THE ECONOMIC IMPACT OF PRESIDENT BUSH'S TAX RELIEF PLAN

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INTRODUCTION

President George W. Bush and Congress are currently engaged in a major debate on the issues of reducing the record-high tax burden and addressing a number of problems in the tax code. The President has proposed to lower marginal income tax rates, reduce the marriage penalty, increase the child tax credit, and phase out the estate tax. The House has passed three tax relief bills: H.R. 3 to reduce marginal income tax rates, H.R. 6 to reduce the marriage penalty and increase the child tax credit, and H.R. 8 to phase out the estate tax.[1] The Senate has not yet acted on any tax relief bill.

One element of the debate over President Bush's tax plan concerns how it will affect household and government budgets as well as the U.S. economy.[2] To assess the plan's economic and budgetary effects and to help frame this debate, analysts in The Heritage Foundation Center for Data Analysis (CDA) conducted a dynamic simulation of the proposals in the President's tax relief plan. The final results show that the Bush plan would significantly increase economic growth and family income while substantially reducing federal debt.[3] For example:

A NOTE TO THE READER

This *Report* is a revised version of Center for Data Analysis *Report* CDA01–01 published on February 22, 2001. The final results of the authors' analysis of the Bush tax plan presented in this *Report* reflect revisions to the static revenue estimates used in the preliminary *Report*, a correction to the corporate tax relief estimate, and modifications in the way the estate tax relief was modeled. These revisions lead to a reduction in the tax "feedback" associated with the plan, compared with the preliminary estimate, but they do not significantly affect the plan's overall economic impact.

- Under President Bush's plan, an average family of four's inflation-adjusted disposable income would increase by $4,544 in fiscal year (FY) 2011, and the national debt

1. H.R. 3, the Economic Growth and Tax Relief Act of 2001, was passed by the U.S. House of Representatives on March 8, 2001; H.R. 6, the Marriage Penalty and Family Tax Relief Act of 2001, was passed on March 29, 2001; and H.R. 8, the Death Tax Elimination Act of 2001, was passed on April 4, 2001.
2. References to President Bush's tax plan refer to the set of proposals he submitted to Congress on February 8, 2001. Details on the implementation and phase-in dates for some of the tax proposals in the Bush plan are derived from the tax plan proposals put forth during President Bush's 2000 election campaign.
3. The results are based on May 2000 and September 2000 Joint Committee on Taxation (JCT) estimates of then-candidate George W. Bush's tax plan. See Joint Committee on Taxation, "Analysis of George W. Bush Tax Reduction Proposal" for Representative Bill Archer, May 2, 2000, and for Representative Charles Rangel, September 28, 2000.

would effectively be paid off by FY 2010.[4]

- The net tax revenue reduction, after accounting for the larger tax base that would result from higher employment and faster economic growth under the Bush plan, is $1.1 trillion from FY 2002 to FY 2011, 33.4 percent less than conventional static estimates.
- The plan would save the entire Social Security surplus and increase personal savings while the federal government accumulated $1.8 trillion in uncommitted funds from FY 2008 to FY 2011, revenue that could be used to reform the Social Security and Medicare systems and reduce the payroll tax.[5]

To date, most other analyses of President Bush's tax plan have relied on "static" budget estimates.[6] Unfortunately, those types of studies are often misleading. For example, static analysis of both the Kennedy and Reagan tax cuts suggested that they would reduce federal revenue significantly, when actually they resulted in substantial increases in tax revenues.[7] The reason static analysis is inaccurate is that it does not account for changes in gross domestic product (GDP), interest rates, employment, hours worked, personal income, savings, and inflation that result from a reduction in tax rates. Therefore, static estimates provide a very limited analysis of the economic and budgetary impact of any policy change. To forecast the change in federal tax revenue, spending, and the economy more accurately, this CDA analysis uses a dynamic model. (See below and Appendix A for more on the methodology employed for this analysis.)

MAIN PROVISIONS OF PRESIDENT BUSH'S TAX RELIEF PLAN

The President's tax relief plan represents a different approach to governing because it generally does not require taxpayers to engage in certain activities in order to receive tax relief.[8] It contains six major proposals that would reduce income tax rates, increase the tax credit for children, address the marriage penalty, allow charitable deductions for people who do not itemize their tax returns, phase out the death tax, and establish a permanent tax credit for research.[9]

Proposal #1: Reduce income tax rates.

Under President Bush's plan, everyone who pays regular income tax would receive a reduction in their taxes.[10] The plan would replace the current five income tax brackets with four lower brackets. The current 15 percent tax bracket would be reduced to 10 percent for the first $6,000 in taxable income for single taxpayers, $10,000 for single parents, and $12,000 for married couples. The 28 percent and 31 percent tax brackets would be reduced to 25 percent of taxable income, and the 36 percent and 39.6 percent tax brackets would be reduced to 33 percent. These reductions in tax

