



The Heritage Foundation

Background

Executive Summary

No. 1199

July 1, 1998

A NEW FRAMEWORK FOR CUTTING TAXES: REFORMING THE TAX CODE AND IMPROVING SOCIAL SECURITY

The tax bill now likely to emerge from Congress will include less than \$100 billion in tax relief over five years. This is particularly disappointing, given the need and opportunity for a major tax cut. Federal revenues are approaching a peacetime high of 21 percent as a proportion of economic output, up two percentage points since Bill Clinton was elected President. Meanwhile, the Congressional Budget Office, which one year ago estimated the five-year deficit to be over \$70 billion, now projects a surplus of over \$270 billion, which represents a swing of \$340 billion largely from higher tax receipts.

Americans need a refund of the huge and unexpected tax windfall now being received by the Internal Revenue Service. Lawmakers need to consider a tax cut package more in line with the \$1.3 trillion tax cut—in today's dollars and gross domestic product (GDP)—proposed by House Democrats in 1981 as an alternative to the Reagan tax package, rather than the modest cut they are considering. If they are not prepared to consider it during this Congress, they should set their sights on the next.

Candidates and lawmakers who are committed to a serious reduction in today's record tax burden thus should design a tax plan that truly would herald the "end of big government" and begin real reforms of the tax system and Social Security. Ana-

lysts at The Heritage Foundation have developed such a plan. It would:

- **Create** worker-owned retirement accounts funded by five percentage points of the current payroll tax.
- **Completely repeal** the marriage penalty.
- **Cut** the long-term capital gains tax to 10 percent and reform the "holding" rules that have added to the complexity of tax returns.
- **Expand** "back-ended" education IRAs to all levels of education, including K–12 and plans offered by private and state institutions of higher education.
- **Repeal** "rollover" limits on Section 125 health plans.
- **Repeal** the death taxes.

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- **Provide** a \$500 tax credit for pre-school children.

According to an analysis of these tax provisions, adopting the Heritage plan would return \$314 billion in income and death taxes to Americans, and \$895 billion in payroll taxes, over the next five years. Using the respected WEFA Group U.S. Macroeconomic model, Heritage analysts project that these tax cuts would generate an average \$10,312 in additional income for each household over the period. They also would lead to over half a million more jobs by the end of the period and an increase of more than \$1 trillion in the wealth of American families as the private savings rate nearly doubles.

The Heritage tax cut plan not only would return unanticipated tax revenue to the families who earned that money, but also would trigger faster income and job growth, allow all workers to open private retirement accounts, and cut future government debt.

The Social Security tax reduction would permit typical workers to place thousands of extra dollars into private retirement plans that earn far higher returns than Social Security provides. In making that choice, workers would forego the portion of Social Security pension benefits associated with their reduced payroll taxes in exchange for income from their Private Savings Accounts. It is important to note that workers would still receive partial income benefits and full insurance benefits. Those forgone Social Security pension benefits would reduce the unfunded liabilities of the Social Security trust fund by \$21.4 billion.

Taken together, the reduced liabilities in Social Security and the reduced tax revenues would result in a net reduction in the projected future liabilities of the federal government (measured in

Executive Summary Table 1		B 1199
The Heritage Tax Plan Would Reduce the Long-Term Obligations of the Federal Government		
		FY 1999–2075
Reduction in Unfunded Social Security Liabilities		\$21.4 billion
Reduction in Government Long-Term Obligations		\$15.6 trillion
<small>Note: Values are expressed in Present Values; see Table I for a more detailed explanation.</small>		
<small>Source: See Table I.</small>		

today's "present value" dollars) of over \$15.5 trillion. ("Present value" is an accounting term that measures how much money would need to be invested today to finance future obligations.) These liabilities include the national debt and the projected unfunded liabilities of Social Security from 1999 to 2075.

This Congress seems poised to return only a small portion of the unexpected tax revenues now surging into the IRS and to make only small reforms in the tax system—with no reforms in Social Security. It is time now for lawmakers and congressional candidates to begin designing the framework for real tax reform and major tax reduction in the next Congress.

—*The principal authors of this study are William W. Beach, Director of the Center for Data Analysis; Stuart M. Butler, Vice President for Domestic and Economic Policy Studies; Gareth G. Davis, Research Assistant in the Center for Data Analysis; Robert Rector, Senior Policy Analyst for Welfare and Family Issues; D. Mark Wilson, Labor Economist in the Center for Data Analysis; and John S. Barry, consultant to The Heritage Foundation.*



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Backgrounder

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No. 1199

July 1, 1998

A NEW FRAMEWORK FOR CUTTING TAXES: REFORMING THE TAX CODE AND IMPROVING SOCIAL SECURITY¹

Congress appears headed toward a tax bill containing less than \$100 billion in tax cuts over five years. The passage by the House in early June of a budget resolution that would return \$101 billion in tax revenue to Americans, which followed the Senate's vote to return only \$30 billion, sets the stage for one of the most disappointing tax "cut" bills in recent history.

This is discouraging because rarely has there been a better opportunity, or clearer need, to return tax revenues to America's families. Consider:

- Tax revenues are far above the projections made in last year's budget. The Congressional Budget Office (CBO) estimates that the government will take in \$340 billion more revenue

between fiscal year 1999 and fiscal year 2003 than it forecast as recently as January 1997.²

- Federal revenues are expected to consume nearly 21 percent of economic output in 1998, a peacetime record.³
- Since Bill Clinton became President in 1993, the tax burden as a proportion of output has risen by nearly two percentage points, equivalent to \$157 billion in

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1. The principal authors of the text and policy are William W. Beach, Stuart M. Butler, Gareth G. Davis, Robert Rector, D. Mark Wilson, and John S. Barry (consultant). The Heritage analysts responsible for each major section of this paper are identified in footnotes appended to each of these sections. Other Heritage analysts who contributed to the text and policy recommendations are Angela Antonelli, Rea Hederman, and Daniel J. Mitchell. Statistical analysis supporting this study was provided by the staff of the Center for Data Analysis of The Heritage Foundation: William W. Beach, Ralph A. Rector, D. Mark Wilson, Gareth G. Davis, Rea Hederman, and Phillippe Lacoude.
 2. Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1998-2007* (Washington, D.C.: Congressional Budget Office, 1997), Table 2-3; Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1999-2008* (Washington, D.C.: Congressional Budget Office, 1998), Table 3.1; letter to the Honorable John R. Kasich from June E. O'Neill, Director, Congressional Budget Office, May 6, 1998 (available on the CBO Web page at <http://www.cbo.gov/showdoc.cfm?index=470>).
 3. According to the Congressional Budget Office, the tax burden was higher in 1944 (21.3 percent) and 1945 (20.8 percent), when the United States was locked in a two-front global war.

Measuring the Heritage Plan

Heritage economists employed the most current and extensive data available to estimate the effects of these policy changes. Analysts constructed each of the revenue estimates shown in Table 1 from data contained in the Bureau of the Census Current Population Survey for 1997 and the Internal Revenue Service (IRS) Public Use Files for 1993 and 1994.

The annual Current Population Survey represents the largest regularly produced collection of demographic data available to the general policy community. The IRS Public Use File is the largest machine-readable sample of individual income tax returns available. Both databases contain tens of thousands of observations selected by the Census or the IRS using stratified random sampling techniques, and each database is the most accurate source available for variables used in this Heritage tax analysis.

The dynamic analyses were conducted using the WEFA Group's Macroeconomic Model specially modified for The Heritage Foundation by the economists at WEFA to reflect the economic and budgetary assumptions of the Congressional Budget Office, announced by the CBO in January 1998.¹

In scoring the Social Security reform proposal, Heritage analysts used the latest projections from the *1998 Report of the Trustees of the Federal Old-Age and Survivors and Disability Insurance Trust Funds*. In all cases, the intermediate projections, which constitute the Trustees' "best guess" of future demographic and economic conditions, were used.

Heritage economists also used special unpublished population projections made available by the Social Security Administration's Office of the Chief Actuary.

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1. The WEFA Group's U.S. Macroeconomic Model was developed in the late 1960s by Nobel Prize-winning economist Lawrence Klein and several of his colleagues at the University of Pennsylvania's Wharton School of Business. It is widely used by *Fortune* 500 companies and by prominent federal agencies and economic forecasting departments. It should be noted that nothing contained in this paper has been endorsed by WEFA, Inc.

extra taxes this year. Just reducing taxes to their level at the time President Clinton took office would mean the average family of four would receive more than \$1,930 in annual tax relief this year.⁴

- The House-passed tax cut resolution of \$101 billion over five years pales in comparison to a tax cut of \$1.3 trillion—in terms of today's dollars and gross domestic product (GDP)—proposed by House Democrats in 1981 as an alternative to the Reagan tax cut.

Placed against this context of a rapidly growing federal government that is absorbing hundreds of

billions in extra projected taxes, the tax relief proposed even in the current House resolution is puny. It would cut total taxes over five years by just 1 percent, meaning that taxes as a proportion of economic output would fall by just 0.3 percent from their near record level. Only one-fourth of the Treasury's unexpected windfall tax revenue (or only one-third of the projected surplus) will be returned to taxpayers. And although the House and Senate do plan to take serious action to end the marriage penalty, the level of tax relief they propose will do little or nothing to end pernicious death taxes, cut the tax penalties on savers and investors, ease the burden on families with children, and begin a serious reform of Social Security.

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4. For the 1993 ratio of federal revenue to nominal gross domestic product, see *Economic Report of the President, 1998* (Washington, D.C.: U.S. Government Printing Office, 1998), Tables B1 and B78. For the current ratio, see Office of Management and Budget, "FY 1999 Mid-Session Review," 1998, Tables 1 and 2.

Candidates for office in November who are committed to reducing today's record tax burden and achieving real reform of the tax system should be planning now for a package of tax changes that would attain a level and scope of tax relief that this Congress appears unwilling to propose and the Clinton Administration unwilling to accept. It may be possible to enact some of the necessary measures this year within the framework of the very modest relief that seems likely to be signed into law. Even more important, it is vital for tax reformers to begin now to make the case for tax reductions and reforms that can be enacted next year.

Serious tax reduction must achieve two objectives:

First, it must be on a scale that gives truth to the President's hollow declaration in his 1996 State of the Union Address that "the era of big government is over" (just returning the tax burden to its 1993 proportion of national output would mean a \$930 billion tax cut over five years).⁵

Second, it should be designed not to placate particular constituencies, but to end damaging deficiencies in the code that hurt economic growth and to pave the way for fundamental reform of the tax code and Social Security.

Analysts at the Heritage Foundation have crafted just such a tax cut plan that would deliver tax relief to America's families at the same time it promotes job creation and economic growth. The Heritage plan would:

1. Create worker-owned retirement accounts funded by five percentage points of the current payroll tax. Providing Private Savings Accounts would substantially increase the ability of families to save for a better retirement and create wealth that could be passed on to their children.

The five-year diversion of payroll taxes equals \$867 billion.

2. Repeal the marriage penalty. Repealing the marriage penalty would assist those families

that pay additional taxes because of the way their income is split between the primary and secondary earner.

The five-year tax savings equals \$101 billion.

3. Cut the tax on long-term capital gains from 20 percent to 10 percent and repeal the complex "holding" rules enacted last year. Reducing the taxes levied on capital gains would produce an immediate increase in federal revenues and a solid, sustainable boost to the general economy. Lower capital gains taxes encourage large and small investors to move (or unlock) their funds from less productive to more productive companies.

The five-year tax savings equals \$6.5 billion with unlocking, and \$66.6 billion without it.

