Issue Brief

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An Analysis of the Dole-Kemp Tax Cuts

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As expected, tax policy will play a prominent role in the 1996 Presidential election. The Republican primary campaign was thick with the debate over the flat tax (and, to a lesser degree, a national sales tax). But that debate has been put on hold as the Republican nominee and his running mate have adopted a tax cut proposal of their own. Their intent is to reduce the tax burden on all Americans, stimulate economic growth, balance the budget by 2002 and reduce regulation.

Without a change in policy, forecasters expect the economy to continue growing at a meager 2.3 percent pace. Candidates Bob Dole and Jack Kemp hope that their proposal will boost growth to levels more in line with the experience of the 1960s and 1980s. What would be the likely economic effects of the Dole-Kemp plan if adopted? And, is it possible to balance the budget while cutting taxes?

What follows is an analysis of the Dole-Kemp tax cuts. The next section summarizes the major proposals. Then comes a discussion of economic, revenue and budgetary effects based upon estimates from our dynamic, neoclassical model of the U.S. economy. The last section discusses distributional implications.

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Description of the Dole-Kemp Tax Cuts

Eighteen specific tax proposals form the Dole-Kemp tax plan.[1] Below we describe five changes that account for 97 percent of the preliminary, $551.3 billion revenue estimate from the Joint Committee on Taxation (JCT). Other proposals contained in the package include: a tax credit for certain charitable contributions; lower estate taxes for some small businesses and tax relief for certain educational expenses.

15% Individual Income Tax Rate Reduction

A 15-percent, across-the board cut in individual income tax rates is the cornerstone of the Dole-Kemp plan. To lessen revenue losses, the rate reduction would be phased in over four years. [See Table 1.] JCT has put the cost of the phased-in rate cut at $411.2 billion over the period 1997 to 2002.

Table 1

PHASE-IN OF DOLE-KEMP RATE REDUCTIONS

PHASE-IN OF DOLE-KEMP RATE REDUCTIONS				
Current Law Rates	**1997**	**1998**	**1999**	**2000 and after**
15.0%	14.51%	13.76%	13.01%	12.75%
28.0%	27.08%	25.68%	24.28%	23.80%
31.0%	29.99%	28.44%	26.89%	26.35%
36.0%	34.82%	33.02%	31.22%	30.60%
39.6%	38.30%	36.32%	34.34%	33.66%
% Reduction in rates	3.3%	8.3%	13.3%	15.0%

Tax Credit for Families with Children

A nonrefundable, tax credit for children under the age of 18 is the next most expensive item. In 1997, taxpayers with children would get to reduce their federal income tax bill by $250 for each qualifying child.[2] After 1997, the credit would increase to $500.

The credit would phase out starting at $75,000 for taxpayers filing single or head of household returns and $110,000 for those filing joint returns. These phaseout amounts would not be indexed for inflation. Also, the credit would be limited to tax liability after the Earned Income Credit. The JCT price tag on the child tax credit is $76.9 billion over 1997 to 2002.

"Capital gains reform also includes indexing—an extremely important consideration because about 80 percent of capital gains arise from inflation."

Capital Gains Reform

In general, this proposal would reduce the maximum tax rate on capital gains for individuals from 28 percent to 14 percent.[3] Capital gains currently taxed at 15 percent would be taxed at 7.5 percent. The proposal would apply to tax years ending after December 31, 1996.

Capital gains reform also includes indexing—an extremely important consideration because about 80 percent of capital gains arise from inflation. The proposal calls for indexing beginning after December 31, 2000. The JCT puts the cost of the entire capital gains proposal at $14.2 billion over 1997 to 2002.

Repeal of the 1993 Increase in Social Security Benefit Taxation

The Dole-Kemp plan would repeal the increased tax on social security benefits enacted in 1993. Before that, up to half of benefits could be subject to income taxes, depending upon the taxpayer's income. Since 1993, social security recipients could have up to 85 percent of their benefits subject to tax. The Dole-Kemp proposal would return to the maximum 50-percent taxation of benefits after December 31, 1996. The JCT cost estimate is $28.5 billion over 1997 to 2002.

American Dream Savings Accounts (ADSA)

The proposal would establish a new type of savings account. Similar to an Individual Retirement Account (IRA), the ADSA would allow individuals to contribute up to $2,000 annually into the account. While contributions would be subject to tax when made, withdrawals would not be taxed under the following circumstances:

❶ the withdrawal is made at least five years after the contribution and

❷ the taxpayer is at least 59½ or is using the withdrawal for the purchase of a first home, higher education, medical expenses or as income while unemployed.

As with IRAs, earnings in the account would accumulate free of tax.

Funds in existing IRAs could be rolled over into ADSAs until December 31, 1998. Although the taxpayer would pay tax on the roll-over amount, subsequent withdrawals would be free of tax.

While ADSAs would provide a significant incentive to save, the revenue loss over the next six years is small because:

❶ the initial contribution is taxable, and

❷ IRA rollovers would produce short-term revenue gains.

JCT estimates the cost over 1997 to 2002 to be $2.8 billion.

Economic Effects

To assess the economic effects of the proposed Dole-Kemp tax cuts, we have used our neoclassical model of the U.S. economy. The model incorporates taxes through their effects on the returns to labor and capital. An increase in take-home pay caused by a tax cut will increase the amount of labor workers are willing to supply. Similarly, an increase in the aftertax return to capital will bring forth more saving and investment. Increases in the amount of capital and labor available to the economy will increase output, income and growth.[4]

Simulating economic effects requires a baseline forecast about how the economy would perform without any change in policy. The baseline we use is similar to those used by the Congressional Budget Office and the Office of Management and Budget. Over the next fourteen years, the U.S. economy is expected to grow at 2.5 percent a year after inflation. [See Appendix Table A-1.]

The Dole-Kemp tax cuts would lower marginal tax rates on work, saving and investment. The elements that will affect incentives the most are capital gains reform, the rate reductions, repeal of the 1993 Social Security benefit tax increase and the American Dream Savings Account. The second most expensive item, the child credit, would have little growth effect because of its minimal effect on marginal tax rates.