4. Both the Congressional Budget Office (CBO) and the Office of Management and Budget estimate that, regardless of the size of the surpluses over the next 10 years, some debt will remain outstanding and incur interest costs. In fiscal year 2011, the CBO estimates, $818 billion in publicly held federal debt cannot be paid because it consists of long-term bonds and savings bonds that will not be available for redemption.
5. "Uncommitted funds" is the term the CBO uses to describe the surplus tax revenue that accumulates because it cannot be used to redeem federal debt (see footnote 4). The CBO assumes that this cash will be invested—possibly in the private market—and earn a rate of return equal to the average rate projected for Treasury bills and notes.
6. Most analysis begins with tax revenue estimates produced by the Joint Committee on Taxation. While the JCT's estimates for changes in tax law reflect some behavioral responses, they do not reflect possible changes in macroeconomic variables. For example, while the JCT would take into account how tax changes increase the amount of itemized deductions or shift compensation from taxable to tax-exempt or tax-deferred forms, its estimates do not take into account how tax changes affect work effort and saving that could affect gross domestic product.
7. For a summary of the revenue offsets generated by the Kennedy and Reagan tax cuts see William W. Beach, Daniel J Mitchell, and D. Mark Wilson, "How Faulty Official Figures Greatly Overstate the Cost of the Bush Tax Plan," Heritage *Backgrounder* No. 1416, March 6, 2001.
8. Targeted tax cuts account for less than 30 percent of the Bush plan.
9. The White House, "The President's Agenda for Tax Relief," at *www.whitehouse.gov/news/reports/taxplan.html* (February 9, 2001).
10. Many taxpayers who currently pay the Alternative Minimum Tax (AMT) will continue to pay the same amount of taxes.

rates would be phased in from 2002 to 2006; however, President Bush is willing to work with Congress to accelerate portions of his plan retroactively to the beginning of 2001.[11]

Proposal #2: Double the child tax credit.

The Bush plan would give additional tax relief to families by increasing the child tax credit from $500 to $1,000 per child and by applying the credit to the Alternative Minimum Tax (AMT).[12] This increase is likely to be phased in from 2002 to 2006, but it could be implemented beginning in 2001.

Proposal #3: Reduce the marriage penalty.

Many married couples who both work face a penalty under the current tax code because their incomes are added together for tax purposes, which places a portion of the income of the second earner in a higher tax bracket than if the couple were to file as single taxpayers. President Bush's tax relief plan would reduce the marriage penalty by creating a deduction for two-earner families. This would allow the lower-earning spouse to deduct 10 percent (up to $3,000) of the first $30,000 of income from the couple's taxable income. The marriage penalty in the current tax code would be alleviated further by the lower marginal income tax rates in the Bush plan, compared with the current steep tax rate structure. As household income increased, married couples would pay less in taxes than they would if the Bush proposal to reduce tax rates were not implemented.

Proposal #4: Expand the charitable deduction to non-itemizing taxpayers.

Today, 70 percent of all those who pay income taxes cannot deduct their charitable donations because they do not itemize deductions. To address this inequity in the tax code, President Bush's tax plan would expand the federal charitable deduction to taxpayers who do not itemize their tax returns.

Proposal #5: Phase out the death tax.

Like taxes on capital gains and savings, taxes on the buildup of value in businesses, farms, ranches, and other enterprises represent a form of double taxation. Many taxpayers spend a lifetime working and investing in a small business to provide a good economic foundation for their children, only to have the Internal Revenue Service assess a tax on their estates of up to 55 percent after their deaths. President Bush's tax plan would phase out the death tax—which levies the world's second highest estate and gift taxes on hardworking families—over the next nine years.[13] Death tax rates would be reduced by 5 percent in 2002, 10 percent in 2004, 15 percent in 2005, 20 percent in 2006, 30 percent in 2007, and 40 percent in 2008.[14] By 2009, the death tax would be completely eliminated.

Proposal #6: Permanently extend the research and experimentation tax credit.

The President's plan would remove the uncertainty about whether the research and experimentation tax credit enacted in 1981 would continue to exist by making the tax credit permanent. Currently, companies can claim a 20 percent tax credit for incremental research and development expenditures. However, expirations of the tax credit in the past resulted in three gaps in coverage, two of which were filled retroactively. The on-again, off-again nature of the tax credit hinders long-term research in the United States. Making the tax credit permanent should help spur sustained investment in new technologies.

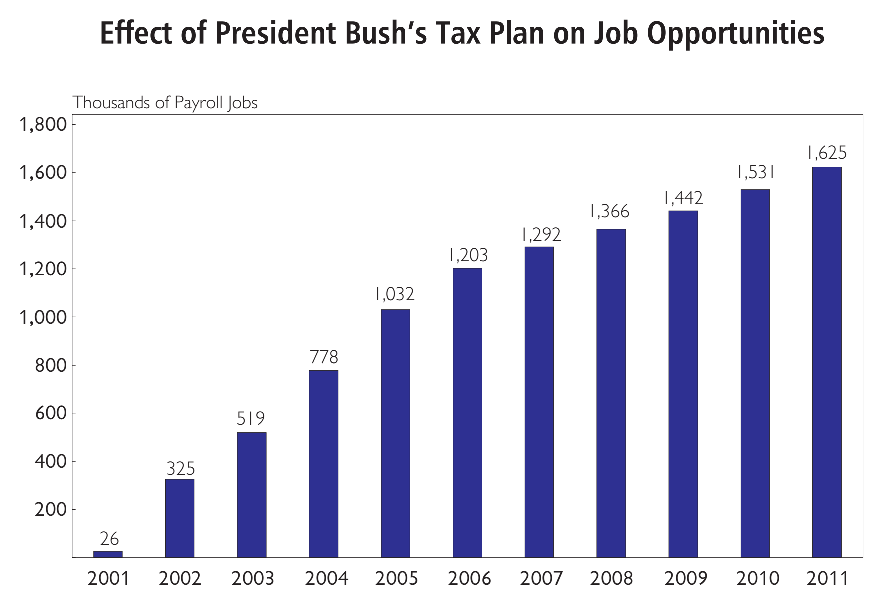
STATIC TAX REVENUE ESTIMATES OF THE BUSH PLAN'S EFFECTS