4. Expand "back-ended" education IRAs to cover all levels of education, including K-12, and all education savings plans, including those offered by states and private institutions of higher education. This proposal would help the families of approximately 19 million school-age and/or college-bound children.

The five-year tax savings equals \$1.4 billion.

5. Modify Section 125. Allow workers in "cafeteria" benefit plans or flexible spending accounts to roll over their own contributions, up to \$500, from one year to the next instead of forfeiting unused funds under the current "use-it-or-lose-it" system. This would encourage more prudent use of medical care, as workers would not have to worry about losing money at the end of the year. Even workers not currently enrolled in cafeteria plans would benefit from lower overall costs to the entire health care system.

The five-year tax savings equals \$2.1 billion.

6. Repeal the death tax. Taxing the transfer of assets from one generation to the next hurts

5. See OMB, "FY 1999 Mid-Session Review," Tables 1 and 2.

Table 1

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How the Heritage Tax Plan Would Affect the Annual Budget and Long-Term Obligations of the Federal Government

Budget Assumptions	Impact on Federal Budget, FY 1999–2003 (Billions of Current Dollars)						Total FY1999– FY2003	Reduction/Increase (-) to Long-Term Obligations FY 1999–2075 (Present Values* in Billions of Dollars)
	1998	1999	2000	2001	2002	2003		
Baseline Revenue Forecast	1,725	1,807	1,825	1,865	1,928	2,060	9,485	
Baseline Outlays Forecast	1,652	1,720	1,777	1,830	1,861	1,953	9,141	
Net Surplus	73	87	48	35	67	107	344	
Tax Policy Recommendations								
A. Reform Social Security								
1) Private Social Security Investment Accounts								
a) 1998 Surplus Distributed Over Five Years		14.60	14.60	14.60	14.60	14.60	73.00	
b) Five Percentage Points of Payroll Tax to Private Accounts		-133.55	-172.08	-179.22	-187.14	-195.05	-867.04	-6,163.87
c) Social Security Retirement Benefits Offset by Private Accounts		0.00	0.10	0.37	0.88	1.71	3.06	6,185.30
Subtotal		-118.95	-157.38	-164.25	-171.66	-178.74	-790.98	21.43
B. Reform the Tax Code								
2) Marriage Penalty Repeal		-12.50	-21.20	-21.90	-22.50	-22.90	-101.00	
3) Reduce Capital Gains Tax Rate (Excludes Unlocking Effect)		-12.60	-12.70	-13.10	-13.50	-14.70	-66.60	
4) Create Education IRAs		-0.06	-0.20	-0.29	-0.39	-0.47	-1.40	
5) Reform Section 125 Rollover Provisions		-0.16	-0.46	-0.47	-0.49	-0.51	-2.09	
6) Repeal Death Taxes		-23.90	-24.80	-26.40	-27.70	-29.50	-132.30	
7) Tax Policy Changes to Enhance Child Care								
a) Repeal Dependent Care Tax Credit		2.50	2.50	2.50	2.49	2.49	12.48	
b) Enact a \$500 per Child Credit for Children Under Five Years of Age		-4.74	-4.72	-4.71	-4.70	-4.69	-23.57	
Subtotal		-51.46	-61.58	-64.38	-66.79	-70.29	-314.48	
Total Social Security and Income Tax Changes		-170.41	-218.96	-228.63	-238.45	-249.03	-1,105.46	15,574.65
Net Surplus/Deficit (-) After Tax Policy Changes		-83.49	-170.62	-193.95	-171.29	-142.03	-761.38	15,553.22
Reduction in Unfunded Social Security Liabilities								21.43
Reduction in Government Long-Term Obligations								15,574.65

Note: * "Present Value" is an accounting term that measures how much money would need to be invested today to finance future obligations. For more information about the economic assumptions and discount rate used, see Appendix A.

The baseline revenue forecast contains CBO's latest estimates for FY1998 and FY1999. For FY1999 through FY2003, the revenue and outlay forecasts include Heritage adjustments. Projections of current CBO, five-year cumulative surplus is \$274 billion. The comparable figure from the Office of Management and Budget is \$496 billion. Government long-term obligations include all major components of spending.

Source: See Appendix A.

small businesses, farmers, the self-employed, and others. Federal death taxes are probably the most expensive taxes to pay and to collect. It is estimated that the \$20 billion in death taxes collected last year actually cost taxpayers \$26 billion.

The five-year tax savings equals \$132.3 billion.

7. Provide greater tax relief for families with children below the age of five. Current tax

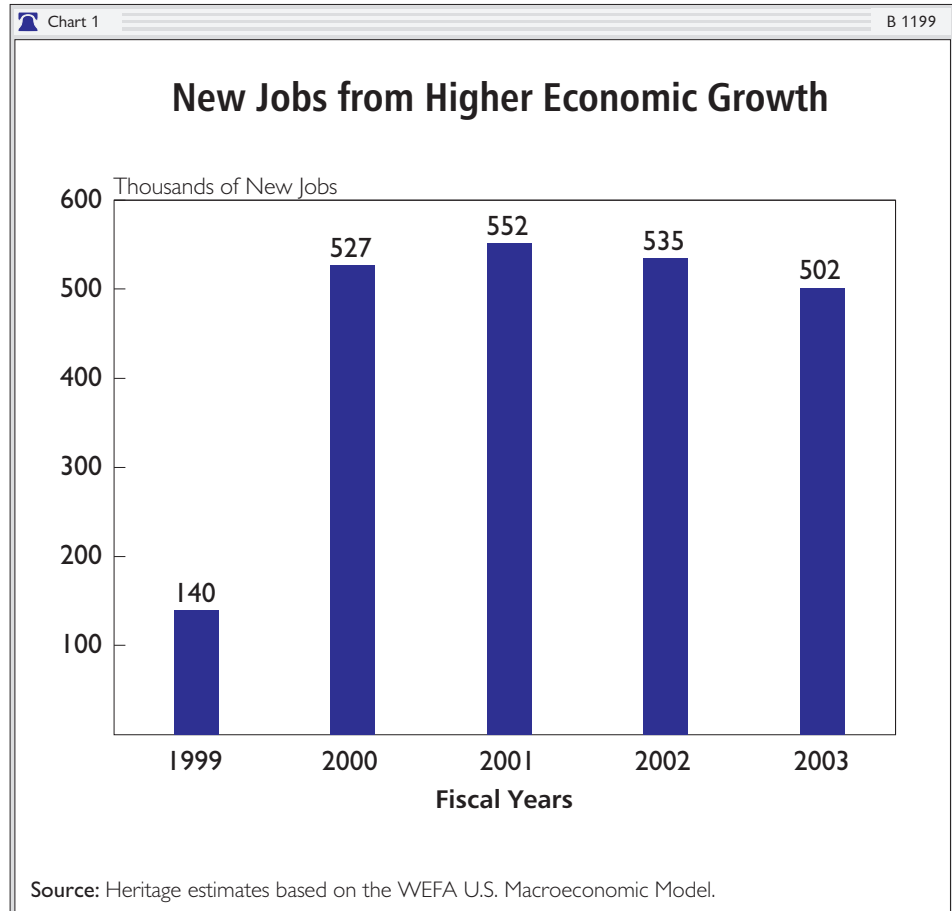
law provides cumbersome, complex, and largely ineffective tax relief to families that need day care for their pre-school children. The Dependent Care Tax Credit should be replaced with a tax credit of \$500 per child under the age of five. An estimated 10.7 million children could have been claimed under this credit in 1997.

The five-year tax savings equals \$11.1 billion.

TOTAL SAVINGS FROM THE TAX PORTION OF THE HERITAGE PLAN = \$314.48 billion over five years. Even after this tax cut (which excludes Social Security reform), the federal budget not only remains in balance, but runs a surplus of \$30.4 billion over five years.

Full implementation of the Heritage tax plan would produce the following economic benefits:

- **The total indebtedness of the government would decline.** The “present value” of government obligations is projected to decline by over \$15.5 trillion between 1999 and 2075 under the Heritage plan.⁶ The long-term unfunded Social Security liability is reduced by approximately \$21 billion. Changes in the major components of on-budget spending and revenues account for the remaining decline in government indebtedness.
- **Personal savings would increase nearly \$1 trillion.** Diverting five percentage points of the payroll tax to private investment accounts nearly doubles the personal savings rate between FY 1998 and the end of FY 2003 to 8.9 percent. In fact, the total amount of personal savings rises by \$1.1 trillion over this five-year period.
- **There would be an average of 451,000 more jobs per year.** Repealing the marriage penalty, federal death taxes, and the rollover prohibi-



tions of cafeteria plans, as well as reducing the capital gains tax and creating education IRAs, reduces the taxes on labor income an average 5.8 percent per year from FY 1999 to FY 2003. Lowering the tax costs a worker faces leads some people to find employment and others to increase their hours. The WEFA model forecasts an increase of 552,000 jobs in FY 2001.

- **The cost of capital would fall by an average of 5 percent per year.** The Heritage tax plan encourages more investment in equipment and factories by reducing the taxes on capital. These lower capital costs stem from repealing the death taxes, which directly tax capital assets, and cutting the capital gains tax rate by 50 percent. The lower capital costs lead to a 24.1 percent increase in investment over five

6. “Present value” is an accounting term that measures how much money would need to be invested today to finance future obligations.

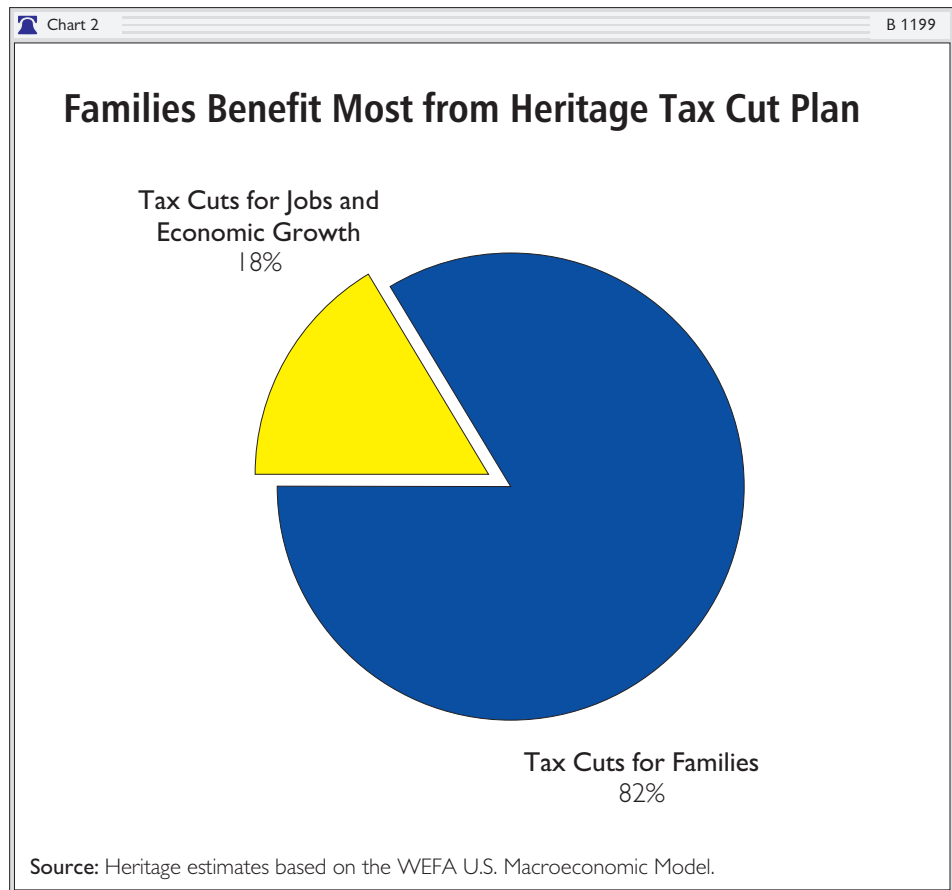
years, which contributes to an increase in worker productivity.