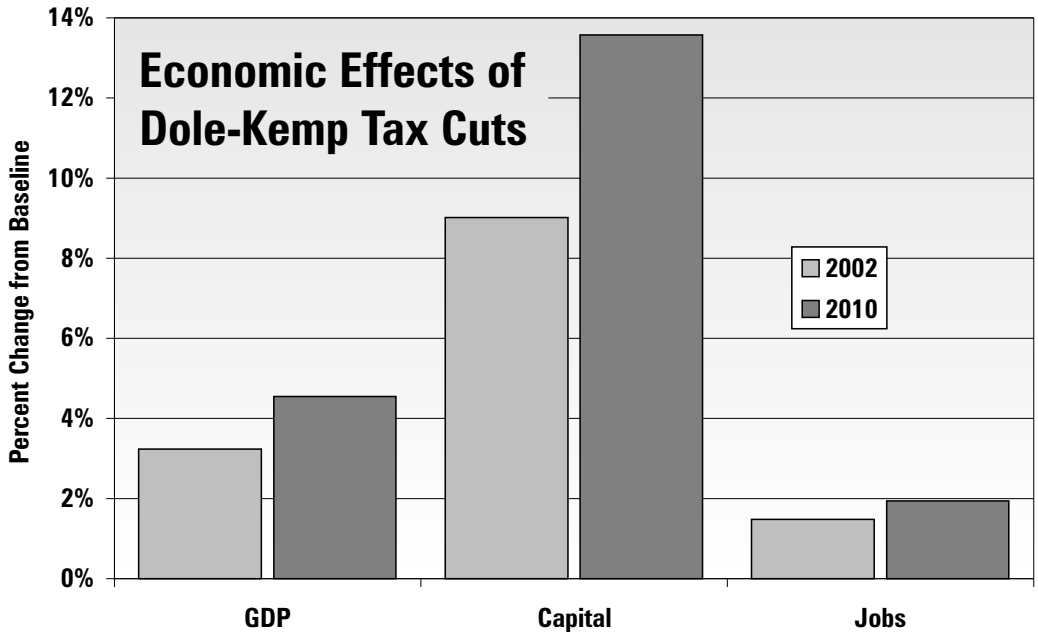
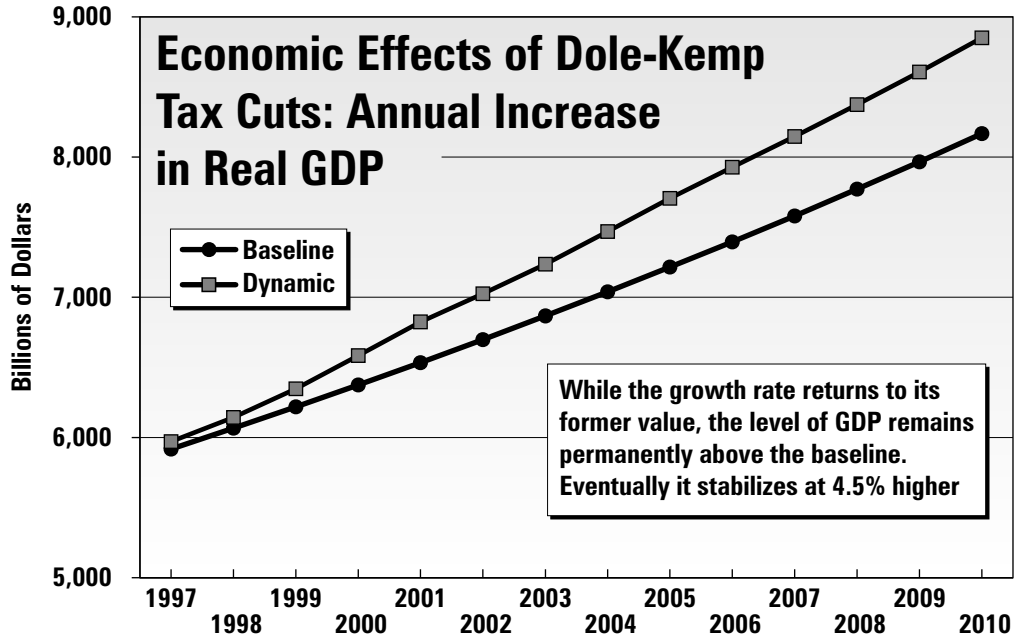


Figure 1

Economic Effects of Dole-Kemp Tax Cuts

Figure 2

Economic Effects of Dole-Kemp Tax Cuts: Annual Increase in Real GDP

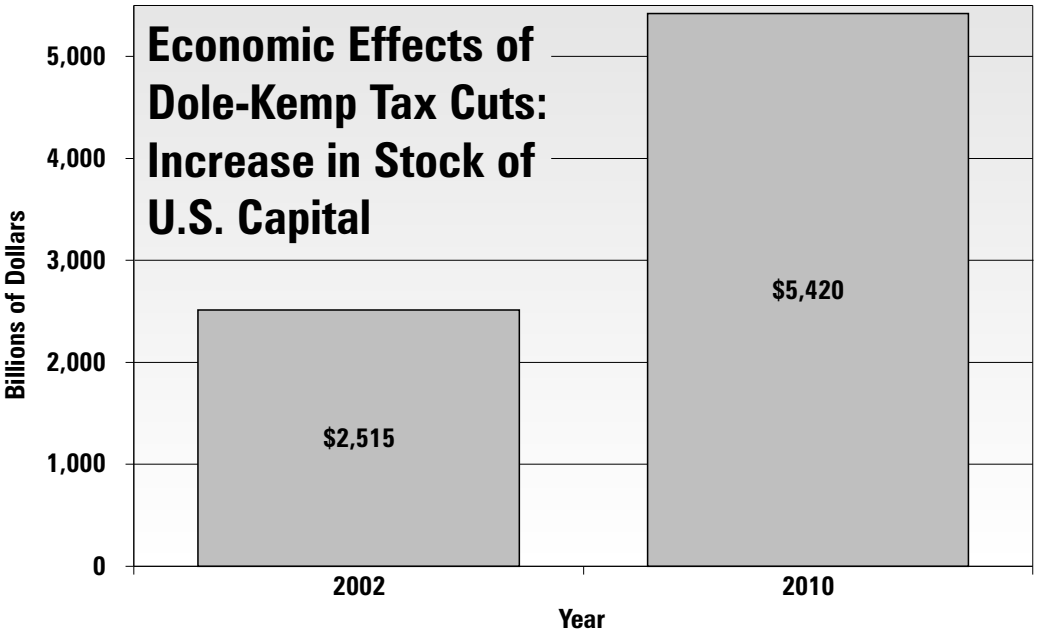


In response to lower tax rates on labor and capital, the economy would initially grow roughly one-half a percentage point faster than otherwise. In 2002, GDP would be 3.2 percent (or $327 billion) higher than the baseline. Once the adjustments are complete, the economy would return to its previous long-run growth *rate* with output remaining at permanently higher *levels*. At the end of the process, the economy would be 4.5 percent larger than it would have been without the tax cuts. [See Figures 1 and 2.]