Economists commonly use static revenue estimates as inputs for conducting fully dynamic simulations of tax policy changes. The first static estimate of the Bush proposals was conducted by the Joint Committee on Taxation (JCT).[15] It

11. The White House, "The President's Agenda for Tax Relief."
12. In 1978, Congress enacted the AMT to make it more difficult for a few thousand very high-income taxpayers to legally avoid paying taxes using various tax deductions and credits.
13. William W. Beach *et al.*, "How Congress's Tax Bill Would Affect Families, the Economy, and the Federal Budget," Heritage Foundation Center for Data Analysis *CDA Report* No. 99–06, September 13, 1999.
14. Details on the death tax phase-out are from the tax plan developed during President Bush's 2000 election campaign.
15. See footnotes 3 and 6.

initially estimated that the Bush plan would reduce federal tax revenue by $1.313 trillion from FY 2002 to FY 2010. Extending the time frame of that analysis to the current Congressional Budget Office (CBO) forecast period—FY 2002 to FY 2011—increases the reduction in tax revenue to $1.554 trillion.[16] Making Bush's proposed tax rate reductions, marriage penalty reductions, and child tax credit increase retroactive to January 2001 would increase the static reduction in tax revenue to $1.699 trillion from FY 2002 to FY 2011, and $1.718 trillion over the 11-year period from FY 2001 to FY 2011.[17]

Chart 1 CDA 01-01Rev



Note: Final Results.
Source: The Center for Data Analysis at The Heritage Foundation.

DYNAMIC ANALYSIS OF THE ECONOMIC AND BUDGETARY EFFECTS

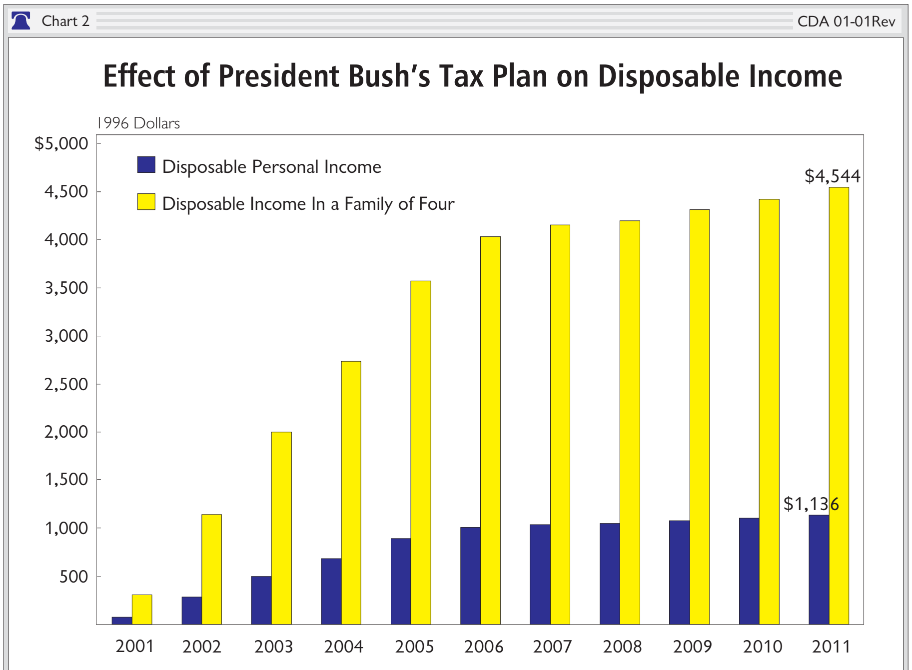
Heritage economists used the WEFA U.S. Macroeconomic Model to conduct a dynamic simulation of President Bush's tax relief plan.[18] In particular, Heritage economists reconstructed WEFA's December 2000 long-term model to embody the economic and budgetary assumptions published by the Congressional Budget Office in January 2001. This specifically adapted model uses the CBO budget assumptions to produce dynamic simulations of the policy changes proposed by President Bush.

Some analysts using static revenue and spending estimates also have calculated the budgetary impact of Bush's plan. The Center on Budget and Policy Priorities (CBPP) estimates that the Bush plan would reduce tax revenue by up to $2.1 trillion and increase interest payments by $400 billion over 10 years.[19] This estimate is very misleading because it includes a number of provisions that are not in the Bush tax plan and because it does not recognize that economic growth and the tax base will increase at a faster pace when tax rates are reduced.[20] The CDA dynamic analysis, by comparison, suggests that under the Bush plan, federal revenue would decrease by just $1.1 trillion. The difference between the static and dynamic estimates results from the increased

16. Heritage Foundation calculation based on JCT data.
17. *Ibid.*
18. The Center for Data Analysis at The Heritage Foundation used the Mark 11 U.S. Macro Model of WEFA, Inc., formerly Wharton Econometric Forecasting Associates, to conduct this analysis. The 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, prominent federal agencies, and economic forecasting departments. The methodologies, assumptions, conclusions, and opinions herein are entirely the work of Heritage Foundation analysts. They have not been endorsed by, nor do they necessarily reflect the views of, the owners of the model.
19. This estimate includes a number of provisions that are not in President Bush's tax plan, such as additional Alternative Minimum Tax reforms and making all tax relief retroactive to January 2001 with no phase-in periods. See Robert Greenstein, "Cost of the Bush Tax Cuts Rises: Making Rate Cuts Retroactive Adds $400 Billion," Center on Budget and Policy Priorities, February 6, 2001, p. 3.

economic activity and higher employment growth that President Bush's tax relief plan will help produce.