- **The economic well-being of succeeding generations would grow dramatically.** The Heritage tax plan focuses on building wealth in all households. Low- and moderate-income households benefit substantially from the hundreds of billions in new savings that Social Security privatization creates. Not only will these new savings provide for comfortable retirement in the future, but they also will be used as nest eggs for the children of current savers. For the first time, Social Security payroll taxes will provide the means for passing wealth to the next generation, who in turn will start their working lives with more money for education, health care, and housing than their parents had. Accompanying this significant public policy change with repeal of the federal death taxes assures that the new wealth of American families will be protected from the rapacious tax appetite of the federal government.

THE HERITAGE TAX CUT PLAN

Congress can craft a tax cut plan that delivers significant tax relief to millions of Americans without undermining the integrity of each individual measure. To be sure, this is not the perfect tax cut plan; but given the range of tax proposals that may be possible in this Congress, if tax writers keep in mind a few simple principles, they can craft tax cuts that would benefit families and the U.S. economy:

- Taxpayers must see an immediate benefit from this year’s budget agreement. The tax cuts should not be phased in over the next five years in order to reduce their “cost” to the Treasury. Taxpayers should not have to wait until after the turn of the century to see the benefits of this relief.
- The tax package must be a step toward good, long-term tax policy. It should not make the current system more complex and thus undermine the future potential for tax reform. To the extent tax cuts can be implemented, lawmakers should insist that the changes lower marginal tax rates, reduce double taxation, and simplify the tax code.



- The tax cuts must be broad-based and benefit the greatest number of Americans possible. Lawmakers should avoid means-testing or other devices that exclude some families to the benefit of others. Moreover, they should not create special or targeted tax breaks that bene-

fit a select group of individuals or industries at the expense of others.

- The tax cuts must promote good, long-term economic effects. Tax cuts for education, for example, should promote long-term savings rather than subsidize college fees or encourage more family debt. Subsidizing college fees and debt will boost higher education costs; long-term savings will control higher education costs.

Features of the plan include the following:

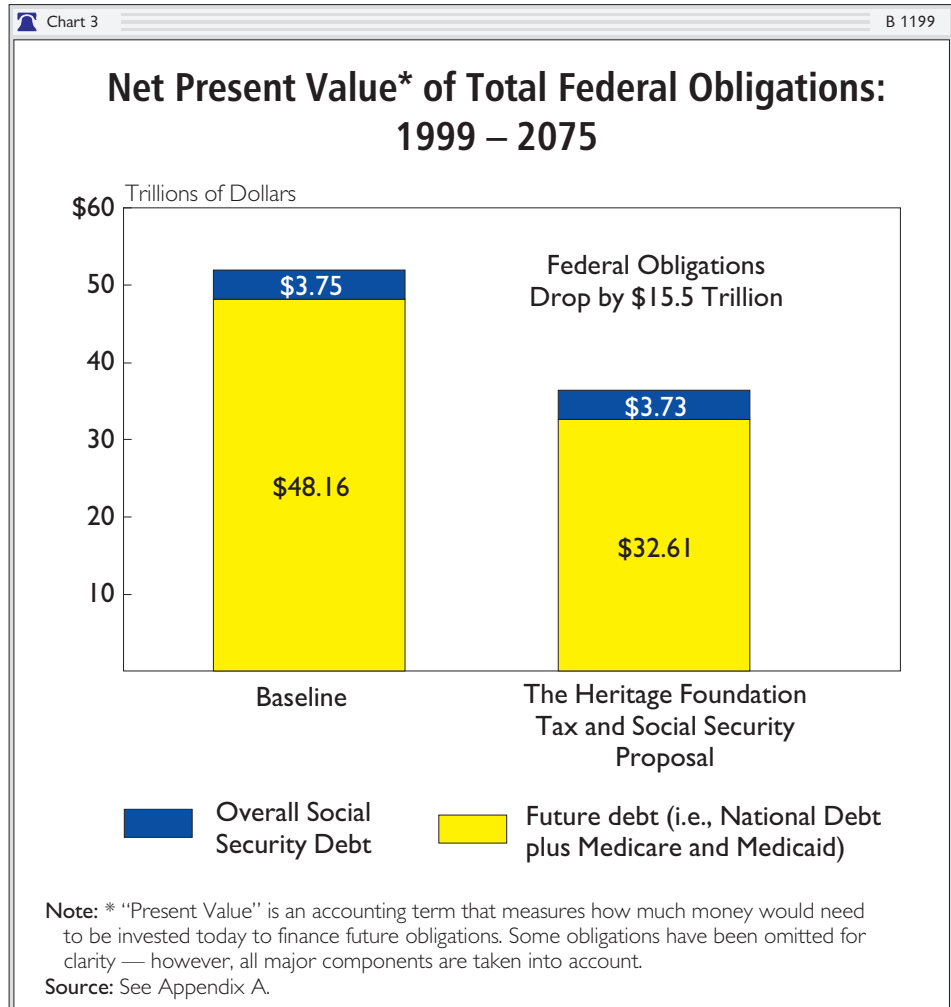
1. Empowering Families to Save: Create Private Savings Accounts.⁷

The Social Security system faces two severe crises. First, it faces a funding crisis: The system simply cannot pay promised benefits to future retirees without major changes in the program. Beginning in 2032, if Congress and the Administration do not make changes, it will not be possible to pay full benefits.

In addition, the system will be burdened with the huge costs of the aging baby boomers. If we consider the workers and retirees currently in the Social Security system, the “present value” of the unfunded liability, measured by the amount (in today’s dollars) of extra money beyond payroll taxes that would be needed

today to pay benefits, would be as much as \$9 trillion to \$12 trillion.⁸ That liability does not appear on the government’s books—it is not figured into the official national debt—but, like the national debt, it is money that future taxpayers will have to pay.

Second, Social Security is a terrible way for most Americans to save for their retirement. Although the system currently provides reasonably good benefits for the disabled and the dependents of deceased workers, most workers face their own Social Security crisis because the program typically is a very poor way to



7. Heritage analysts responsible for this section are Gareth G. Davis, Stuart M. Butler, and Daniel J. Mitchell.
8. Martin Feldstein, “The Missing Piece in Policy Analysis: Social Security Reform,” *American Economic Review*, Vol. 86, No. 2 (May 1996).

save for retirement. Indeed, the retirement income generated from Social Security contributions generally is far below the amount these same contributions would generate in the safest private investments or even in U.S. Treasury bills.

For example, Social Security's inflation-adjusted rate of return is only 1.2 percent for a typical average household of two 30-year-old earners with children, in which each parent makes just under \$26,000.⁹ Such couples will pay a total of about \$320,000 in Social Security taxes over their lifetime (including employer payments) and can expect to receive benefits of about \$450,000 (in 1997 dollars, before applicable taxes, after retiring at age 67, the retirement age when they are eligible for full Social Security Old-Age benefits).

Had this average household placed that same amount of lifetime employee and employer tax contributions into conservative tax-deferred IRA-type investments—such as a mutual fund composed of 50 percent U.S. government Treasury bills and 50 percent equities—they could expect a real rate of return of over 5 percent per year prior to the payment of taxes after retirement. In this latter case, the total amount of income accumulated by retirement would equal approximately \$975,000 (in 1997 dollars, before applicable taxes).

Social Security needs to be reformed to deal with these twin crises. The reform should do two things: help secure the ability of the system to deliver on its promises to beneficiaries, and enable today's workers to look forward to more income in retirement.

The Heritage Proposal. The Heritage tax plan would achieve both of these goals by allowing—not requiring—workers to place a portion of their payroll taxes now devoted to retirement income (but not disability or other

insurance elements) into a private savings account instead.

Workers who exercised this choice would exchange income from their Private Savings Accounts for the Social Security retirement benefits associated with the portion of their taxes they placed in a private account. They would, however, receive the Social Security benefits financed by the rest of their payroll taxes.¹⁰ The insurance elements of Social Security, such as disability and benefits for the dependents of workers who die before retirement, would not be affected, and all Americans, whether or not they opened a private savings account with a portion of their payroll taxes, would be entitled to a minimum benefit from traditional Social Security.

Specifically, every worker would be permitted to divert five percentage points of his or her Social Security payroll tax into a private retirement savings account that met certain federal requirements. General federal revenues would be used to make up the resultant shortfall in trust fund receipts. The reduction in Social Security benefits would be based on the number of years during which the individual elected to place a part of his or her payroll tax in a private account.

While this proposal involves a significant “cost” to the Treasury from the perspective of the annual unified budget accounts, it leads to a reduction in the long-term unfunded liability of the Social Security trust fund. Taken together, the total liabilities of the federal government that will have to be paid by future taxpayers (specifically, the national debt plus the unfunded liabilities of Social Security) would be sharply cut.

Meanwhile, workers could look forward to a higher income during retirement, thanks to the

9. William W. Beach and Gareth G. Davis, “Social Security's Rate of Return,” Heritage Foundation *Center for Data Analysis Report* No. CDA98-01, January 15, 1998.

10. See Appendix A, Social Security section for details on the benefit reductions and Private Savings Accounts.

better returns likely to flow from private accounts.¹¹

2. Eliminating the Second Earner Bias: Repeal the Marriage Penalty.¹²

In the government's attempt to tax equal-earning couples at the same rate, to incorporate progressive marginal rates, and to enforce marriage neutrality, the federal tax system unintentionally penalizes millions of American families. As the Congressional Budget Office has stated, "The incompatibility of those three goals... results in continuing tension within the tax code."¹³

This tension in the tax code harms the pocketbooks of Americans and the institution of marriage, and has significant implications for the economic and cultural health of our nation. Throughout the tax code, joint filers are repeatedly disadvantaged: Married couples are forced to pay more than they would pay on aggregate as single filers, benefits are consistently lower for married couples in comparison to single individuals, and secondary earners receive lower levels of Social Security benefits than they would have realized had they remained single.

The marriage penalty is arguably the most significant of the secondary earner biases. In short, "the basic source of the marriage tax is the fact that key elements of the tax law depend on an individual's family situation, including the rate schedule, the standard deduction, and the earned income tax credit. Hence, the act of getting married per se affects individuals' tax liabilities, even if their work and saving decisions stay the same."¹⁴

In most cases, federal income tax laws require that married couples file joint tax returns based on the combined income of husband and wife. When a husband and wife both work, the secondary earner (that person with the lower income) in effect is taxed at the top rate of the primary earner, taxed at the margin. As a consequence, a married couple may pay more taxes than they would if each spouse were taxed as a single.

Unfortunately for the American taxpayer, the federal government has grown dependent on the marriage penalty. The millions of dollars in excess revenues that the government reaps at the expense of married couples has led many to argue preposterously that any significant change in the tax system is impossible because of the potential cost. These revenues do not belong in Washington in the first place, and they must be returned to the taxpayer.

According to the Congressional Budget Office, an estimated 42 percent of married couples incurred marriage penalties in 1996; "more than 21 million married couples paid an average of nearly \$1400 in additional taxes in 1996 because they must file jointly."¹⁵ Most severely affected by these marriage penalties were couples with a more equal division of income between husband and wife and those who receive Earned Income Tax Credit (EITC) benefits. Essentially, Americans with the lowest incomes and those families dependent upon two wage earners are the biggest casualties of our current tax policy.