Much of the higher growth comes from increased capital formation. Initially, the aftertax return to new capital would go up.[5] For example, the aftertax return on corporate capital would increase by 14 percent. The resulting higher investment would lead to more capital formation than under the baseline. By 2002, the stock of U.S. capital would be 9 percent higher than otherwise, and 14 percent higher by 2010. [See Table 2 and Figure 3.]

Figure 3

Economic Effects of Dole-Kemp Tax Cuts: Increase in Stock of U.S. Capital



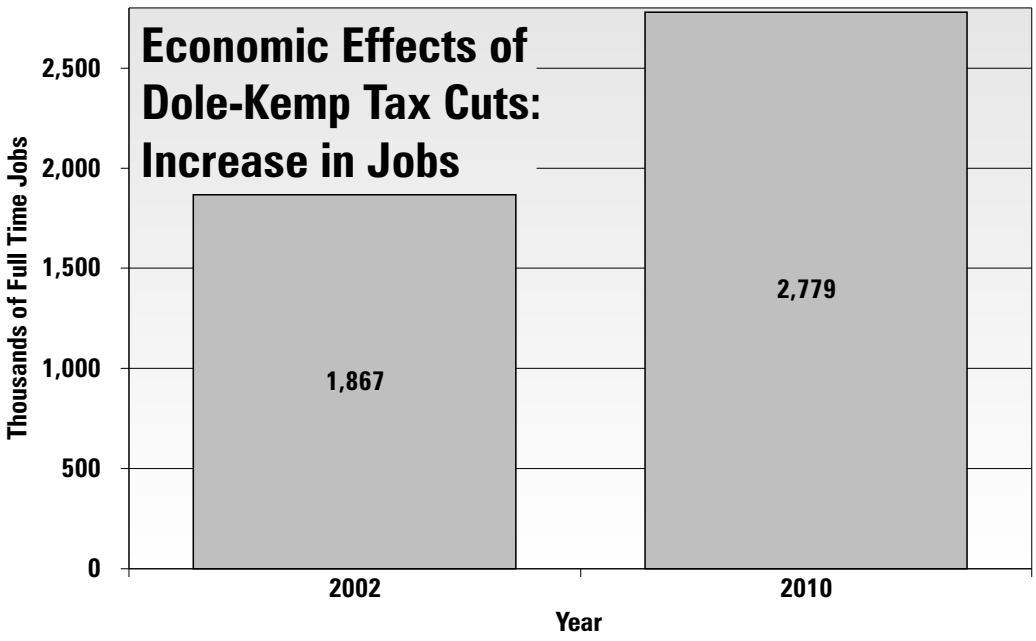


Figure 4

Economic Effects of Dole-Kemp Tax Cuts: Increase in Jobs

Workers also would benefit. The economy would produce almost 1.9 million additional jobs by 2002 and 2.8 million by 2010. [See Figure 4.] Due to the tax cuts and increased growth, take-home pay would increase by up to 5.5 percent.

Budgetary Effects

As mentioned earlier, preliminary estimates from the Joint Committee on Taxation place the *static* cost of the Dole-Kemp tax cuts at $551.3 billion. Our static estimate of $555.9 billion is virtually the same.

Interaction with the Alternative Minimum Tax

What has had private analysts (including ourselves) puzzled is the seemingly low JCT estimate of $411.2 billion in static revenue loss for the 15% rate reduction. Simply applying the phased-in rate reductions to current budget projections of individual income taxes suggests a revenue loss of roughly $550 billion over 1997 to 2002.[6]

"Due to the tax cuts and increased growth, take-home pay would increase by up to 5.5 percent."

This discrepancy apparently is due to interaction between the proposed rate cut and a complicated part of the tax code known as the alternative minimum tax (AMT). The AMT exists to make sure that everyone pays his or her "fair share" of tax. It is triggered when *taxable* income differs substantially from a broad definition of *gross* income. These differences arise primarily from large itemized deductions or when income comes from "sheltered" activities such as oil and gas investments.

Once triggered, the AMT increases the taxable income of affected taxpayers by denying deductions they could otherwise take. And income under the AMT is taxed at a marginal of rate 26 or 28 percent. Currently, about 300,000 taxpayers fall under the AMT.

As now structured, the proposed 15% rate reduction would not apply to the AMT rates. As a result, several million more taxpayers are likely to find themselves subject to the AMT. Hardest hit would be taxpayers with incomes between $75,000 and $200,000 who file joint returns and itemize. Fortunately, this quirk is unlikely to survive the legislative drafting process, particularly since many in Congress along with staff would fall into the "hardest hit" category.

Table 2

CHANGE FROM BASELINE IN KEY ECONOMIC VARIABLES

(amounts in $billions)

[1] Change represents nominal and real dollars because simulation holds prices constant.

[2] Includes revaluation of assets.

[3] Net aftertax income to capital divided by the stock of U.S. capital.

[4] Return to an investor on a new investment in corporate capital less taxes, inflation and depreciation.

[5] Hours worked divided by 1,960 hours, or 49, 40-hour weeks a year.

[6] Change in the total stock of capital plus the change in net foreign investment.

[7] Personal consumption plus the change in private domestic wealth. More comprehensive measure of income than Commerce's because it includes asset revaluation and the foreign sector.

[8] Real private savings divided by real disposable private income.

[9] On National Income and Product Account basis.

[10] Federal, state and local governments.

Estimates from the Fiscal Associates Tax Model.

CHANGE FROM BASELINE IN KEY ECONOMIC VARIABLES

OUTPUT

Year	GDP[1]		
	Difference	%Change	Addition to Growth Rate
1997	52.0	0.7%	0.7%
1998	77.1	0.9%	0.3%
1999	128.7	1.5%	0.6%
2000	209.2	2.3%	0.8%
2001	289.0	3.0%	0.7%
2002	326.9	3.2%	0.2%
2003	368.1	3.5%	0.2%
2004	429.5	3.8%	0.4%
2005	490.8	4.2%	0.3%
2006	530.7	4.3%	0.1%
2007	565.2	4.4%	0.1%
2008	602.9	4.4%	0.1%
2009	642.2	4.5%	0.1%
2010	686.6	4.5%	0.1%