Specifically, the CDA dynamic analysis projects that the Bush plan would:



Note: Final Results.
Source: The Center for Data Analysis at The Heritage Foundation.

- Significantly increase economic growth. By the end of FY 2011, GDP (adjusted for inflation) would be $246 billion higher than the CBO baseline forecast. The rate of economic growth would increase by an average of 0.2 percentage point per year (from 3.1 percent to 3.3 percent) from FY 2002 to FY 2011 (see Appendix B).

- Create more job opportunities. As Chart 1 shows, over 1.6 million more Americans would be working at the end of FY 2011, compared with the CBO baseline forecast. Moreover, the unemployment rate would average just 4.7 percent instead of 4.9 percent from FY 2002 to FY 2011.

- Substantially increase family income. By the end of FY 2011, disposable personal income for an average family of four (adjusted for inflation) would increase by $4,544 (see Chart 2).[21] In response to this increase in family budgets, consumer spending would rise by $255 billion, or $3,390 for each family of four.

- Increase family savings. By the end of FY 2011, the average savings for a family of four would be $1,017 more (adjusted for inflation) than the CBO baseline forecast.[22]

- Significantly increase investment. Investment (adjusted for inflation) would increase by an average of $51 billion per year from FY 2002 to FY 2011. By the end of FY 2011, the net capital stock would be $317 billion higher under the Bush plan, and productivity would increase by an average of 0.1 percentage point (from 2.4 to 2.5 percent) over the 10-year period.

- Slightly increase relative price levels. Stronger economic growth would only raise the average rate of inflation from 2.6 percent to 2.7 percent between FY 2002 and FY 2011. However, average inflation would be lower than it was during the 1990s (2.9 percent) and significantly lower than the 3.4 percent inflation rate in 2000.

- Modestly raise Treasury bond rates. Under the Bush plan, 10-year Treasury bond rates would increase by an average of 0.4 percentage point (from 5.7 percent to 6.1 percent)

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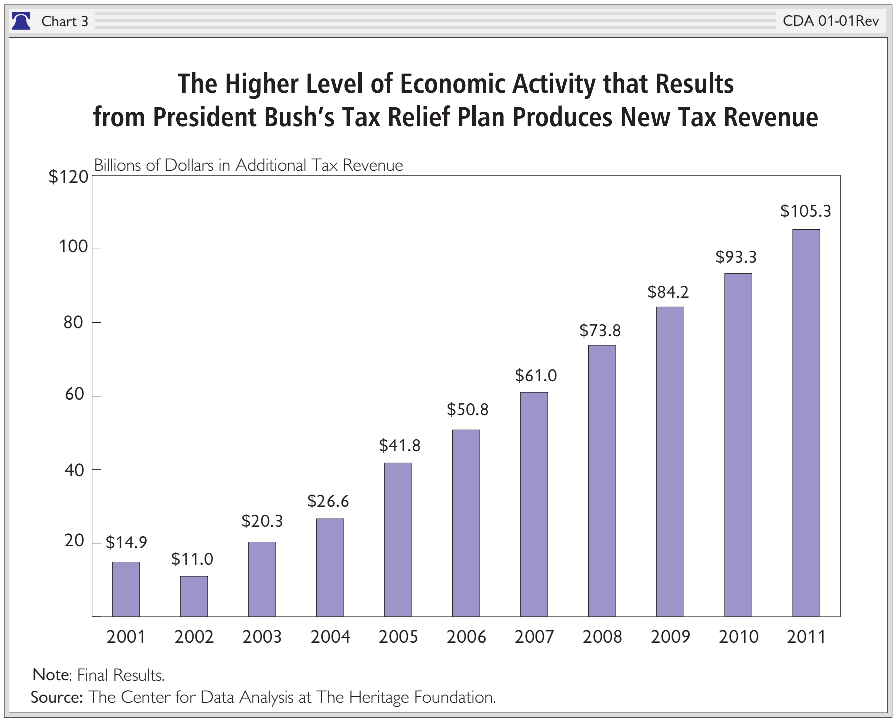
20. For a review of the CBPP estimate and its shortcomings, see "Why the Center on Budget and Policy Priorities Is Wrong About the Cost of Bush's Tax Plan," *Heritage Extra* Supplement, February 16, 2001, at *www.heritage.org/shorts/taxbriefingroom/20010216cbpp.html.*
21. This is the increase in disposable personal income per person adjusted for inflation times four.
22. This is the increase in savings per person adjusted for inflation times four.



a dynamic analysis using the WEFA model suggests that, because the tax relief would increase economic growth and employment, the larger tax base would generate $583 billion in tax revenue that is unaccounted for in a static analysis (see Chart 3). In other words, when the proposed tax relief's effect on economic performance is taken into account, the actual loss to the Treasury is just 66.1 percent of the purely static reduction in tax revenues over 11 years.

- Increase federal net interest payments by $272 billion from FY 2002 to FY 2011.

between FY 2002 and FY 2011.[23] However, the average 10-year Treasury bond rate would be lower than it was during the 1990s (6.7 percent) and about the same as it was last year (6.0 percent).