Consider what happens to two \$30,000 wage earners who decide to wed. As a single

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11. See Beach and Davis, "Social Security's Rate of Return," Table 1. "Present value" is an accounting term that measures how much money would need to be invested today to finance future obligations.
 12. Heritage analysts responsible for this section include William W. Beach and Rea Hederman.
 13. Congressional Budget Office, *For Better or For Worse: Marriage and the Federal Income Tax* (Washington, D.C.: U.S. Government Printing Office, June 1997), p. XII.
 14. Daniel R. Feenberg and Harvey S. Rosen, "Recent Developments in the Marriage Tax," *National Tax Journal*, Vol. 47, No. 1 (March 1995), p. 2.
 15. CBO, *For Better or For Worse*, p. 1.

individual, a \$30,000 wage earner would pay \$3,457.50. The principle of marriage neutrality means that when a \$30,000 wage earner marries another \$30,000 wage earner, the new tax liability should be \$6,915. Under joint filing, however, this married couple, who now earn a combined total of \$60,000, are now taxed \$7,795 per year; there is, in other words, an \$880 penalty for marriage.

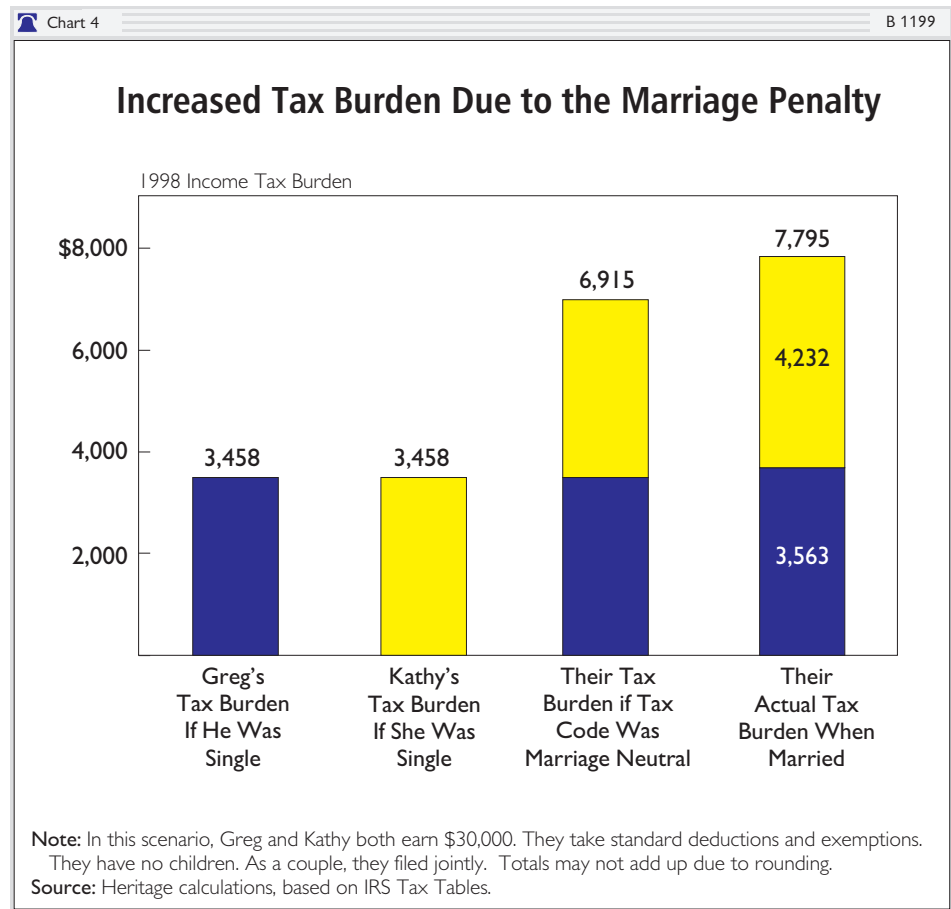
According to the ideal of marriage neutrality, tax burdens should not be altered when two people decide to marry. However, the goal of progressive taxation is violated under such circumstances. Progressivity states that a person (or, under today's joint filing, a combination thereof) who has twice the income of another pays more than twice the taxes. The tax system has sided with the ideal of progressive taxation and punished hard-working Americans.

The second earner bias, and the marriage penalty specifically, can have significantly negative economic implications for the country as a whole. Not only do these faults of the tax system stand as an obstacle to marriage, but they can discourage husbands or wives from entering the work force. "By adding together husband and wife under the rate schedule, tax laws both encourage families to identify a primary and secondary worker, and then place an extra burden on the secondary worker because

her wages come on top of the primary earner's. The secondary earner is on the margin."¹⁶

As the family realizes lower income levels, the nation realizes lower economic output. From a strictly economic standpoint, for potential workers to avoid the labor force as a result of peculiarities within the tax code is a clear sign of failure to maximize eligible resources. As a result, the nation as a whole fails to reach its potential, demonstrated by decreased earnings, output, and international competitiveness.

The Heritage Proposal. Families with married parents should not be penalized by federal tax policy. The Heritage proposal permits married taxpayers to choose the tax filing status



16. Edward J. McCaffery, *Taxing Women* (Chicago and London: University of Chicago Press, 1997), p. 15.

The Marriage Penalty: Struggling Middle-Income Couples Are Hit Hard.

Take, for example, a family in which the husband, Paul, earns \$60,000 annually. Paul's first \$16,000 of income goes untaxed under the modern-style married tax rate schedule; earnings from \$16,001-\$42,350 are taxed at a 15 percent rate; and earnings from \$42,351-\$102,300 are taxed at a 28 percent rate.

With two young children, Paul's wife Sara seriously considers joining the labor force. Unfortunately for Sara and her family, because of the secondary earner bias, her first dollar of income will be taxed immediately at a 28 percent rate. Even if Sara accepts a job that pays only \$30,000—half of what her husband makes—she will end up paying \$8,367.50 in before-credit taxes, well below her husband's burden of \$6,315. With increased child care costs and work expenses, what appeared to have increased the family's income to \$90,000 now looks like a wash.

With reference to women in Sara's situation, the Congressional Budget Office has said, "The higher initial tax rate she faces when married reduces the value of her work and thus may induce her to work fewer hours each week, fewer weeks each year, or even not to work at all."¹ Inherently, Sara's decision to work less or avoid the workforce entirely affects both her family and the national economy.

The CBO went on to say that "generally higher tax rates for lower-earning spouses prompt them to work between 4 percent and 7 percent less than they would if they could file individually. Overall, requiring couples to file joint tax returns induces them to work less. As a result, their total earnings are between 0.7 percent and 1.2 percent less than they would otherwise be."²

1. CBO, *For Better or For Worse*, p. 10.

2. *Ibid.*, p. 12.

that gives them the lowest tax on the income they earn individually.

This option is available widely in the states: 10 states allow married couples to file separately when paying state income tax; an additional 21 states have rate schedules that reduce or eliminate the marriage penalty.¹⁷

In nearly half of all married households, such taxpayers will find that filing as single taxpayers will result in lower taxes. Common income (such as interest on a savings account or dividends) would be apportioned between the two taxpayers according to the percentage of total income that each earned from their jobs.

The standard deduction or the itemized deductions would be treated in a similar fashion. These married taxpayers would recombine their income when determining whether or not they are eligible for tax credits.

3. Unlocking Economic Growth: Cut the Capital Gains Tax.¹⁸

One of the most important things Congress can do this year to spur job and economic growth is to reduce capital gains taxes. Lower capital gains taxes stimulate economic growth by reducing the cost of capital: Taxes make up one part of the cost of capital, and lowering capital taxes reduces the "price" of capital to all kinds of borrowers.

17. *Ibid.*, p. 62.

18. Heritage analyst William W. Beach contributed this section.

Table 2 B 1199

Estimated Distribution of Individual Capital Gains Tax Relief

Regular Income Before Claiming Capital Gains	Percent of Filers Who Declare Capital Gains	Cumulative Percentage	Percent of Total Value of Capital Gains	Cumulative Percentage
Under \$30,000	41.18%	41.18%	29.83%	29.83%
\$30,000 to \$39,999	11.12%	52.31%	5.25%	35.08%
\$40,000 to \$49,999	9.28%	61.59%	4.63%	39.72%
\$50,000 to \$74,999	17.42%	79.01%	8.77%	48.49%
\$75,000 to \$99,999	8.67%	87.68%	6.01%	54.50%
Over \$100,000	12.32%	100.00%	45.50%	100.00%

Source: Heritage calculations; based on IRS Public Use File for 1993.

When borrowing costs fall, entrepreneurs create more new businesses, managers of existing businesses expand their factories and buy new machines, and families buy new cars and homes. All of this expansion in economic activity means more jobs and higher worker productivity. Productivity gains that stem from workers using new and improved machines help to increase average wages, thus returning income benefits even to households that may never have capital gains income.

Some Members of Congress still believe that lower taxes on capital gains benefit only rich taxpayers. The data, however, tell a different story. As Table 2 illustrates, nearly 88 percent of all current taxpayers with capital gains declarations on their tax returns have incomes from other sources (such as wages, salaries, self-employment, and pensions) under \$100,000; and 55 percent of all capital gains dollars are found in households with incomes below \$100,000.

In other words, those taxpayers who would benefit from a 50 percent cut in the capital

gains tax rates are likely to be in the middle class.

Just as lawmakers should shun the “tax cuts for the rich” argument, they should reject the counsel of those tax economists who suggest that lowering the effective tax rate on capital will not result in a significant change in capital gains declarations. History suggests otherwise.

Experience with changes in capital gains tax rates over the past 25 years indicates strongly that rate decreases (or exclusions) produce more declarations of capital gains, and thus more capital gains taxes. Owners of appreciated assets who face high tax rates generally hold on to their assets in anticipation of lower future rates. When rates come down, the amount of capital gains taxes goes up. In fact, it appears that last year’s reduction in the capital gains tax rate has produced a huge windfall of federal tax revenue.

Economists estimate that trillions of dollars in unrealized capital gains (perhaps as much as \$7.5 trillion) exist in the portfolios of American taxpayers.¹⁹ Some economists have esti-

19. See, for example, Jude Wanniski’s March 15, 1995, testimony before the Senate Finance Committee as cited in Stephen Moore and John Silvia, “The ABCs of the Capital Gains Tax,” Cato Institute *Policy Analysis* No. 242, October 4, 1995.

mated that significant capital gains rate changes could produce substantial economic benefits and create revenue windfalls for federal and state governments.

In a 1994 article for the *American Economic Review*, Leonard Burman and William Randolph, two leading tax economists on the staff of the Congressional Budget Office, estimated the response of taxpayers to rate reductions as being on the order of 1 to 6 in the short term. This means that for every 1 percent drop in the rate (or the equivalent in exclusions), capital gains realizations would rise by 6 percent.²⁰

A 50 percent reduction in the capital gains tax rate, therefore, has the potential of raising declarations by 300 percent. It is from this increase in declarations that the federal government receives capital gains revenues above what it would have received without the 50 percent tax cut.

The Heritage proposal. Congress should cut the tax rates on long-term capital gains from 20 percent to 10 percent, and from 10 percent to 5 percent for lower income tax margins, and repeal the complex “holding” rules enacted last year.