CAPITAL FORMATION

Year	Gross Investment		Gross Private Domestic Investment		Stock of capital[2]		Avg aftertax return to capital[3]		Real aftertax return to new corporate capital[4]	
	Difference	%Change	Difference	%Change	Difference	%Change	Difference	%Change	Difference	%Change
1997	-5.5	-0.4%	217.4	16.2%	313.9	1.4%	0.58%	12.9%	0.48%	13.8%
1998	-36.6	-2.7%	217.6	15.4%	677.2	2.9%	0.64%	14.3%	0.44%	12.1%
1999	-51.0	-3.6%	250.1	17.0%	1,083.8	4.4%	0.64%	14.4%	0.52%	14.4%
2000	-39.6	-2.7%	288.0	18.7%	1,574.1	6.2%	0.71%	15.7%	0.48%	13.4%
2001	-6.3	-0.4%	288.1	18.1%	2,078.4	7.8%	0.62%	13.6%	0.38%	10.3%
2002	24.3	1.5%	242.8	14.6%	2,514.6	9.0%	0.40%	8.7%	0.29%	7.9%
2003	61.7	3.7%	213.3	12.2%	2,885.2	9.9%	0.19%	4.2%	0.26%	7.2%
2004	103.9	5.9%	254.6	13.9%	3,294.4	10.8%	0.14%	3.1%	0.22%	6.0%
2005	135.8	7.3%	270.1	14.1%	3,717.6	11.6%	0.09%	1.9%	0.18%	5.0%
2006	163.5	8.4%	220.6	11.0%	4,071.5	12.2%	-0.04%	-0.8%	0.14%	4.0%
2007	191.0	9.4%	206.1	9.8%	4,399.1	12.6%	-0.11%	-2.3%	0.12%	3.5%
2008	219.0	10.3%	209.8	9.5%	4,728.3	12.9%	-0.15%	-3.1%	0.12%	3.2%
2009	246.5	11.1%	216.9	9.4%	5,067.4	13.3%	-0.17%	-3.6%	0.11%	3.2%
2010	277.9	11.9%	226.5	9.3%	5,420.4	13.6%	-0.20%	-4.1%	0.11%	3.2%

EMPLOYMENT & EARNINGS

Year	Full-time Jobs[5] (thousands)		Average real wage rate		Average aftertax real wage rate	
	Difference	%Change	Difference	%Change	Difference	%Change
1997	38	0.0%	$0.09	0.5%	$0.06	0.6%
1998	95	0.1%	$0.11	0.7%	-$0.05	-0.5%
1999	267	0.2%	$0.17	1.0%	$0.43	4.3%
2000	1,092	0.9%	$0.19	1.1%	$0.48	4.7%
2001	1,890	1.5%	$0.20	1.1%	$0.39	3.7%
2002	1,867	1.5%	$0.24	1.4%	$0.36	3.4%
2003	1,786	1.4%	$0.30	1.7%	$0.54	5.1%
2004	2,112	1.6%	$0.32	1.8%	$0.56	5.2%
2005	2,458	1.9%	$0.34	1.9%	$0.56	5.2%
2006	2,553	1.9%	$0.36	2.0%	$0.58	5.3%
2007	2,605	1.9%	$0.37	2.0%	$0.57	5.2%
2008	2,648	1.9%	$0.38	2.1%	$0.59	5.3%
2009	2,699	1.9%	$0.39	2.1%	$0.60	5.4%
2010	2,779	1.9%	$0.41	2.2%	$0.62	5.5%

Table 2 (continued)

CHANGE FROM BASELINE IN KEY ECONOMIC VARIABLES FOR SIMULATIONS												
CONSUMPTION, SAVING & WEALTH												
Year	**Personal consumption**		**Change in private domestic wealth[6]**		**Private domestic income[7]**		**Real disposable private income**		**Real private savings**		**Private savings rate[8]**	
	Differnce	**%Change**	**Differnce**	**%Change**	**Differnce**	**%Change**	**Differnce**	**%Change**	**Differnce**	**%Change**	**Differnce**	**%Change**
1997	70.5	1.4%	91.0	9.6%	161.5	2.6%	139.3	3.1%	67.5	16.4%	1.2%	12.9%
1998	133.1	2.4%	109.1	11.0%	242.2	3.7%	186.1	4.1%	80.0	19.0%	1.3%	14.3%
1999	198.3	3.4%	105.5	10.2%	303.9	4.5%	242.7	5.2%	87.7	20.3%	1.3%	14.4%
2000	259.9	4.3%	162.7	15.1%	422.6	5.9%	291.7	6.1%	101.3	22.7%	1.5%	15.7%
2001	301.6	4.7%	209.9	19.0%	511.5	6.8%	305.6	6.1%	95.9	20.6%	1.3%	13.6%
2002	311.9	4.6%	217.7	18.9%	529.6	6.7%	276.1	5.4%	70.2	14.6%	0.8%	8.7%
2003	309.1	4.3%	219.0	18.1%	528.0	6.3%	243.6	4.6%	44.9	9.0%	0.4%	4.2%
2004	323.7	4.3%	258.5	20.4%	582.2	6.6%	246.9	4.6%	40.2	7.8%	0.3%	3.1%
2005	348.5	4.4%	288.9	21.8%	637.4	6.9%	252.5	4.6%	34.8	6.5%	0.2%	1.9%
2006	356.4	4.3%	296.8	21.4%	653.3	6.7%	231.6	4.1%	17.7	3.2%	-0.1%	-0.8%
2007	361.8	4.1%	312.5	21.5%	674.3	6.6%	220.3	3.8%	7.8	1.4%	-0.2%	-2.3%
2008	371.3	4.0%	338.4	22.3%	709.7	6.6%	215.2	3.6%	2.0	0.3%	-0.3%	-3.1%
2009	383.7	3.9%	368.6	23.3%	752.3	6.6%	213.0	3.4%	-2.0	-0.3%	-0.4%	-3.6%
2010	397.9	3.9%	404.3	24.4%	802.3	6.7%	212.1	3.3%	-5.5	-0.9%	-0.4%	-4.1%

GOVERNMENT ACCOUNTS						
Year	**Federal Receipts[9]**		**Federal Surplus or deficit (-)[9]**		**Government Surplus or deficit (-)[9,10]**	
	Difference	**%Change**	**Difference**	**%Change**	**Difference**	**%Change**
1997	-19.5	-1.2%	-6.6	3.5%	2.4	-1.5%
1998	-44.9	-2.6%	-18.5	9.8%	-2.8	1.7%
1999	-78.4	-4.3%	-45.1	22.2%	-19.8	11.3%
2000	-70.9	-3.7%	-37.0	16.7%	3.0	-1.5%
2001	-55.8	-2.8%	-17.0	6.3%	38.9	-16.1%
2002	-52.7	-2.5%	-1.1	0.4%	67.6	-25.6%
2003	-43.5	-2.0%	9.7	-3.1%	93.6	-32.9%
2004	-4.2	-1.5%	21.0	-6.2%	122.3	-39.8%
2005	-33.9	-1.4%	23.9	-6.5%	144.4	-43.5%
2006	22.7	0.9%	-21.8	5.5%	376.4	-104.1%
2007	30.3	1.1%	-16.4	3.8%	431.1	-110.0%
2008	38.7	1.4%	-5.3	1.1%	502.1	-117.5%
2009	47.8	1.6%	0.5	-0.1%	574.0	-123.2%
2010	57.9	1.8%	7.9	-1.4%	656.5	-129.8%

Dynamic Revenue Effects

Official scorekeepers like the JCT still do not provide *dynamic* revenue estimates. That is to say, their estimates do not account for the likely economic effects of tax changes. However, if a tax cut leads to a better economy, the added growth will offset some revenue loss from the cut.