The CDA dynamic analysis reveals that President Bush's tax relief plan would exert a positive effect on the federal budget. Specifically, the results suggest that the plan would:

- Reduce federal tax revenue by $1.1 trillion from FY 2002 to FY 2011. This would be the largest amount of tax relief in 20 years, and the share of GDP taken by federal taxes would fall from 20.7 percent in FY 2001 to 19.0 percent in FY 2011.

- Produce positive economic "feedback" for the Treasury. Static estimates that do not account for the tax relief's influence on the economy suggest that President Bush's plan would decrease revenues to the federal Treasury by $1.7 trillion over 11 years.[24] However,

Total federal spending would rise by $303 billion because of the higher interest payments and slightly higher inflation adjustments to other federal spending.

- Reduce the federal surplus by $1.4 trillion from FY 2002 to FY 2011. Even with higher spending, the total surplus would be $4.2 trillion from FY 2002 to FY 2011. Moreover, because employment and payroll tax revenue will rise, the Social Security surplus would increase by $85 billion and the Medicare Part A surplus would increase by $39 billion, making more resources available over the next 10 years to reform those programs.

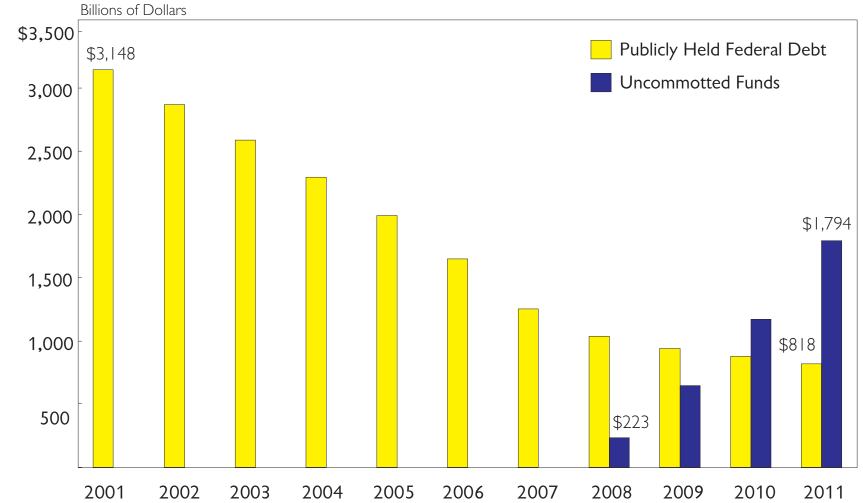
- Effectively pay off the federal debt. The Bush plan would decrease federal debt to the lowest possible level at which it could be redeemed—$818 billion in FY 2011 (see Chart 4).[25] From FY 2001 to FY 2011, federal debt as a percentage of GDP would decline from 30.5 percent to just 4.7 percent under the plan.

23. Because of lower unemployment, an increase in the demand for money, and the Federal Reserve's assumed reaction to higher levels of economic activity, the plan also would increase short-term interest rates.
24. Center for Data Analysis calculation based on JCT estimates. This includes making tax rate reductions, reducing the marriage penalty, and doubling the child tax credit retroactive to January 2001.

- Accumulate $1.8 trillion in uncommitted funds.[26] Without any tax relief, the federal Treasury will accumulate $3.2 trillion in excess taxes and interest.[27] With the substantial tax relief contemplated by the Bush plan, this amount would decline by $1.4 trillion (see Chart 4). The remaining funds would have to be invested with banks and the Federal Reserve or in some other private-sector asset, or used to reform Social Security and reduce payroll taxes.

Chart 4 CDA 01-01Rev

Effect of President Bush's Tax Plan on Publicly Held Federal Debt and Uncommitted Funds



Note: Uncommitted funds is the term CBO uses to describe the surplus tax revenue that accumlates because it can not be used to redeem federal debt. CBO assumes that this cash will be invested — possibly in the private market — and earn a rate of return equal to the average rate projected for Treasury bills and notes.
Source: The Center for Data Analysis at The Heritage Foundation

DIFFERENCES BETWEEN HERITAGE ANALYSIS AND OTHER STUDIES

The analysis in this *CDA Report* is often called a dynamic or behavioral analysis. Dynamic tax analysis attempts to capture the many ways that taxpayer behavior changes following a significant tax policy change. For example, dramatic decreases in the taxes on labor or capital will cause more labor or capital to be employed in productive activities. A business owner who knows that his or her own labor will be taxed less may work more; a non-employed spouse may seek work outside the home once the taxes on labor fall. Overall, additional labor or capital can spur the economy to higher levels of output, which causes a growth in tax revenues as a result of the expansion of the tax base.

Those who employ static analysis, like the Center on Budget and Policy Priorities and Citizens for Tax Justice, assume that taxpayers will not alter their behavior in the face of significant tax policy changes. Thus, a major drop in taxes produces no additional labor or new uses of capital, just a drop in federal revenues.