Congress reduced the top capital gains tax rate from 28 percent to 20 percent in the Taxpayer’s Relief Act of 1997, which resulted in significant increases in federal revenues as investors sold appreciated assets that the higher tax rate had “locked up.” However, at the same time that Congress boosted tax collections and lowered the cost of capital by cutting the top capital gains tax rate, it also passed accounting and tax rules that increased taxpayers costs of complying with capital gain tax law.

The new “holding period” rules are so complex that even the IRS had great difficulty determining how to design the tax form

(Schedule D) that taxpayers use when declaring their capital gains; not until late February of 1998 did the IRS issue this important schedule for the 1997 tax year.

By cutting the tax rate by 50 percent, Congress will add new revenues as more taxpayers “unlock” more of their appreciated assets. And by repealing the complex holding period rules, Congress will reduce the cost taxpayers currently face when complying with tax law. Both reforms lead to a fairer, simpler, and flatter tax code.

4. Providing Health Choices for Americans: Allow Workers to Roll Over Flexible Spending Accounts.²¹

Members of Congress have the opportunity to put Americans more in charge of their own health care decisions and to make health insurance and medical services more accessible, more accountable, and more affordable for working families. That opportunity lies in making a slight revision in Section 125 of the Internal Revenue Code, which governs flexible spending accounts (FSAs) and “cafeteria” plans.

These tax-free accounts allow workers to save for unexpected costs of medical services or benefits not covered by their employer-provided health insurance packages. Today, both employers and employees can contribute to FSAs, and the money in these accounts can be used to pay for out-of-pocket medical expenses or for the co-payments and deductibles of their employer-provided packages.

Under the “use-it-or-lose-it rule,” however, employees who do not use all of the pre-tax money they set aside each year for medical needs must lose any excess money in the accounts at the end of that year. From the standpoint of cost control, this policy is counterproductive since it creates an incentive for

20. Leonard E. Burman and William C. Randolph, “Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data,” *American Economic Review*, Vol. 84, No. 4 (September 1994), p. 803.

21. Heritage analysts responsible for this section include William W. Beach and Gareth G. Davis.

working families to expend all the funds in their FSAs, even if the medical services they purchase are only marginally desirable or beneficial, rather than lose the money entirely.

The Heritage Proposal. Congress could easily correct this flaw by modifying Section 125 to allow workers to roll over up to \$500 of unused FSA funds, year after year, tax-free. The immediate results of such a change would be an increase in the direct purchasing of medical services from doctors and other providers, a change in the dynamics of the current insurance market, and an increase in personal savings for future health care spending or retirement.²²

As more funds are saved through such roll-over FSAs or cafeteria plans and are available for retirees' health care coverage, the future demands on Medicare would decline. The change in revenue to the federal Treasury in the meantime, based on Heritage Foundation calculations, would amount only to an average revenue decrease of \$482 million per year, or \$2.1 billion over five years.

Revising Section 125 of the Internal Revenue Code would result in immediate benefits for a significant portion of the American work force. According to the Bureau of Labor Statistics, as of 1994, 21.7 million private-sector employees chose to take advantage of employee-provided FSAs—14.8 million employed in medium to large establishments and 6.9 million in small establishments. In addition, 50 percent of state and local government employees had FSAs.²³

Today, FSAs and cafeteria plans are gaining popularity in the marketplace. They have been proven to meet the needs of a diversified pool of workers. If FSA funds can be rolled over tax-free, they will become a great boon, stimu-

lating employee savings and enhancing employee security.

5. Helping Families Afford a Total Quality Education: Expand Education Savings Accounts.²⁴

Last year, as part of the Taxpayer's Relief Act of 1997, Congress and the President established education IRAs as a new way for American families to save for their children's college education. As a result of the new law, families with an annual income of less than \$110,000 are able to set aside up to \$500 in after-tax earnings each year for future college expenses. This money can then be withdrawn to pay for qualified higher education expenses without any further taxes being paid.

With the exception of the income cap on eligible families, education IRAs are sound tax policy (the accounts eliminate the double taxation on savings) and sound education policy (they also encourage savings for college rather than debt).

The rising cost of higher education is one of the major concerns facing American families today. Over the past 18 years, the cost of a college education has increased some 221 percent, while the general rate of inflation and the average household income have increased only about 80 percent.

Furthermore, the cost of college is uncertain, making it difficult for families to anticipate just how much they must put aside or how much debt they or their children will have to incur to pay for a college education. Both the uncertainty and the generally high cost of a college education should be matters of concern to Congress and the President.

The Heritage Proposal. Congress should expand the scope of education savings

22. Robert E. Moffit and William W. Beach, "Rollover Flexible Spending Accounts: More Health Choices for Americans," Heritage Foundation *Background* No. 1159, February 24, 1998.

23. "Talking Points on Section 125," Employers Council for Flexible Compensation, Washington, D.C., 1997.

24. John Barry, a consultant, contributed this section.

accounts to cover not only higher education expenses, but also primary and secondary education costs.

Senator Paul Coverdell (R-GA), Senator Robert Torricelli (D-NJ), and House Speaker Newt Gingrich (R-GA) proposed such a sensible approach earlier in the 105th Congress. The measure (H.R. 2646), as passed by both the House of Representatives and the Senate, would expand education IRAs to cover primary and secondary education expenses and would increase the annual contribution limit to \$2,000 per student.

Ideally, both the annual contribution limit and income cap should be eliminated. In the end, all families should have the ability to save all that is necessary to secure a quality education for their children from kindergarten through graduate school.

Moreover, the coverage of tax-free education savings should be expanded to include new and innovative education investment plans. Numerous states and several private interests, for example, have established prepaid tuition plans. These programs allow families to lock in future college tuition at or below today's tuition rates.

Such prepaid tuition plans are attractive to families because they guarantee a predetermined amount of future education. Thus, prepaid tuition plans not only help families save for college, but also eliminate the uncertainty of ever-increasing college tuition costs. All of these plans, both public and private, as well as other innovative education investment options, deserve the full support of Congress and the President.

6. Helping Family Businesses and Farms: Repeal the Death Tax.²⁵

Death taxes place burdens on those groups in society that current tax policy intends most to help: minority and female business people; farmers; the self-employed; and (indirectly but no less significantly) blue-collar workers, especially those just starting their working careers.

The estate tax hurts small businesses. Investing in a business is one of the many forms of saving—for some families, the only form. For most small firms, every available dollar goes into the family business—the dry cleaning business, the restaurant, the trucking company—because the business creates an asset for the children and income for the owners. Women re-entering the work force after raising children often find self-employment the only employment open to them. Minorities also rely heavily on self-employment.

All of the financial security provided by these businesses is put at risk if the owner dies with a taxable estate. In an important 1995 study of how minority businesses perceive the estate tax,²⁶ Joseph Astrachan and Craig Aronoff found that:

- Some 90 percent of the surveyed minority businesses knew that they might be subject to the federal estate tax;
- About 67 percent of these businesses had taken steps (including gifts of stock, ownership restructuring, life insurance purchases, and buy/sell agreements) to shelter their assets from taxation;
- Over 50 percent of these same businesses indicated that they would not have taken these steps had there been no estate tax; and
- Some 58 percent of all businesses in the survey anticipated failure or great difficulty surviving after determining their estate taxes.

25. William W. Beach is responsible for this section.

26. Joseph H. Astrachan and Craig E. Aronoff, "A Report on the Impact of the Federal Estate Tax: A Study of Two Industry Groups," Family Enterprise Center of the Coles School of Business, Kennesaw State College, July 24, 1995.

Death taxes are, in a real sense, more “affordable” as income rises. In other words, what appears to be a progressive tax contains a regressive dimension.

Students of the estate tax are continually struck by the frequency with which taxpayers are insufficiently prepared to pay the tax, and nearly as frequently by the correspondence between those unprepared and those who have not had the benefit of high-priced legal and accounting advice. Indeed, legal avoidance of high death-tax liabilities is closely related to the fees taxpayers can pay throughout their lives for expensive tax-planning advice. Taxpayers who cannot pay these tax-planning fees end up paying high estate taxes.

Not only do death taxes reduce potential employment and undermine the promise that hard, honest work will be rewarded, but they also reward consumption and undermine saving. What can be said generally about income taxes can be emphatically affirmed about death taxes: Accumulation of even modest wealth will lead to heavy taxes, while consumption of income results in relatively light taxation.

In other words, it makes tax-planning sense to buy vacations in Aspen or a painting by Rubens rather than invest in new productive equipment and new factories.

Federal death taxes are probably the most expensive taxes to pay and to collect. Death taxes raise just a bit more than 1 percent of total federal revenues, but they are amazingly expensive for the taxpayer and the tax collector.

Christopher Erlich places total compliance costs (including economic disincentives) at 65 cents for every dollar collected. Other studies

that subtract disincentives and examine only direct outlays by taxpayers to comply with estate tax law put compliance costs at about 31 cents.²⁷ This additional cost of compliance means that the \$20 billion collected in federal death taxes last year actually cost taxpayers \$26 billion.

The Heritage Proposal. Congress should repeal the death tax. The economic effects of the disincentive to savings and investment are quite striking, especially in light of the relatively small amounts of federal revenue raised by federal death taxes.

An analysis by The Heritage Foundation, using the WEFA Group’s U.S. Macroeconomic Model, found that repealing the estate tax would have a large and beneficial effect on the economy.²⁸ Specifically, the Heritage analysis found that if the tax were repealed this year, over the next nine years:

- The nation’s economy would average as much as \$11 billion per year in extra output;
- An average of 145,000 additional new jobs could be created;
- Personal income could rise by an average of \$8 billion per year above current projections; and
- The deficit actually would decline, since revenues generated by extra growth would more than compensate for the meager revenues currently raised by the inefficient estate tax.

Richard Fullenbaum and Mariana McNeill recently confirmed these results in an important study for the Research Institute for Small and Emerging Business.²⁹ In a simulation of

27. For a review of this literature, see Richard F. Fullenbaum and Mariana A. McNeill, “The Effects of the Federal Estate and Gift Tax on the Aggregate Economy,” Research Institute for Small and Emerging Business *Working Paper Series* 98-01, 1998, p. A-2.

28. See William W. Beach, “The Case for Repealing the Estate Tax,” Heritage Foundation *Background* No. 1091, August 21, 1996.

29. See Fullenbaum and McNeill, “The Effects of the Federal Estate and Gift Tax on the Aggregate Economy,” esp. pp. 11–15.

estate tax repeal using the WEFA U.S. Macroeconomic Model, they found that private investment would rise by an average of \$11 billion over the seven years following repeal. Consumption expenditures would rise by an average of \$17 billion (after inflation), and an average of 153,000 new jobs would be created in this more buoyant economy.³⁰

7. Helping Families Care for Their Children: Create a Parental Care Preschooler Tax Credit.³¹

During the baby-boom era, when most of today's parents were born, the federal government had a deliberately low-tax policy which was friendly to families and children. But that family-friendly policy has long since disappeared.

In 1950, the typical family of four paid about 5 percent of its income in taxes to the federal government. Today, that same family would pay roughly 23 percent of its income in direct federal taxes. Adding state, local, and indirect taxes raises the tax bite typically to about 37 percent. This means that in the average two-earner married-couple family, the mother works not to raise her family's standard of living, but primarily to pay for the enormous tax increases imposed by decades of government spending.

Studies show that many parents would prefer to work less and spend more time with their children. But with today's record peacetime levels of taxation, many mothers feel compelled to enter the work force.

Working mothers with young children, particularly preschool children, commonly pay for some child-care services. Combined with the impact of the marriage penalty, this means that a mother can work full-time and yet add only a few dollars to the family's net monthly income. If, on the other hand, the mother stays at home to care for her children, leaving the husband as

the only earner, the family does not receive the dependent care tax relief available to mothers who work outside the home.

