credit has been to remove the estates of lower and middle-income taxpayers from the tax rolls. This level of credit has been in place since 1987. With rising incomes and asset values, however, estates of middle-income taxpayers are more likely to be subject to tax.

This proposal would increase the unified credit to \$248,300 effectively excluding \$750,000 in gross estate from tax. The new credit would be indexed for inflation after 1995.

Doing so would reduce the economy-wide marginal tax rate on capital by 0.3 percent and lower the cost of capital by 0.3 percent. By the year 2000:

- Higher investment would increase capital formation in the U.S. by \$119 billion.
- This larger stock of U.S. capital would lead to the creation of 38,000 new jobs.
- More capital and labor would yield an extra \$45 billion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$15 billion higher than otherwise.
- Ignoring economic effects, the proposal would decrease federal tax revenues by \$12 billion between 1995 and 2000.
- Higher growth would generate an extra \$8 billion to federal payroll, corporate and personal income, and excise taxes
- On net, federal revenues would lose only \$4 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would pick up \$1.8 billion between now and the end of the decade.

Table 31
CHANGES IN THE ECONOMY
Increase Estate Tax Exclusion to \$750,000 and Index

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-0.20%	-0.20%	0.02%	0.00%	0.04%	0.02%
1996	-0.24%	-0.23%	0.05%	0.01%	0.12%	0.02%
1997	-0.27%	-0.25%	0.08%	0.01%	0.20%	0.03%
1998	-0.30%	-0.28%	0.11%	0.02%	0.28%	0.03%
1999	-0.32%	-0.29%	0.14%	0.03%	0.35%	0.03%
2000	-0.34%	-0.31%	0.16%	0.03%	0.40%	0.03%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	1.1	0.002	10.0
1996	3.2	0.006	29.2
1997	5.9	0.013	52.0
1998	8.7	0.021	74.9
1999	11.8	0.030	98.9

Table 32

CHANGES IN THE ECONOMY

Increase Estate Tax Exclusion to \$750,000 and Index

**Each job represents 2,040 labor hours annually.

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	0.1	0.0	0.2	0.0	0.3	0.2	0.4
1996	0.3	0.0	0.3	0.0	0.6	0.4	1.0
1997	0.5	0.0	0.4	0.1	1.0	0.7	1.8
1998	0.7	0.1	0.6	0.1	1.5	1.0	2.6
1999	1.0	0.1	0.7	0.2	2.0	1.4	3.5
2000	1.2	0.2	0.9	0.2	2.5	1.7	4.3

Table 33

DYNAMIC REVENUE CHANGES

Increase Estate Tax Exclusion to \$750,000 and Index (\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	-1.4	0.3	-1.1	-0.9
1996	-1.6	0.6	-1.0	-0.6
1997	-1.8	1.0	-0.8	-0.1
1998	-2.1	1.5	-0.6	0.5
1999	-2.3	2.0	-0.3	1.2
2000	-2.5	2.5	0.0	1.8

Table 34

REVENUE CHANGES

Increase Estate Tax Exclusion to \$750,000 and Index (\$bil. Nom.)

Year	Percentage Change in Jobs	Change in Jobs (mil.)	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate	Change in Pretax Wage Rate (annual)
1995	0.00%	0.002	0.0%	\$ 4	\$ 6
1996	0.01%	0.006	0.0%	\$ 13	\$ 18
1997	0.01%	0.013	0.1%	\$ 22	\$ 32
1998	0.02%	0.021	0.1%	\$ 32	\$ 46
1999	0.03%	0.030	0.1%	\$ 42	\$ 60

Table 35

LABOR MARKET EFFECTS

Increase Estate Tax Exclusion to \$750,000 and Index

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	1.1	0.4	0.7	0.4	-0.9	1.2
1996	3.2	1.1	2.1	1.3	-0.6	1.4
1997	5.9	1.9	4.0	2.5	-0.1	1.6
1998	8.7	2.7	6.0	3.7	0.5	1.8
1999	11.8	3.7	8.2	5.0	1.2	2.0
2000	14.6	4.4	10.2	6.2	1.8	2.2
1995-2000	45.3	14.1	31.2	19.1	1.8	10.2

Table 36

COMPOSITION OF NET CHANGES IN INCOME FLOWS

Increase Estate Tax Exclusion to \$750,000 and Index (\$bil. Nom.)