While still officially shunned, dynamic analysis is gaining greater acceptance among economists, policy analysts, the media and the public. In announcing his tax plan, Bob Dole included the assessment of his economic advisers suggesting that higher economic growth from the tax cuts would offset 27 percent of the revenue loss.

Our estimates more than confirm this claim. We find that the additional growth stimulated by the tax cuts would offset 35 percent of the static revenue loss between 1997 and 2002. After that, the offset would increase to 47 percent. [See Table 3.]

"…the additional growth stimulated by the tax cuts would offset 35 percent of the static revenue loss between 1997 and 2002."

Table 3

STATIC & DYNAMIC FEDERAL REVENUE EFFECTS

(amounts in $billions)

Estimates from Fiscal Associates Tax Model.

STATIC & DYNAMIC FEDERAL REVENUE EFFECTS			
Year	**Static**	**Dynamic**	**% Offset**
1997	-25.5	-8.3	67.6%
1998	-56.9	-35.1	38.3%
1999	-102.3	-76.7	25.0%
2000	-115.9	-80.6	30.4%
2001	-124.8	-80.3	35.6%
2002	-130.6	-81.9	37.3%
2003	-137.7	-76.0	44.8%
2004	-144.2	-74.3	48.5%
2005	-151.3	-82.4	45.5%
2006	-158.6	-85.3	46.2%
2007	-167.4	-89.6	46.4%
2008	-176.8	-94.3	46.6%
2009	-187.3	-99.7	46.8%
2010	-198.3	-105.1	47.0%
1997-2002	-555.9	-362.9	34.7%
2003-2010	-1183.9	-630.8	46.7%

Table 4

DISTRIBUTION OF STATIC AND DYNAMIC CHANGES FROM DOLE-KEMP TAX CUTS, 2002

Estimates from Fiscal Associates Tax Model.

See Appendix Table A-2 for supporting estimates.

DISTRIBUTION OF STATIC AND DYNAMIC CHANGES FROM DOLE-KEMP TAX CUTS, 2002					
	Returns	**Baseline AGI**	**Baseline Tax**	**Static Change in Tax**	**Change in Aftertax Income**
All Returns	100.0%	100.0%	100.0%	100.0%	100.0%
No adjusted gross income	0.8%	-1.5%	0.0%	0.0%	0.0%
$1 under $5,000	10.3%	0.6%	0.0%	0.0%	0.3%
$5,000 under $10,000	9.4%	1.5%	0.1%	0.1%	0.7%
$10,000 under $15,000	8.8%	2.4%	0.5%	0.5%	1.2%
$15,000 under $20,000	7.0%	2.7%	1.0%	1.6%	1.5%
$20,000 under $25,000	6.1%	3.0%	1.6%	2.6%	1.8%
$25,000 under $30,000	4.6%	2.8%	1.7%	2.5%	1.7%
$30,000 under $40,000	13.1%	10.2%	6.5%	9.6%	6.5%
$40,000 under $50,000	8.6%	8.6%	6.2%	8.7%	5.8%
$50,000 under $75,000	19.2%	27.1%	20.6%	28.2%	19.4%
$75,000 under $100,000	6.4%	12.8%	12.2%	6.4%	8.5%
$100,000 under $200,000	4.2%	12.9%	16.2%	5.3%	12.2%
$200,000 under $500,000	1.1%	7.5%	12.9%	13.4%	12.7%
$500,000 under $1,000,000	0.2%	3.3%	6.8%	7.1%	7.2%
$1,000,000 or more	0.1%	6.1%	13.7%	14.0%	20.4%
CUMULATIVE DISTRIBUTION					
No adjusted gross income	0.8%	-1.5%	0.0%	0.0%	0.0%
$1 under $5,000	11.1%	-0.9%	0.0%	0.0%	0.3%
$5,000 under $10,000	20.4%	0.6%	0.1%	0.1%	1.0%
$10,000 under $15,000	29.2%	3.0%	0.6%	0.6%	2.2%
$15,000 under $20,000	36.2%	5.7%	1.6%	2.2%	3.7%
$20,000 under $25,000	42.3%	8.8%	3.2%	4.7%	5.5%
$25,000 under $30,000	46.9%	11.6%	4.8%	7.3%	7.2%
$30,000 under $40,000	60.0%	21.7%	11.4%	16.8%	13.8%
$40,000 under $50,000	68.7%	30.4%	17.5%	25.6%	19.6%
$50,000 under $75,000	87.9%	57.4%	38.1%	53.8%	39.0%
$75,000 under $100,000	94.3%	70.2%	50.4%	60.2%	47.5%
$100,000 under $200,000	98.5%	83.2%	66.6%	65.5%	59.7%
$200,000 under $500,000	99.7%	90.6%	79.4%	78.9%	72.4%
$500,000 under $1,000,000	99.9%	93.9%	86.3%	86.0%	79.6%
$1,000,000 or more	100.0%	100.0%	100.0%	100.0%	100.0%

Deficit Effects

The Dole-Kemp plan also calls for a 2 percent reduction in the $10.4 *trillion* the federal government plans to spend between 1997 and 2002. Forty percent of the proposed $217 billion in spending cuts would come from a 10 percent "downsizing" of non-defense administrative costs.

Including revenue offsets from economic effects and assuming the spending cuts are made, the Dole-Kemp tax cuts would not increase the deficit. Provided the Congress or the administration come up with a plan to balance the budget by 2002, that same plan with the Dole-Kemp tax and spending changes also would balance. [See Table 2, Government Accounts.]

Distributional Effects

Just as static revenue estimates ignore economic effects, so do standard distributional estimates. Such a distributional analysis would show that 60 percent of the Dole-Kemp tax cuts would go to taxpayers earning under $100,000. Because these same taxpayers pay 50 percent of federal income taxes, the tax cut package is slightly progressive. [See Table 4.]