President Clinton proposes to "solve" this problem with new subsidies for day care. The Clinton proposal targets over \$20 billion of the projected budget surplus on one kind of service: the care of children outside of the family environment and away from parents. In addition to providing tax relief to middle-class parents who use day care, Clinton is proposing billions in new government day-care spending through such programs as the Child Care and Child Development Block Grant and Head Start. Two-thirds of the funds under the Clinton plan is allocated to new government spending, not tax reduction.

Thus under Clinton's plan, middle-class parents who hire others to care for their children will receive some help for their day-care costs, but parents who make a great financial sacrifice so that one parent can remain at home to care for their young children will receive neither assistance nor tax relief. Indeed, families who care for their own children will be taxed to pay for day care used by typically more affluent families.

To deal with the burden of excessive taxes on families with children, Congress should provide tax relief to parents, not new spending directed to day-care centers. In providing that tax relief, Congress should allow parents to decide how best to care for their children; it should aim to expand rather than narrow their options.

Furthermore, Congress should treat all working families with preschool children equally. Under no circumstances should it discriminate against families who make a financial sacrifice so that one parent can remain at home (either full-time or part-time). Nor should paid professional day care be favored

30. *Ibid.*, p. 15.

31. The Heritage analyst responsible for this section is Robert Rector.

over the unpaid care given by the children's grandparents.

Congress took a small step last year toward rolling back the punitive taxation of families with children by enacting a tax credit for children under the age of 18. The credit will be worth \$400 per child in 1998 and \$500 in each subsequent year. Congress should build on this foundation by providing additional badly needed tax relief to working families with preschool children.

The Heritage Proposal. Current law provides a cumbersome and complex system of tax relief for second-earner mothers working outside the home who use child care services. Under the Heritage proposal, this Dependent Care Tax Credit would be replaced with a new \$500 tax credit per preschool child. This would be in addition to the credit enacted last year, and the credit would not be refundable.

In other words, the total credit available would be limited to the amount that otherwise would be paid by the family in income tax—it could not be claimed against Social Security payroll taxes and would be calculated after the Earned Income Tax Credit had been computed.

HOW THE HERITAGE PLAN WOULD BENEFIT JOBS AND THE ECONOMY³²

The Heritage Foundation tax cut plan promotes job creation and economic growth while delivering substantial tax relief to American families over the next five years. The plan also promotes significant increases in private savings devoted to retirement.

- Over 70 percent of the \$1,104.6 billion in total tax cuts goes to help families save for a better retirement.
- Another 18 percent would be used to reduce the high taxes imposed on families who try to pass down their life's work to their children and to reduce the tax penalties on savings and investment.
- The remaining 10.4 percent would flow to American families to eliminate the marriage penalty and promote savings for their children's education, the out-of-pocket medical expenses that are not covered by insurance, and the additional child credit.

Heritage Foundation economists analyzed the tax cut plan's impact on jobs and economic growth using the January 1998 U.S. Macroeconomic Model of the WEFA Group. WEFA economists reconstructed their January model for The Heritage Foundation to embody CBO economic and budgetary assumptions published by the CBO in January of this year.³³ Thus, it is fair to say that simulations of policy changes using this specifically adapted model produce dynamic results based on CBO assumptions.

Next, the elements of the Heritage tax plan were entered into the model to simulate the plan's dynamic economic impacts. See Appendix A for a description of how elements of the Heritage tax plan were incorporated into this adapted version of the WEFA U.S. Macroeconomic Model.

The Heritage analysis using the WEFA model indicates that a balanced package of tax cuts to help families and encourage investment will result in a stronger, more vigorous general economy over the five-year period between FY 1999 and FY 2003 (see Appendix B). This analysis suggests that the Heritage tax cut plan would:

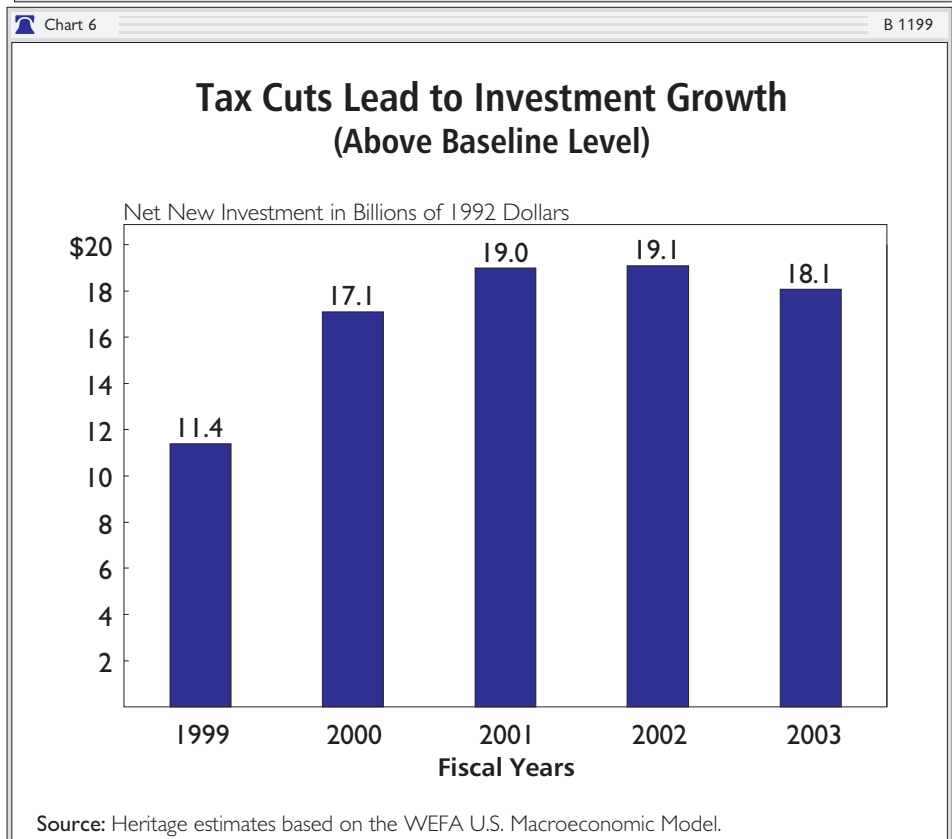
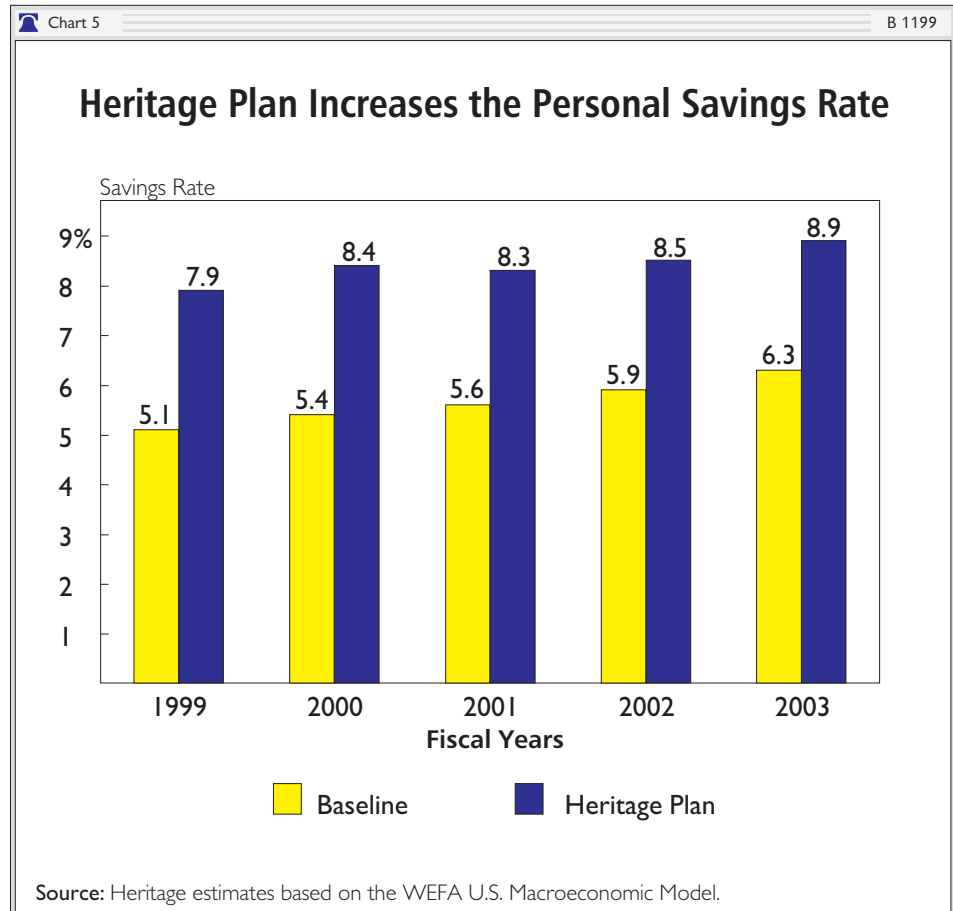
- **Increase real GDP.** The Heritage tax plan increases the real gross domestic product by \$50.2 billion in FY 2003. Despite this increase

32. Heritage analysts responsible for this section are D. Mark Wilson and William W. Beach.

33. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1998–2008*. See also the Appendix A for a description of The Heritage Foundation's use of the WEFA Model and various steps incorporated to simulate the budget resolution. It should be noted that the methodologies, assumptions, conclusions, and opinions herein are entirely those of Heritage Foundation economists and have not been endorsed by, and do not necessarily reflect the views of, the owners of the WEFA U.S. Macroeconomic model.

in economic growth, inflation, as measured by the Consumer Price Index, remains a low 2.7 percent. The model also indicates that the increases in output are due in part to real growth in productivity. The rate of growth in productivity increases 0.3 percentage points in FY 1999 and 0.1 percentage points in FY 2001, which is a significant expansion for an economy currently operating at near-capacity levels.

- **Increase average household income over \$2,280.** The Heritage tax plan produces \$248.7 billion in additional, inflation-adjusted disposable income for households in FY 2003—equal to \$2,288 in higher income for the average American household. Almost 92 percent of this increase flows directly into Private Savings Accounts.
- **Increase household saving and investment.** Personal saving increases by \$229.2 billion and inflation-adjusted investment rises by \$18.1 billion in FY 2003. This private-sector saving and investment will improve the productive capacity of the U.S. economy and the standard of living for future generations.



- **Spur job creation.** Repealing the marriage penalty and death taxes and reducing the capital gains tax rewards work and promotes economic growth. The Heritage tax plan produces an average of 451,000 more jobs per year over the five-year period. In fact, in FY 2001, the simulation shows that the private sector produces 552,000 more jobs. The average unemployment rate is lower under the Heritage plan than in the baseline economy.
- **Produce economic “feedback.”** Using mostly “static” estimates that take only limited account of the tax cut’s influence on the economy’s performance, the Heritage tax plan would reduce revenues to the federal Treasury by \$313.6 billion over five years (excluding Social Security reform). The more “dynamic” analysis using the WEFA model, however, suggests that because the tax cut plan promotes stronger economic growth, the expanding tax base feeds new tax revenues back into the federal Treasury. These new tax revenues replace or “feed back” 23.3 percent of the expected revenues lost to the Treasury under a static analysis.