*Replacement of capital assets that have worn out or become obsolete.

**Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.

The Entire Package

Because of interactions, the economic and revenue effects of the proposals taken as a whole would be less than the sum of the individual pieces. For example, if one proposal already reduces the amount of capital income in the tax base, a subsequent proposal to reduce it further would have a smaller effect.

The package as a whole would reduce the economy-wide marginal tax rate on capital by 26 percent and lower the cost of capital by 18 percent. By the year 2000:

- Higher investment would increase capital formation in the U.S. by \$10 trillion.
- This larger stock of U.S. capital would lead to 3.1 million additional jobs.
- More capital and labor would yield an extra \$3.7 trillion in gross domestic product between 1995 and 2000. By the year 2000, annual GDP would be \$1.1 trillion higher than otherwise.
- This greater economic activity would boost the near-term annual growth rate by 2 percentage points.

The federal static revenue loss would be small. Additional income, payroll and excise tax revenues from added economic growth, however, would lead to a sizable net gain for the federal government:

- Ignoring economic effects, the proposal would lose \$19 billion in federal tax revenues between 1995 and 2000.
- However, federal payroll, corporate and personal income, and excise taxes would be \$642 billion higher than otherwise due to greater economic activity generated by the proposal.
- As a result, the net effect on federal revenues would be a gain of \$623 billion over 1995 to 2000.
- Including higher state and local revenues from added growth means government at all levels would net \$1 trillion between now and the end of the decade.

Table 37
CHANGES IN THE
ECONOMY
Entire Package

**The baseline forecast used the economic assumptions contained in the Clinton administration's February budget, which assumes real GDP growth of 2.8%, 2.7%, 2.6%, 2.6%, and 2.5% for 1995 through 1999.*

Percentage Change from Baseline* in:						
Year	Tax on Capital	Cost of Capital	GDP	Jobs	Capital	Real Growth Rate
1995	-22.6%	-16.7%	1.7%	0.2%	4.4%	1.7%
1996	-23.5%	-16.9%	4.4%	0.6%	11.7%	2.2%
1997	-24.4%	-17.1%	7.2%	1.1%	19.0%	2.3%
1998	-25.1%	-17.2%	9.4%	1.7%	24.9%	2.3%
1999	-25.8%	-17.4%	11.3%	2.2%	29.9%	2.2%
2000	-26.4%	-17.5%	12.4%	2.6%	32.6%	2.0%

Change from Baseline* in:			
Year	GDP (\$bil. Nom.)	Jobs** (mil.)	Capital (\$bil. Nom.)
1995	107.9	0.209	1,013.5
1996	305.0	0.655	2,840.5
1997	527.5	1.268	4,849.2
1998	739.5	1.941	6,678.1
1999	951.0	2.596	8,456.3

Table 38

CHANGES IN THE ECONOMY Entire Package

***Each job represents 2,040 labor hours annually.*

Year	Federal Social Security Tax	Federal Corporate Income Tax	Federal Personal Income Tax	Other Federal Taxes	Federal Total	State and Local	Total Government
1995	9.1	0.5	18.1	1.8	29.5	17.4	47.0
1996	25.8	1.4	26.6	4.5	58.2	38.9	97.2
1997	44.6	2.7	35.7	7.5	90.4	63.1	153.5
1998	62.5	4.5	46.3	10.4	123.6	87.1	210.7
1999	80.3	6.4	56.6	13.2	156.6	110.9	267.5
2000	94.2	8.7	65.4	15.5	183.7	129.9	313.6

Table 39

DYNAMIC REVENUE CHANGES Entire Package (\$bil. Nom.)