Of greater concern should be the extent to which people are better off after the tax cut, something that static analysis does not measure correctly. That is, what happens to people's incomes after tax? Income resulting from added growth would be more evenly distributed because much of it accrues to workers through greater job opportunities and higher wages. And lower and middle income taxpayers rely more heavily on income from labor than income from capital.

Static & Dynamic Change in Average Aftertax Income by Quintile, 2002

Average Aftertax Income[1]			
Quintiles	**Baseline**	**Static**	**Dynamic**
All	$39,444	$40,423	$43,560
First	$1,261	$1,264	$1,454
Second	$15,402	$15,583	$16,200
Third	$29,608	$30,247	$31,452
Fourth	$50,573	$51,814	$54,126
Fifth	$100,377	$103,205	$114,570

Increase in Average Aftertax Income				
Quintiles	**Static**		**Dynamic**	
All	$979	2.5%	$4,116	10.4%
First	$4	0.3%	$193	15.3%
Second	$181	1.2%	$798	5.2%
Third	$639	2.2%	$1,844	6.2%
Fourth	$1,242	2.5%	$3,553	7.0%
Fifth	$2,828	2.8%	$14,194	14.1%

Table 5

Static & Dynamic Change in Average Aftertax Income by Quintile, 2002

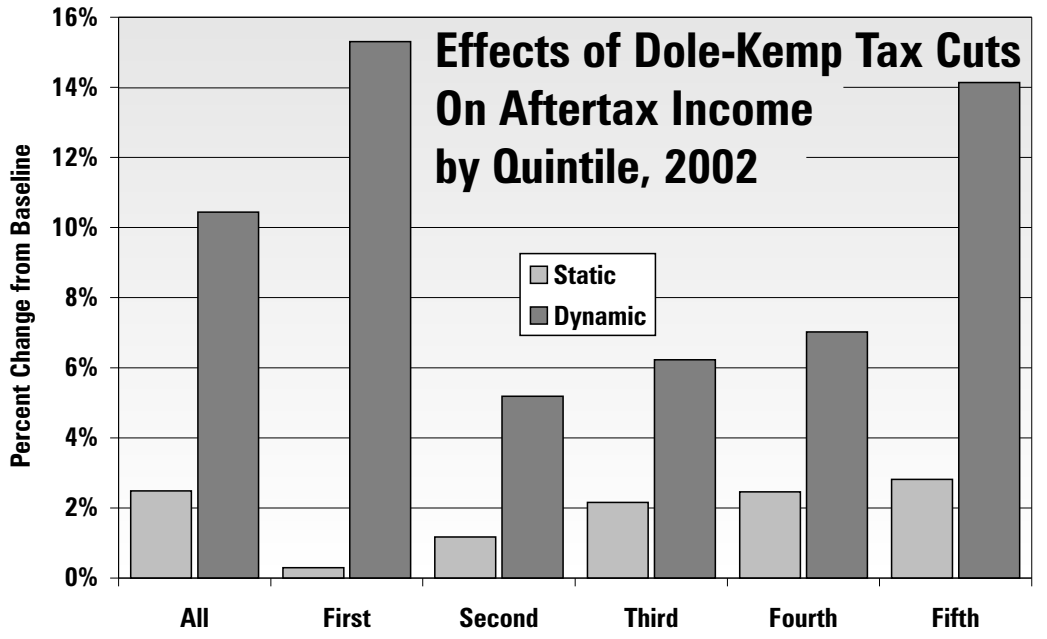
[1] Adjusted Gross Income divided by number of returns.

Estimates from Fiscal Associates Tax Model.

On average, taxpayers in the middle of the income distribution would experience roughly a 6 percent increase in aftertax income from the Dole-Kemp tax cuts. Those in the top fifth would see their aftertax incomes increase by 14.1 percent. Taxpayers in the bottom fifth would experience the largest increase in aftertax income, 15.3 percent, because they pay little or no income tax and, therefore, get to keep more of their gains from growth. [See Table 5 and Figure 5.]

Figure 5

Effects of Dole-Kemp Tax Cuts On Aftertax Income by Quintile, 2002



Conclusion

"The key to boosting growth and, with it, jobs and incomes is increasing the incentives to work, save and invest."

Despite claims that this is "the best economy in a generation," U.S. growth rates are well below previous historical averages. Subpar economic growth is at the root of job insecurity, pressures on average incomes and persistent budget deficits. The key to boosting growth and, with it, jobs and incomes is increasing the incentives to work, save and invest.

The tax cuts proposed by Bob Dole and Jack Kemp would help restore those incentives. Temporarily boosting growth from a projected 2.5 percent to 3 percent, the tax cuts would increase the U.S. economy by over 3 percent and add almost 2 million jobs over the next six years. Most Americans would experience a 6 to 15 percent increase in income after taxes. Higher-than-expected growth would produce additional tax revenues that would offset 35 percent of static revenue losses. As long as the government can come up with a budget that balances by 2002, that budget including the Dole-Kemp tax and spending cuts also would balance.

Bob Dole and Jack Kemp have also said that these tax cuts are an intermediate step on the road to a "flatter, fairer and simpler" tax code. Let's hope they are right, because that is what it will take to restore 3+ percent growth to the U.S. economy permanently.

Endnotes

1. For more detail see the Joint Committee on Taxation Staff Description of the Tax Cut Proposals in Republican Presidential Candidate Bob Dole's Economic Plan, Released by the House Ways and Means Committee, August 8, 1996.
2. To qualify, a taxpayer would have to satisfy relationship and dependency tests.
3. Treatment of gains from certain items such as collectibles and certain depreciable real estate would not be eligible for the lower rate.
4. For more on the model see Gary and Aldona Robbins, *Accounting for Growth: Incorporating Dynamic Analysis into Revenue Estimation*, Lewisville, TX: Institute for Policy Innovation, Policy Report No. 138, July 1996.
5. With the increased capital formation, that aftertax return would ultimately return to its former level. See Gary and Aldona Robbins, *Eating Out Our Substance (II): How Taxation Affects Investment*, Lewisville, TX: The Institute for Policy Innovation, TaxAction Analysis, Policy Report No. 134, November 1995.
6. For example, current budget projections call for individual income tax revenues of $830 billion in fiscal year 2002. A 15 percent rate cut would cost about $125 billion compared to the $101 billion JCT estimate.

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Appendix

Table A-1

BASELINE ECONOMIC ASSUMPTIONS

(amounts in $billions)

[1] Includes revaluation of assets.

[2] Net aftertax income to capital divided by the stock of U.S. capital.

[3] Return to an investor on a new investment in corporate capital less taxes, inflation and depreciation.

[4] Hours worked divided by 1,960 hours, or 49, 40-hour weeks a year.