The CBPP's recent analysis of the Bush tax plan is a particularly stark example of static analysis.[28] For the CBPP, the economy would not react to the tax plan, which they argue "costs" the federal Treasury $2.1 trillion. Labor and capital costs would fall, but no one would alter their work behavior and buy new equipment any more frequently than they would have without the tax change; families would get to keep more of their income, but oddly would fail to spend or save any of it. Businesses, too, would do nothing to boost the economy through their spending and investment decisions, which would remain unchanged even in the face of the largest tax cut since 1981. Everything would remain the same—interest rates, unemployment, even the actions of the Federal Reserve—despite Chairman Alan Greenspan's

25. This amount reflects publicly held debt. Net federal debt equals publicly held debt less uncommitted funds. See also footnotes 4 and 5.
26. See footnote 5.
27. Peter B. Sperry, "Growing Surplus, Shrinking Debt: The Compelling Case for Tax Cuts Now," Heritage Foundation *Backgrounder* No. 1408, February 7, 2001.
28. See Greenstein, "Cost of the Bush Tax Cuts Rises," p. 3.

statement that tax relief would affect Federal Reserve monetary policy.

Heritage analysts, on the other hand, argue that a dynamic model is necessary because tax relief does elicit economic responses, as history has shown. The economy grows following a tax cut, jobs are created, and the tax base expands. This expansion leads to new revenue from the new wages and higher incomes, which offsets the decline in tax revenue from the tax cut (see Chart 3). Instead of reducing tax revenue by $1.7 trillion over 10 years, the net reduction of the Bush plan would be just $1.1 trillion as a result of economic growth that would produce $568 billion in new revenue.

CONCLUSION

As Congress debates the merits of President Bush's tax plan, Members will generally be viewing the plan's effects through the economic lens provided by the Congressional Budget Office. This CDA analysis of the Bush tax plan adopts the latest economic and budgetary outlook of the CBO. However, it incorporates those assumptions in a leading model of the U.S. economy to ascertain the likely effects of the plan's proposals on the economy and on the budgets of taxpayers and the government.

This dynamic analysis shows that President Bush's tax plan will boost economic activity, create over 1.6 million new jobs, and strengthen the incomes of taxpayers. The plan would reduce excess tax revenue and effectively pay off the publicly held federal debt by FY 2010. Real economic growth, which recently has slowed dramatically, would rise an average of $147 billion per year from FY 2002 to FY 2011. On average, a family of four's after-tax budget would increase by $4,544, which would lead to an increase in consumption and saving. Spending on personal items such as health care and school clothes would increase by an average of $163 billion, and America's anemic savings rate would increase from 1.9 percent to 2.9 percent.

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APPENDIX A

Methodology

Heritage Foundation economists in the Center for Data Analysis (CDA) followed a two-step procedure in analyzing the budgetary and economic effects of President Bush's tax and budget plan.

First, preliminary static tax revenue estimates for the Bush plan were obtained from the Joint Committee on Taxation (JCT).[29] The JCT tax revenue estimates are based on a static methodology that generally does not account for the macroeconomic effects that would result from a reduction in tax rates. These effects include changes in gross domestic product (GDP), interest rates, employment, personal income, and inflation that can significantly affect tax revenues. Therefore, the static estimates provide a very limited analysis of the economic and budgetary impact of any policy change. To forecast the change in federal tax revenue, spending, and the economy more accurately, a dynamic model must be used.

The preliminary JCT static revenue estimates were for fiscal years (FY) 2002 to 2010. Heritage economists extended these estimates to FY 2011. Certain tax relief provisions of the Bush plan—tax rate reductions, marriage penalty reduction, and doubling the child tax credit—were also made retroactive to January 1, 2001. These changes increase the JCT static revenue estimate from $1.3 trillion (FY 2002 to FY 2010) to $1.8 trillion (FY 2001 to FY 2011).

Second, the static revenue changes were introduced into the WEFA U.S. Macroeconomic Model. The WEFA model is a dynamic model of the U.S. economy that is designed to estimate how the general economy is reshaped by policy reforms, such as tax law and spending changes. Heritage economists have developed a revised WEFA model for The Heritage Foundation that embodies the economic and budgetary assumptions published by the CBO in January 2001. This specifically adapted WEFA model produces dynamic responses from the CBO baseline as a result of the proposed policy changes.

The Simulation

The WEFA model contains a number of variables that are used to simulate proposed policy changes. The following sections describe how the CDA static estimates were introduced into the WEFA model to estimate the dynamic economic and budget results.

Average Effective Personal Income Tax Rate. The WEFA model contains a variable that measures the total amount of all federal taxes on individual income as a percentage of the nominal personal income tax base. Heritage economists adjusted this average effective tax rate downward for each of the forecast years to reflect the static revenue decrease estimates.

Corporate Tax Revenue. The WEFA model contains a variable that measures the total amount of federal corporate tax revenue. Heritage economists adjusted the revenue downward for each of the forecast years to reflect the static revenue decrease estimates.

Indirect Business Tax Revenue. WEFA economists recommend using the variable that measures federal indirect business tax revenue to model estate tax relief instead of the average effective personal income tax rate. Heritage economists adjusted the revenue downward for each of the forecast years to reflect the static revenue decrease estimates.

Labor Force Participation and Average Weekly Hours. Small adjustments were made in the model's exogenous labor force participation rate and in the number of hours worked to account for the dynamic effects of decreasing marginal income tax rates. Previous Heritage research has estimated that eliminating wealth transfer taxes would increase the labor supply by 97,200.[30] An addition change was made to the

29. Joint Committee on Taxation, "Analysis of George W. Bush Tax Reduction Proposal for Representative Bill Archer," May 2, 2000, and for Representative Charles Rangel, September 28, 2000.

30. William W. Beach, "Time to Repeal Federal Death Taxes: The Nightmare of the American Dream," Heritage Foundation *Backgrounder* No.1428, April 4, 2001.

labor supply as estate tax relief is phased in from 2003 through 2009.