Year	Static Federal Tax Change	Dynamic Federal Tax Change	Net to Federal Government	Net to All Governments
1995	23.4	29.5	52.9	70.4
1996	35.9	58.2	94.1	133.0
1997	0.8	90.4	91.2	154.3
1998	-9.8	123.6	113.8	200.9
1999	-26.7	156.6	129.9	240.9
2000	-42.5	183.7	141.2	271.1

Table 40

REVENUE CHANGES Entire Package (\$bil. Nom.)

Year	Percentage Change in Jobs	Change in Jobs (mil.)	Percentage Change in Aftertax Wage Rate	Change in Aftertax Wage Rate	Change in Pretax Wage Rate (annual)
1995	0.2%	0.209	1.9%	\$ 543	\$ 793
1996	0.6%	0.655	4.3%	\$ 1,310	\$ 1,910
1997	1.1%	1.268	6.5%	\$ 2,089	\$ 3,038
1998	1.7%	1.941	8.1%	\$ 2,773	\$ 4,026
1999	2.2%	2.596	9.4%	\$ 3,393	\$ 4,924

Table 41

LABOR MARKET EFFECTS Entire Package

Year	Change in GDP	Change in Capital Consumption Allowances*	Change in National Income	Change in Aftertax Labor Compensation	Change in Government Revenue	Change in Net Aftertax Capital Income**
1995	107.9	36.4	71.5	45.3	70.4	-44.2
1996	305.0	102.8	202.2	128.2	133.0	-59.1
1997	527.5	176.8	350.7	222.2	154.3	-25.8
1998	739.5	245.0	494.5	312.0	200.9	-18.4
1999	951.0	312.3	638.8	401.5	240.9	-3.6
2000	1,114.7	361.0	753.7	471.4	271.1	11.3

Table 42

COMPOSITION OF NET CHANGES IN INCOME FLOWS Entire Package (\$bil. Nom.)

**Replacement of capital assets that have worn out or become obsolete.*

***Can be negative because it may depress the return on existing assets. Investors, however, receive a higher return on all new investments.*

Conclusion

Policymakers usually focus on issues of fairness when making alterations to U.S. tax policy, which has ironically led to both a raising and lowering of marginal rates over the years. Formulating a pro-growth tax policy, however, requires looking at tax policy on the basis of how it affects labor and capital, the factors of production.

The six proposals contained in this pro-growth package would succeed in lowering costs of both capital and labor, which would result in sharply higher growth in real GDP, investment, job creation, wages and government revenue. It would help restore the higher growth rates experienced in the U.S. up until 1989, putting the country back on the fast track to a higher standard of living. This combination should prove popular with both Congress and voters.

Taken together, these six proposals would put the American economy back on its historical growth track. [Figure 4.] Instead of losing \$2.3 trillion between 1995 and the end of the decade, adoption of these proposals would increase real GDP by \$40 billion, relative to the 3 percent post-World War II growth trend. [Figure 5.]

Figure 4
Growth Projections
Including 6-Steps Package

Instead of losing \$2.3 trillion in real GDP between 1995 and 2000, the growth package would put the U.S. economy back on trend.