[5] Change in the total stock of capital plus the change in net foreign investment.

[6] Personal consumption plus the change in private domestic wealth. More comprehensive measure of income than Commerce's because it includes asset revaluation and the foreign sector.

[7] Real private savings divided by real disposable private income.

[8] On National Income and Product Account basis.

[9] Federal, state and local governments.

Estimates from Fiscal Associates Tax Model.

BASELINE ECONOMIC ASSUMPTIONS

OUTPUT

Year	GDP	Real GDP	Growth Rate
1997	7,852.2	5,917.7	2.6%
1998	8,257.8	6,066.2	2.5%
1999	8,684.5	6,218.6	2.5%
2000	9,132.7	6,374.4	2.5%
2001	9,604.1	6,534.3	2.5%
2002	10,100.1	6,698.2	2.5%
2003	10,621.9	6,866.5	2.5%
2004	11,170.0	7,038.5	2.5%
2005	11,746.5	7,214.9	2.5%
2006	12,353.1	7,395.9	2.5%
2007	12,990.2	7,581.0	2.5%
2008	13,660.5	7,770.9	2.5%
2009	14,365.6	7,965.7	2.5%
2010	15,107.5	8,165.6	2.5%

CAPITAL FORMATION

Year	Gross Investment	Gross Private Domestic Investment	Stock of Capital[1]	Return to Aftertax capital[2]	Real aftertax return to new corporate capital[3]
1997	1,269.0	1,342.7	22,223.1	4.49%	4.49%
1998	1,341.6	1,410.3	23,279.5	4.49%	4.49%
1999	1,408.9	1,475.0	24,377.6	4.49%	4.49%
2000	1,478.0	1,543.2	25,520.6	4.50%	4.50%
2001	1,523.6	1,588.9	26,688.5	4.55%	4.55%
2002	1,597.3	1,663.6	27,908.5	4.58%	4.58%
2003	1,677.5	1,745.4	29,186.1	4.61%	4.61%
2004	1,761.2	1,831.1	30,523.6	4.64%	4.64%
2005	1,848.4	1,920.7	31,923.7	4.66%	4.66%
2006	1,937.3	2,012.3	33,386.9	4.69%	4.69%
2007	2,031.7	2,109.8	34,917.5	4.72%	4.72%
2008	2,128.2	2,209.4	36,516.4	4.75%	4.75%
2009	2,228.7	2,313.4	38,186.4	4.78%	4.78%
2010	2,335.2	2,423.5	39,932.1	4.82%	4.82%

EMPLOYMENT & EARNINGS

Year	Full-time Jobs (thousands)[4]	Average real wage rate	Average real aftertax wage rate
1997	101,326	$16.42	$9.55
1998	102,929	$16.58	$10.06
1999	104,561	$16.75	$10.12
2000	106,223	$16.91	$10.24
2001	107,914	$17.08	$10.45
2002	109,636	$17.25	$10.52
2003	111,389	$17.43	$10.59
2004	113,173	$17.60	$10.73
2005	114,991	$17.77	$10.81
2006	116,842	$17.95	$10.89
2007	118,726	$18.12	$10.98
2008	120,646	$18.30	$11.08
2009	122,601	$18.48	$11.16
2010	124,592	$18.66	$11.26

Table A-1 (continued)

BASELINE ECONOMIC ASSUMPTIONS

BASELINE ECONOMIC ASSUMPTIONS						
CONSUMPTION, SAVING & WEALTH						
Year	**Personal Consumption**	**Change in private domestic wealth[5]**	**Private domestic income[6]**	**Real Disposable Private Income**	**Real Private Savings**	**Private savings rate[7]**
1997	5,207.1	947.0	6,154.0	4,454.6	412.1	9.3%
1998	5,478.8	987.6	6,466.4	4,568.3	421.5	9.2%
1999	5,770.6	1,032.0	6,802.6	4,689.1	432.6	9.2%
2000	6,080.5	1,077.9	7,158.4	4,816.8	445.7	9.3%
2001	6,434.2	1,102.6	7,536.8	4,969.8	465.0	9.4%
2002	6,780.8	1,153.7	7,934.5	5,108.5	481.7	9.4%
2003	7,143.2	1,209.7	8,352.9	5,249.1	498.7	9.5%
2004	7,524.8	1,267.7	8,792.4	5,393.3	515.9	9.6%
2005	7,927.4	1,327.7	9,255.1	5,541.8	533.8	9.6%
2006	8,354.3	1,388.2	9,742.4	5,696.2	552.6	9.7%
2007	8,802.0	1,452.6	10,254.5	5,853.4	571.7	9.8%
2008	9,276.3	1,517.6	10,794.0	6,016.7	591.9	9.8%
2009	9,776.8	1,585.3	11,362.2	6,185.1	612.9	9.9%
2010	10,303.1	1,657.4	11,960.5	6,357.6	634.7	10.0%

GOVERNMENT ACCOUNTS			
Year	**Federal Receipts[8]**	**Federal Surplus or Deficit (-)[8]**	**Government Surplus or Deficit (-)[8,9]**
1997	1,625.6	-190.2	-157.5
1998	1,713.1	-189.3	-161.7
1999	1,806.6	-203.4	-175.0
2000	1,900.6	-221.4	-192.2
2001	1,974.7	-271.9	-241.8
2002	2,077.5	-294.9	-263.9
2003	2,188.4	-316.5	-284.5
2004	2,305.0	-339.9	-307.0
2005	2,427.4	-365.8	-331.9
2006	2,554.0	-396.6	-361.7
2007	2,688.9	-427.8	-391.8
2008	2,828.7	-464.3	-427.2
2009	2,975.7	-504.0	-465.8
2010	3,131.8	-545.2	-505.9

Table A-2

DISTRIBUTIONAL EFFECTS OF THE DOLE-KEMP TAX CUTS, 2002

(Amounts in $millions)

Estimates from Fiscal Associates Tax Model.