In other words, when the tax cut plan’s effect on economic performance is accounted for, the actual “cost” of the plan to the Treasury is only 76.7 percent of the purely static reduction in tax revenues over five years. This revenue feedback, when combined with the tax plan’s impact on federal spending and the effect of slightly lower Old-Age and Survivors Disability Insurance (OASDI) benefit payments, increases the overall feedback effect on the federal deficit to 38.3 percent over five years.

CONCLUSION

This Congress, like the one elected in 1994, is pledged to reduce taxes and spending. And President Clinton, according to his own pledge, is committed to ending the era of big government. But while Congress has enacted tax relief and ended programs, government continues to grow.

More specifically, major spending control exists only on paper—with the hard decisions on how to

meet the targets put off until future years—and the tax cuts enacted since the beginning of 1995 have placed only a mild restraint on the growth of taxes. This year, the federal government will take in an estimated \$1.7 trillion, equivalent to roughly \$17,000 in taxes for the average family. Americans are now paying a higher proportion of their national income than at any time since the last years of World War II. Moreover, Americans are now paying far more in taxes than Congress intended, with the Congressional Budget Office forecasting hundreds of billions of dollars in unanticipated taxes flowing to Washington over the next five years.

If taxpayers discover they have paid too much in tax when they file their tax returns on April 15, they know they are entitled to a refund. Congress should be honoring that normal principle of taxation and returning extra taxes to the taxpayers. But a majority of Members of Congress evidently are unwilling to do that, as is the Clinton Administration. Nor is Congress willing this year to take the serious steps needed to reform the tax system and Social Security that can be achieved with today’s strong economy and surging tax revenues.

But even if perceived political constraints prevent Congress this year from significantly reforming and reducing the share of family budgets that go to the federal government, now is the time to construct a framework for serious action. This framework should be discussed with the American people this November and in Congress next year.

Analysts at The Heritage Foundation have developed such a framework. It would sharply reduce income taxes, earmarking over two-thirds of the projected surplus to income tax relief—doing so in ways that would encourage saving and end today’s bias against marriage and child-rearing. And it would take a large step toward reforming Social Security by giving workers the right to devote part of their payroll taxes to a private savings account—doing so in a way that would significantly cut the total liabilities of the federal government.

—*The principal authors of the text and policy are: William W. Beach, Director of the Center for Data*

Analysis; Stuart M. Butler, Vice President for Domestic and Economic Policy Studies; Gareth Davis, Research Assistant in the Center for Data Analysis; Robert Rector, Senior Policy Analyst for Welfare and Family Issues; D. Mark Wilson, Labor Economist in the Center for Data Analysis; and John S. Barry, consultant to The Heritage Foundation.

—Other Heritage analysts who contributed to the text and policy recommendations are: Angela

Antonelli, Director of the Thomas A. Roe Institute for Economic Policy Studies; Rea Hederman, Research Analyst in the Center for Data Analysis; and Daniel J. Mitchell, McKenna Senior Fellow in Economics.

—Statistical Analysis supporting this study was provided by the staff of the Center for Data Analysis: William W. Beach; Ralph A. Rector, Project Manager; Gareth Davis; Rea Hederman; Phillippe Lacoude, intern; and D. Mark Wilson.

APPENDIX A: METHODOLOGY³⁴

Heritage economists follow a two-step procedure in analyzing the revenue and economic effects of proposed policy changes.

First, estimates are prepared of revenue changes that stem from changes in the taxpaying population eligible for the tax change, from the base of taxable income absent any change in the economy, and from the tax rates. These estimates frequently are called “static” estimates, largely because they are unaffected by changes in the behavior of taxpayers that stem from tax policy reforms.

Second, these static revenue changes and other important modifications of tax law are introduced into the WEFA U.S. Macroeconomic Model. The WEFA model has been designed in part to estimate how the general economy is reshaped by policy reforms. The results of simulations performed in the WEFA model produce the “dynamic responses” to policy changes.

The following sections describe how Heritage economists prepared the static estimates described in the paper and how these results and other assumptions were introduced into the WEFA model.

THE REVENUE AND OUTLAY BASELINE

Heritage analysts revised the five-year revenue and expenditure forecasts of the Congressional Budget Office that were issued on March 3, 1998. These revisions first accounted for additional FY 1998 and FY 1999 revenues announced by the CBO in a May 5, 1998, letter to John Kasich (R-OH), chairman of the House Budget Committee.

Second, Heritage extended the CBO’s forecast of higher revenues for FY 1998 and FY 1999 to fiscal years 2000 through 2003. Minor changes were made in the CBO expenditure forecasts to reflect smaller outlays due, among other things, to slower

than expected inflation. The year-over-year change rates in the Heritage revenue forecasts follow forecasted growth rates in WEFA’s income tax base.

It is worth noting that these adjustments resulted in a five-year cumulative surplus that is \$70 billion above the CBO’s cumulative surplus and \$152 billion below the amount forecasted by the Office of Management and Budget in its FY 1999 Mid-Session Review.

TAX POLICY ASSUMPTIONS

Social Security

Heritage analysts used the Center for Data Analysis *Social Security Revenue and Expenditure Model* to estimate the net effect on the federal government’s liabilities of a 5.0 percentage point carve-out of Old-Age and Survivors Insurance taxes that is coupled with a proportional reduction in future benefit payments.³⁵

Under the Heritage proposal, workers between 20 and 61 years of age can choose to divert 5.0 percentage points of their payroll taxes into a Private Savings Account. For each year they divert their taxes, participants lose 2.44 percent (or 1/41) of Old-Age and Survivors Insurance benefits that are payable after they reach age 62. Entitlement to pre-retirement Survivors Insurance, Disability Insurance, and any benefits payable to children of deceased workers are not affected by participation.

This policy change was introduced into the WEFA U.S. Macroeconomic Model by reducing the OASDI payroll tax rate by 5.0 percentage points and constraining the model to devote the resulting increase in disposable personal income to savings. OASDI transfer payments were also reduced by a small amount to reflect the decline in OASDI benefit payments for workers with Private

34. Inquiries concerning matters covered in this section should be addressed to Ralph A. Rector, Project Manager for the Center for Data Analysis.

35. For a description of the model, see *Center for Data Analysis Social Security Revenue and Expenditure Model* working paper, available upon request.

Savings Accounts. Finally, tax revenues on a Unified Budget basis were increased by \$14.6 billion for FY 1999 to FY 2003 to reflect the distribution of the FY 1998 surplus.

The net effect of this proposal on the present value of federal liabilities is estimated using the baseline contained in the Congressional Budget Office's May 1998 *Long-Term Budgetary Pressures and Policy Options*. Heritage analysts used the elasticities contained in Section II G to adjust the intermediate projections of the 1998 *Report of the Trustees of the Federal Old-Age and Survivors and Disability Insurance Trust Funds* so that they conformed with the economic assumptions contained in the CBO's baseline.

The CBO projection assumes a long-term growth in total factor productivity consistent with that actually experienced during the post-war period. This was interpreted to imply a rate of real wage growth consistent with the historical wage growth experienced over this period, and the Trustees' projected long-term annual growth rate of real wages was adjusted from 0.9 percent to 1.4 percent. Analysts also altered the Trustees' inflation and GDP assumptions to match those projected by the CBO. However, Heritage analysts adopted the Trustees' population forecasts.

The CBO's projection of implied interest rates on the national debt shows a slow increase for the next 20 years followed by a rapid increase over the following 30 years, with rates over 9 percent by the year 2050. Sustained interest rates at this level have a profound effect on the overall level of debt. For example, holding the CBO's interest rates and debt growth rates constant past 2050 results in estimated payments on the national debt that exceed the entire GDP in 2075. The imbalance between interest payments and the economy as a whole is caused, in part, by applying a long-term trend even when debt reaches very high levels. A

simple but accurate way to address this problem is to use a logistic differential equation in which interest rates asymptotically approach a limit value as the debt increases. Using this approach and an assumed maximum interest rate of 7 percent, Heritage analysts fitted a logistic curve based on a sensitivity analysis performed on the WEFA model. Both the CBO baseline forecast and the Heritage Foundation forecast were adjusted using this method of calculating interest payments.

Heritage analysts projected the net present value effect on the future liabilities of the federal government from reductions in payroll tax receipts and Social Security benefits. A nominal discount rate of 5.3 percent was used to value these amounts. This discount rate is based on the Social Security Trustees' long-term real interest rate projection of 2.8 percent. The Heritage nominal rate also reflects the CBO's projected long-term inflation rate of 2.5 percent. In line with the practice of the Social Security Administration's Office of the Chief Actuary, a participation rate of 100 percent in the private retirement account was assumed.³⁶

Marriage Penalty Provisions

Heritage analysts used revenue estimates for marriage penalty repeal prepared by the staff of the Joint Committee on Taxation (JCT) for H.R. 2456 (105th Congress, 2nd Session).³⁷ This legislation would permit a married taxpayer to choose the filing status (married or single) that produces the least amount of tax liability. The legislation also states rules for allocating joint income, deductions, and exemptions between married taxpayers. Heritage also used data relating to this form of marriage penalty repeal contained in the CBO's review of marriage penalties and bonuses, *For Better or for Worse: Marriage and the Federal Income Tax*. This report provides estimates of the level of marriage penalty and the amount of change in tax liabilities stemming from correcting the second-earner bias

36. A preliminary analysis indicated that while lower rates of participation may have some effect on the magnitude of the net change in long-term federal liabilities, they do not appear to affect the direction of this change.

37. This legislation was co-sponsored by Representatives David McIntosh (R-IN) and Gerald Weller (R-IL). For JCT's revenue estimates, see letter to the Honorable Jerry Weller from Lindy L. Paull, Chief of Staff, Joint Committee on Taxation. Contact the Center for Data Analysis for a copy of this letter.

in a manner similar to that described in H.R. 2456.

The purely static revenue loss estimated by the JCT staff was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Capital Gains Provisions

The Heritage Foundation's estimate of the reduced capital gains tax revenues from individuals is based on data from the 1993 IRS Statistics of Income and revenue forecasts from the Heritage Foundation Individual Income Tax Model. Heritage analysts selected only those tax returns that contained taxable capital gains in 1993, subtracted the amount of these gains from the taxpayer's adjusted gross income, and created a new income variable that summed all of the taxpayer's income except capital gains income. Forecasts of capital gains declarations under current law were made that assumed an annual growth in the base of 4 percent and a real tax rate elasticity of -0.43 percent. These forecasted declarations and associated capital gains taxes were distributed across the new income variable.

These baseline capital gains taxes were reduced by 50 percent to reflect a drop in the long-term tax rate from 20 percent to 10 percent. These reductions were designated the "purely static" revenue losses under this provision. To calculate the changes in revenues under an assumption of "unlocking," Heritage economists assumed a transitory elasticity of -5.0 percent and -3.0 percent, respectively, for years one and two of the tax plan; a permanent elasticity of -1.8 percent was assumed for years after the second year. The application of these elasticities to the base of capital gains declarations significantly decreased the purely static revenue losses. The difference between these purely static revenue losses and the revenues stemming from "unlocking" were introduced to the WEFA U.S. Macroeconomic Model as

a proportional change in the average effective personal income tax rate.