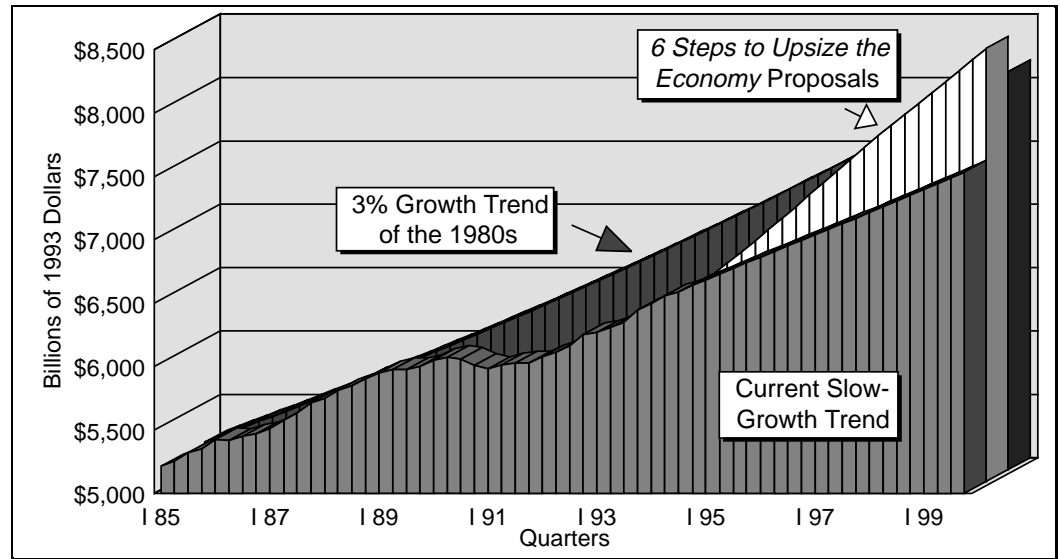
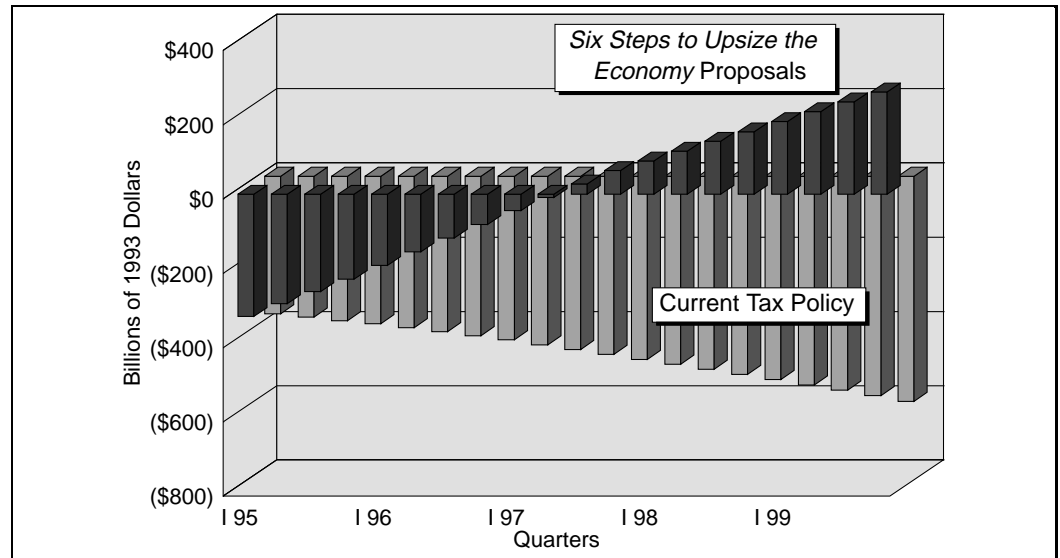


Figure 5
Change in GDP Relative to
3% Growth Trend



About the Authors

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TaxAction Analysis is the tax policy arm of the Institute for Policy Innovation, a non-profit, non-partisan public policy organization. TaxAction Analysis recognizes that changing tax policy affects incentives to work, save, and invest. These changes in economic behavior are frequently ignored in static government forecasts, resulting in policy decisions that negatively affect economic growth, capital formation, employment, and local, state, and federal revenues. TaxAction Analysis publishes **Economic Scorecard**, a quarterly newsletter, as well as additional commentary on tax policy.

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