Business Sector Price Index. The business sector price index was reduced to reflect the lower tax rates on business income that would be reported on personal income tax forms. An additional change was made to reflect lower estate tax compliance costs that are borne by the business sector. These adjustments are based on previous research conducted by Heritage economists.[31]

Corporate AAA Bond Rate. Previous Heritage research has estimated that eliminating wealth transfer taxes would reduce the required yield on corporate AAA bonds by 3 percent.[32] This component of estate tax relief is phased in from 2003 through 2009 as estate tax rates are reduced and eliminated.

Monetary Policy. The model assumes that the Federal Reserve Board will react to this policy change as it has historically. This assumption was embodied in the Heritage model simulation by including the stochastic equation in the WEFA model for monetary reserves.

31. D. Mark Wilson, William W. Beach, Ralph A. Rector, and Rea S. Hederman, "How Congress's Tax Bill Would Affect Families, the Economy, and the Federal Budget," Heritage Foundation Center for Data Analysis *CDA Report* No. 99-06, September 13, 1999; and William W. Beach, "Time to Repeal Federal Death Taxes: The Nightmare of the American Dream," Heritage Foundation *Backgrounder* No.1428, April 4, 2001.

32. Beach, "Time to Repeal Federal Death Taxes."

How President Bush's Tax Plan Would Affect Selected Economic Indicators
(Final Results)

Economic Indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002–2011 (Average)
Gross Domestic Product (In Billions of 1996 Dollars)												
Forecast	9,504.6	9,814.8	10,181.7	10,524.2	10,869.6	11,219.7	11,572.0	11,927.6	12,298.0	12,691.2	13,099.5	11,419.8
Baseline	9,503.0	9,791.1	10,125.6	10,435.0	10,746.5	11,069.2	11,401.2	11,743.4	12,094.8	12,467.1	12,854.0	11,272.8
Difference	1.6	23.7	56.1	89.2	123.1	150.5	170.8	184.2	203.2	224.1	245.5	147.0
Real GDP Growth Rate (Percent Change from Year Ago)												
Forecast	2.8	3.3	3.7	3.4	3.3	3.2	3.1	3.1	3.1	3.2	3.2	3.3
Baseline	2.8	3.0	3.4	3.1	3.0	3.0	3.0	3.0	3.0	3.1	3.1	3.1
Difference	0.0	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.2
Total Employment (In Thousands of Jobs)												
Forecast	133,443	135,437	137,248	139,362	141,266	142,975	144,788	146,806	149,012	151,160	152,886	144,094
Baseline	133,417	135,112	136,729	138,584	140,234	141,772	143,496	145,440	147,570	149,629	151,261	142,983
Difference	26	325	519	778	1,032	1,203	1,292	1,366	1,442	1,531	1,625	1,111
Unemployment Rate (Percent of Civilian Labor Force)												
Forecast	4.4	4.5	4.5	4.6	4.6	4.7	4.7	4.8	4.8	4.7	4.7	4.7
Baseline	4.4	4.5	4.5	4.7	4.8	4.9	5.0	5.1	5.2	5.2	5.2	4.9
Difference	0.0	0.0	0.0	-0.1	-0.2	-0.2	-0.3	-0.3	-0.4	-0.5	-0.5	-0.2
Disposable Personal Income (In Billions of 1996 Dollars)												
Forecast	6,800.5	7,019.0	7,180.1	7,397.7	7,683.8	7,882.6	8,109.6	8,318.4	8,560.0	8,822.5	9,121.4	8,009.5
Baseline	6,779.2	6,939.0	7,039.1	7,203.5	7,428.4	7,591.9	7,807.3	8,010.9	8,241.3	8,493.2	8,780.2	7,753.5
Difference	21.3	80.0	141.0	194.2	255.4	290.7	302.3	307.5	318.7	329.3	341.2	256.0
Disposable Income Per Capita (In 1996 Dollars)												
Forecast	24,543	25,126	25,496	26,059	26,852	27,326	27,887	28,375	28,962	29,607	30,360	27,605
Baseline	24,466	24,840	24,996	25,375	25,959	26,318	26,848	27,326	27,884	28,502	29,224	26,727
Difference Per Person	77	286	500	684	893	1,008	1,039	1,049	1,078	1,105	1,136	878
Difference for Family of Four	308	1,144	2,000	2,736	3,572	4,032	4,156	4,196	4,312	4,420	4,544	3,511
Consumption Expenditures (In Billions of 1996 Dollars)												
Forecast	6,442.9	6,654.9	6,845.7	7,022.6	7,218.5	7,407.7	7,584.6	7,749.9	7,914.3	8,085.8	8,244.7	7,472.9
Baseline	6,438.1	6,625.6	6,782.1	6,922.9	7,079.4	7,235.5	7,389.8	7,540.1	7,689.1	7,845.8	7,990.0	7,310.0
Difference	4.8	29.3	63.6	99.7	139.1	172.2	194.8	209.8	225.2	240.0	254.7	162.8
Personal Savings (In Billions of 1996 Dollars)												
Forecast	116.5	117.7	82.3	110.9	187.0	189.2	227.1	260.5	323.5	403.0	529.4	243.1
Baseline	100.4	68.3	7.6	20.0	75.4	76.9	126.6	170.3	238.5	323.1	453.0	156.0
Difference	16.1	49.4	74.7	90.9	111.6	112.3	100.5	90.2	85.0	79.9	76.4	87.1

Note: All years are fiscal year end. Some numbers may not add due to rounding.
Source: Center for Data Analysis at The Heritage Foundation.