Estate and Gift Tax Provisions

Heritage Foundation estimates of the static revenue impact of the increase in the unified credit and the introduction of a family-owned business exclusion are based on data from the JCT summary of estate and gift taxes prepared for the House Ways and Means Committee hearing on January 28, 1998.³⁸ Additional data were drawn from 1993 IRS Statistics of Income and revenue forecasts based on these and JCT data produced by the Heritage Foundation Estate and Gift Tax Model. Heritage forecasts of estate tax revenues for fiscal years 1999 to 2003 were distributed across adjusted gross income following the techniques described by Daniel Feenberg, Andrew Mitrusi, and James Poterba in "Distributional Effects of Adopting a National Retail Sales Tax," *Tax Policy and the Economy*, Conference Report, National Bureau of Economic Research, September 1996, pp. 20–22. The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Educational IRA Provisions

The Heritage Foundation's estimates of the static revenue impact of the educational IRA provisions in this plan are based directly on the amounts estimated by the JCT. The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Section 125 Rollover Provisions

For the data in Table 1, Heritage economists estimated annual revenue changes stemming from Section 125 reform by constructing a model based on publicly available data and technically derived tax rate and program participation assumptions.

38. See Joint Committee on Taxation, "JCT Description of Present Law and Background on Estate and Gift Taxes (JCX-2-98) for Ways and Means Committee Hearing Jan. 28, 1998," printed in Bureau of National Affairs, *Daily Tax Report* No. 18, 1998, pp. L-11 through L-22.

Heritage used data on worker participation in flexible saving account plans published by the Bureau of Labor Statistics. The Bureau's *Earnings and Employment Reports* for 1993 and 1994 contain participation data for small, medium, and large private firms. These estimates were confirmed by survey data developed in 1997 by Hewitt Associates, a national benefits consulting company. Heritage calculated a weighted midpoint participation rate of 20 percent and applied this percentage against an estimate of total establishment payroll employment for 1998. This employment estimate total (123,859,000 establishment employees) was taken from a forecast produced by WEFA, Inc., and is available upon request from the Center for Data Analysis at The Heritage Foundation. The participation rate estimates from Hewitt Associates also are available upon request.

The average annual amount of flexible saving account health care coverage purchased by participating workers (\$744) comes from studies prepared by the General Accounting Office in 1988, 1990, and 1992. Heritage analysts confirmed these estimates by comparing them with an estimate of average participation produced by Hewitt Associates for 1997. Heritage assumed that the rollover provision would lead participating workers to purchase an additional \$89 in annual health care coverage and capped the maximum amount of the rollover at \$500 per worker. Assuming this additional purchase raises the level of revenue decreases from the policy change. Average effective tax rates were derived from data contained in the IRS Public Use File for 1994.

Heritage's estimates for fiscal year 1998 were projected forward into fiscal years 1999 through 2003 by a formula that contains annual estimates of price changes and employment growth among participating employees. All values in Table 1 are expressed in nominal or current millions of dollars.

The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Under-Five Child Credit

The Heritage Foundation's static revenue estimate of the new tax credit for children under five years of age was calculated from the 1997 March Current Population Survey and the 1994 IRS Public Use File. Taxpayers would be eligible to claim the credit if they had federal tax liability after deducting the 1997 Child Tax Credit and the Earned Income Tax Credit. The credit is \$500 per child under the age of five for all taxpayers who qualify and is non-refundable. The projected number of children under the age of five was taken from the Bureau of the Census Middle Series Projections. The average value of the credit per child was assumed to increase in pace with inflation each year up to a maximum of \$500. The total value of the credit is offset by the elimination of the Dependent Care Tax Credit.

MODEL SIMULATION ASSUMPTIONS

The WEFA January 1998 CBO Baseline model was initially modified to reflect current law.³⁹

Social Security Reform

Heritage economists decreased the Social Security payroll tax by 5.0 percentage points and constrained the WEFA model to devote this tax cut to private saving. The loss in payroll tax revenue was made up with increased government borrowing and a net increase in government debt. OASDI transfer payments were also reduced by a small amount to reflect the decline in OASDI benefit payments for workers with Private Savings Accounts. Finally, tax revenues on a Unified Budget basis were increased by \$14.6 billion for FY

39. The January 1998 CBO Baseline model originally had the Social Security payroll tax increasing from 6.2 percent in 2005 to 6.48 percent in 2008; the Medicare payroll tax increasing from 1.45 percent in 2003 to 1.63 percent in 2008; and the minimum wage increasing from \$5.15 in 1999 to \$6.15 in 2003. These policy assumptions were removed from the model, creating a corrected baseline forecast.

1999 to FY 2003 to reflect the distribution of the FY 1998 surplus.

Average Effective Tax Rate

The WEFA model contains a variable that measures the total amount of all federal taxes on individual income as a percentage of nominal personal income. Heritage adjusted this average effective tax rate downward for each of the forecast years to reflect the purely static revenue decreases resulting from adoption of the Heritage tax plan.

Monetary Policy

The model assumes that the Federal Reserve Board will react to these policy changes. This assumption was embodied in our simulation by including the stochastic equation for monetary reserves.

Labor Force Participation and Average Weekly Hours

A small adjustment of 0.18 index points was made in the model's labor force participation rate to account for the dynamic effects of repealing the marriage penalty and the estate and gift tax, as well as reducing the capital gains tax. A small adjustment was also made in average weekly hours to account for the dynamic effects of repealing the marriage penalty. These adjustments in the labor force participation rate and average weekly hours

are based on previous research by Heritage economists and the Congressional Budget Office study "Labor Supply and Taxes," January 1996.

Declarations of Capital Gains

Heritage economists adjusted federal tax collections to reflect a higher level of capital gains declarations. The base was increased to reflect estimated elasticities associated with significant capital gains rate reductions.⁴⁰

Corporate AAA Bond Rates

Heritage economists decreased the corporate AAA bond rate by 50 basis points to reflect the drop in taxes on capital stemming from capital gains and estate tax reform. This variable is a component in a large WEFA equation that calculates the cost of capital.

Business Sector Price Index

Heritage economists decreased the business sector price index by an average of 0.25 points to reflect the lower compliance costs associated with the repeal of the estate tax. With repeal comes less reliance on accountants and lawyers to comply with estate and gift tax law. Experts on estate tax compliance have estimated that current compliance costs equal 31 percent of total taxes collected.⁴¹ This variable is a component in a large WEFA equation that calculates the cost of capital.

40. See Burman and Randolph, "Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data."

41. Fullenbaum and McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," p. A-2.

APPENDIX B

How the Heritage Tax Plan Would Affect Selected Economic Indicators

	1999	2000	Fiscal Year 2001	2002	2003	Average FY 1999–FY2003
Gross Domestic Product						
	In Billions of 1992 Dollars					
Heritage Plan	7,576.4	7,741.8	7,902.3	8,068.4	8,250.9	7,908.0
Baseline	7,551.9	7,693.6	7,848.4	8,014.0	8,200.7	7,861.7
Difference	24.5	48.2	53.9	54.4	50.2	46.2
Employment						
	In Thousands of Jobs					
Heritage Plan	126,867	128,684	130,194	131,655	133,175	130,115
Baseline	126,727	128,157	129,642	131,120	132,673	129,664
Difference	140	527	552	535	502	451
Unemployment Rate						
	Percent of Civilian Labor Force					
Heritage Plan	5.2	5.2	5.4	5.6	5.7	5.4
Baseline	5.1	5.4	5.6	5.8	5.9	5.6
Difference	0.1	-0.2	-0.2	-0.2	-0.2	-0.1
Disposable Personal Income						
	In 1992 Dollars					
Heritage Plan	5,806.4	5,976.9	6,112.0	6,253.5	6,408.2	6,111.4
Baseline	5,619.6	5,744.0	5,873.3	6,008.5	6,159.5	5,881.0
Difference	186.8	232.9	238.7	245.0	248.7	230.4
Personal Savings						
	In 1992 Dollars					
Heritage Plan	536.3	603.9	630.1	675.2	741.1	637.3
Baseline	337.2	378.5	408.5	451.0	511.9	417.4
Difference	199.1	225.4	221.6	224.2	229.2	219.9
Personal Savings Rate						
	Percent of Disposable Income					
Heritage Plan	7.9	8.4	8.3	8.5	8.9	8.4
Baseline	5.1	5.4	5.6	5.9	6.3	5.7
Difference	2.8	3.0	2.7	2.6	2.6	2.7
Investment						
	Billions of 1992 Dollars					
Heritage Plan	984.9	1,033.0	1,071.6	1,106.8	1,143.2	1,067.9
Baseline	973.5	1,015.9	1,052.6	1,087.7	1,125.1	1,051.0
Difference	11.4	17.1	19.0	19.1	18.1	16.9
Housing Starts						
	Millions					
Heritage Plan	1.470	1.506	1.459	1.450	1.434	1.464
Baseline	1.458	1.480	1.434	1.433	1.426	1.446
Difference	0.012	0.026	0.025	0.017	0.008	0.018
Light Vehicle Sales						
	Millions					
Heritage Plan	14.835	15.630	16.068	16.130	15.992	15.731
Baseline	14.863	15.488	15.931	16.033	15.942	15.651
Difference	-0.028	0.142	0.137	0.097	0.050	0.080

Note: Some totals may not add due to rounding.

How the Heritage Tax Plan Would Affect Selected Economic Indicators

	1999	Fiscal Year			2003	Average FY 1999–FY2003
		2000	2001	2002		
Real Federal Funds Rate		Annualized Percent				
Heritage Plan	5.6	5.1	5.1	5.3	5.4	5.3
Baseline	5.7	5.3	5.2	5.3	5.3	5.4
Difference	-0.1	-0.2	-0.1	0.0	0.1	-0.1
Treasury Bond, 30 Year		Annualized Percent				
Heritage Plan	6.4	6.2	6.2	6.3	6.2	6.3
Baseline	6.4	6.2	6.2	6.2	6.0	6.2
Difference	0.0	0.0	0.0	0.1	0.2	0.1
Consumer Price Index		Annualized Rate of Change				
Heritage Plan	2.3	2.6	2.8	2.9	2.8	2.7
Baseline	2.5	2.7	2.8	2.8	2.8	2.7
Difference	-0.2	-0.1	0.0	0.1	0.0	0.0
User Cost of Capital		Index Value, Annualized Rate				
Heritage Plan	101.2	100.8	100.5	101.8	101.6	101.2
Baseline	106.3	105.8	105.1	106.0	105.3	105.7
Difference	-5.1	-5.0	-4.6	-4.2	-3.7	-4.5
Output Per Hour		Annualized Rate of Change, Non-Farm Businesses				
Heritage Plan	0.5%	0.9%	0.9%	0.7%	1.2%	0.8%
Baseline	0.2%	0.9%	0.8%	0.7%	1.2%	0.8%
Difference	0.3%	0.0%	0.1%	0.0%	0.0%	0.0%
Fiscal Effects						
(Excluding Revenue Allocation to Private Savings Accounts)						
Change in Federal Tax Revenue		(Billions of Current Dollars)				Total
Static Change in Tax Revenues	-51.5	-61.5	-64.2	-66.5	-70.0	-313.6
Dynamic Change in Tax Revenues	-23.8	-50.0	-52.5	-56.0	-58.4	-240.7
Revenue Feedback	27.7	11.5	11.7	10.5	11.6	73.0
Feedback Percent	53.8%	18.7%	18.2%	15.8%	16.6%	23.3%
Change in Net Federal Deficit		(Billions of Current Dollars)				Total
Baseline Surplus Forecast (WEFA)	-2.0	-3.0	12.0	68.0	52.0	127.0
Static Surplus Forecast	-53.5	-64.5	-52.2	1.5	-18.0	-186.6
Dynamic Surplus Forecast	-25.0	-51.1	-37.3	11.4	-13.2	-115.1
Economic Feedback	28.5	13.4	14.9	9.9	4.8	71.5
Feedback Percent	53.3%	20.8%	28.6%	673.0%	26.8%	38.3%

Note: Some totals may not add due to rounding.