DISTRIBUTIONAL EFFECTS OF THE DOLE-KEMP TAX CUTS, 2002							
	Number of Returns (thousands)	Baseline AGI	Baseline Tax	Static Change in Tax	Change in AGI	Change in Tax	Change In Aftertax Income
All Returns	133,450	6,148,301	884,488	-130,595	467,491	-81,856	549,347
No adjusted gross income	1,077	-90,248	0	0	0	0	0
$1 under $5,000	13,680	35,169	0	0	1,442	0	1,442
$5,000 under $10,000	12,494	93,509	602	-102	3,997	115	3,882
$10,000 under $15,000	11,767	148,404	4,266	-697	6,294	-353	6,648
$15,000 under $20,000	9,324	165,124	9,232	-2,048	6,822	-1,424	8,246
$20,000 under $25,000	8,131	186,396	13,864	-3,347	7,463	-2,613	10,076
$25,000 under $30,000	6,165	172,782	14,687	-3,281	6,915	-2,609	9,524
$30,000 under $40,000	17,448	624,906	57,861	-12,518	26,130	-9,764	35,894
$40,000 under $50,000	11,530	530,564	54,630	-11,422	23,071	-8,996	32,067
$50,000 under $75,000	25,679	1,663,123	182,183	-36,809	76,801	-29,592	106,393
$75,000 under $100,000	8,591	787,449	108,061	-8,364	44,821	-1,949	46,771
$100,000 under $200,000	5,609	796,011	143,338	-6,924	68,705	1,796	66,910
$200,000 under $500,000	1,526	460,024	113,885	-17,498	59,885	-9,919	69,804
$500,000 under $1,000,000	289	201,146	60,447	-9,299	33,621	-5,740	39,361
$1,000,000 or more	138	373,945	121,432	-18,288	101,524	-10,807	112,330
Joint Returns	57,600	4,236,507	640,409	-87,734	340,278	-51,182	391,460
No adjusted gross income	384	-34,097	0	0	0	0	0
$1 under $5,000	558	1,397	0	0	54	0	54
$5,000 under $10,000	1,213	8,709	0	0	444	0	444
$10,000 under $15,000	2,074	25,639	0	0	1,256	0	1,256
$15,000 under $20,000	1,705	29,598	526	-87	1,366	1	1,366
$20,000 under $25,000	1,778	40,230	1,620	-617	1,749	-454	2,203
$25,000 under $30,000	1,684	46,682	2,657	-853	1,993	-663	2,656
$30,000 under $40,000	7,117	252,955	18,855	-5,132	10,889	-4,150	15,039
$40,000 under $50,000	6,604	302,606	26,805	-6,302	13,201	-5,174	18,376
$50,000 under $75,000	20,669	1,337,440	133,095	-28,269	61,058	-23,159	84,217
$75,000 under $100,000	7,342	672,746	88,506	-5,150	37,592	427	37,165
$100,000 under $200,000	4,811	682,487	119,705	-3,192	57,129	4,355	52,774
$200,000 under $500,000	1,303	392,446	96,179	-14,824	48,954	-8,242	57,196
$500,000 under $1,000,000	245	170,155	51,196	-7,911	27,052	-4,878	31,930
$1,000,000 or more	114	307,515	101,265	-15,395	77,540	-9,243	86,783
Single Returns	54,589	1,357,278	186,831	-30,108	92,919	-20,987	113,906
No adjusted gross income	527	-42,341	0	0	0	0	0
$1 under $5,000	11,364	29,404	0	0	1,246	0	1,246
$5,000 under $10,000	8,129	61,800	602	-102	2,664	115	2,550
$10,000 under $15,000	5,606	71,651	4,077	-666	3,082	-367	3,449
$15,000 under $20,000	4,906	87,661	7,120	-1,157	3,645	-809	4,455
$20,000 under $25,000	4,289	98,645	9,348	-1,516	3,947	-1,123	5,071
$25,000 under $30,000	3,264	91,726	9,460	-1,533	3,625	-1,176	4,801
$30,000 under $40,000	7,493	269,226	29,731	-4,826	11,262	-3,416	14,678
$40,000 under $50,000	3,483	160,701	21,224	-3,472	7,137	-2,402	9,539
$50,000 under $75,000	3,741	242,441	38,963	-6,387	12,041	-4,801	16,842
$75,000 under $100,000	1,012	92,657	16,141	-2,650	5,956	-1,963	7,919
$100,000 under $200,000	567	80,169	17,318	-2,765	8,541	-1,932	10,473
$200,000 under $500,000	161	48,480	12,879	-1,993	8,148	-1,291	9,439
$500,000 under $1,000,000	30	20,699	6,235	-969	4,651	-622	5,273
$1,000,000 or more	16	44,359	13,732	-2,073	16,972	-1,199	18,171

DISTRIBUTIONAL EFFECTS OF THE DOLE-KEMP TAX CUTS, 2002							
	Number of Returns (thousands)	Baseline AGI	Baseline Tax	Static Change in Tax	Change in AGI	Change in Tax	Change In Aftertax Income
Other Returns	21,262	554,516	57,248	-12,753	34,293	-9,688	43,981
No adjusted gross income	166	-13,811	0	0	0	0	0
$1 under $5,000	1,758	4,368	0	0	142	0	142
$5,000 under $10,000	3,152	23,000	0	0	888	0	888
$10,000 under $15,000	4,087	51,114	189	-31	1,956	14	1,942
$15,000 under $20,000	2,713	47,865	1,586	-804	1,810	-616	2,426
$20,000 under $25,000	2,064	47,521	2,896	-1,214	1,767	-1,035	2,802
$25,000 under $30,000	1,217	34,374	2,569	-895	1,297	-770	2,067
$30,000 under $40,000	2,838	102,725	9,275	-2,560	3,979	-2,199	6,177
$40,000 under $50,000	1,443	67,257	6,601	-1,647	2,734	-1,419	4,153
$50,000 under $75,000	1,269	83,242	10,125	-2,152	3,701	-1,633	5,334
$75,000 under $100,000	237	22,045	3,414	-564	1,273	-413	1,686
$100,000 under $200,000	231	33,354	6,315	-967	3,035	-628	3,663
$200,000 under $500,000	62	19,098	4,827	-680	2,783	-386	3,168
$500,000 under $1,000,000	15	10,292	3,016	-419	1,918	-239	2,157
$1,000,000 or more	8	22,070	6,435	-820	7,012	-365	7,376

Table A-2 (continued)

DISTRIBUTIONAL EFFECTS OF THE DOLE-KEMP TAX CUTS, 2002

About the Authors

Gary Robbins is President of Fiscal Associates, an Arlington, VA-based economic consulting firm, and John M. Olin Senior Research Fellow of IPI. Mr. Robbins has developed a general equilibrium model of the U.S. economy that specifically incorporates the effects of taxes and government spending. He was Chief of the Applied Econometrics Staff at the U.S. Treasury Department from 1982 to 1985. He served as assistant to the Under Secretary for Tax and Economic Affairs from 1981 to 1982, and as Assistant to the Director of the Office of Tax Analysis from 1975 to 1981. Recent publications include IPI Policy Report #124: *Putting Capital Back to Work for America*, and IPI Policy Report #127: *Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy.* Mr. Robbins' articles and analysis frequently appear in the financial press. He received his master's degree in Economics from Southern Methodist University.

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