Appendix B CDA01-01Rev

How President Bush's Tax Plan Would Affect Selected Economic Indicators
(Final Results)

More Economic Indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002–2011 (Average)
Savings Rate	Percent of Disposable Personal Income											
Forecast	1.7	1.7	1.1	1.5	2.4	2.4	2.8	3.1	3.8	4.6	5.8	2.9
Baseline	1.5	1.0	0.1	0.3	1.0	1.0	1.6	2.1	2.9	3.8	5.2	1.9
Difference	0.2	0.7	1.0	1.2	1.4	1.4	1.2	1.0	0.9	0.8	0.6	1.0
Investment	In Billions of 1996 Dollars											
Forecast	1,534.0	1,639.5	1,743.5	1,836.8	1,935.5	2,029.2	2,122.3	2,209.7	2,295.0	2,373.5	2,440.7	2,062.6
Baseline	1,533.0	1,632.9	1,729.2	1,814.1	1,902.2	1,986.5	2,070.2	2,147.8	2,218.9	2,282.4	2,332.9	2,011.7
Difference	1.0	6.6	14.3	22.7	33.3	42.7	52.1	61.9	76.1	91.1	107.8	50.9
Net Capital Stock - Nonresidential	In Billions of 1996 Dollars											
Forecast	9,685.6	10,350.7	11,032.5	11,718.5	12,409.8	13,103.9	13,797.0	14,482.0	15,155.0	15,816.8	16,461.9	13,432.8
Baseline	9,685.4	10,346.3	11,018.1	11,687.6	12,355.3	13,019.9	13,678.3	14,324.4	14,952.1	15,560.9	16,144.7	13,308.8
Difference	0.2	4.4	14.4	30.9	54.5	84.0	118.7	157.6	202.9	255.9	317.2	124.1
Consumer Price Index	Percent Change from Year Ago											
Forecast	2.7	2.7	2.6	2.5	2.6	2.7	2.7	2.7	2.6	2.6	2.6	2.7
Baseline	2.7	2.8	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.6
Difference	0.0	-0.1	-0.1	0.0	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Treasury Bill, 3 Month	Annualized Percent											
Forecast	4.7	4.9	4.9	4.9	5.0	5.2	5.4	5.5	5.5	5.5	5.6	5.2
Baseline	4.7	4.9	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Difference	0.0	0.0	-0.1	0.0	0.1	0.3	0.5	0.6	0.6	0.6	0.7	0.3
Treasury Bond, 10 Year	Annualized Percent											
Forecast	4.8	5.4	5.6	5.8	6.0	6.2	6.3	6.4	6.4	6.4	6.4	6.1
Baseline	4.8	5.4	5.5	5.6	5.7	5.8	5.8	5.8	5.8	5.8	5.8	5.7
Difference	0.0	0.0	0.1	0.2	0.3	0.4	0.5	0.6	0.6	0.6	0.6	0.4

Note: All years are fiscal year end. Some numbers may not add due to rounding.
Source: Center for Data Analysis at The Heritage Foundation.

Appendix B CDA01-01Rev

How President Bush's Tax Plan Would Affect Selected Federal Budget Indicators
(Final Results)

Federal Budget Indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002–2011 (Total)
Federal Tax Revenue					In Billions of Dollars							
Forecast	2,130.3	2,199.5	2,277.7	2,366.8	2,456.3	2,558.1	2,681.0	2,815.5	2,963.5	3,128.2	3,307.4	26,754.0
Baseline	2,135.0	2,236.0	2,342.8	2,452.6	2,569.5	2,688.5	2,815.8	2,954.9	3,106.8	3,270.8	3,446.8	27,884.5
Difference	-4.7	-36.5	-65.1	-85.8	-113.2	-130.4	-134.8	-139.4	-143.3	-142.6	-139.4	-1,130.5
Change in Federal Tax Revenue					In Billions of Dollars							
Static Change to Tax Revenue	-19.6	-47.5	-85.4	-112.4	-155.0	-181.2	-195.8	-213.2	-227.5	-235.9	-244.7	-1,698.6
Dynamic Change to Tax Revenue	-4.7	-36.5	-65.1	-85.8	-113.2	-130.4	-134.8	-139.4	-143.3	-142.6	-139.4	-1,130.5
Revenue Feedback	14.9	11.0	20.3	26.6	41.8	50.8	61.0	73.8	84.2	93.3	105.3	568.1
Feedback Percent	76.0%	23.2%	23.8%	23.7%	27.0%	28.0%	31.2%	34.6%	37.0%	39.6%	43.0%	33.4%
Federal Spending					In Billions of Dollars							
Forecast	1,853.0	1,923.7	1,985.7	2,062.5	2,151.1	2,208.2	2,275.4	2,362.4	2,448.7	2,534.4	2,623.8	22,575.9
Baseline	1,853.0	1,923.0	1,983.0	2,055.0	2,137.0	2,185.0	2,242.0	2,319.0	2,397.0	2,475.0	2,557.0	22,273.0
Difference	0.0	0.7	2.7	7.5	14.1	23.2	33.4	43.4	51.7	59.4	66.8	302.9
Federal Surplus/Deficit					In Billions of Dollars							
Forecast	277.3	275.8	292.0	304.3	305.2	349.9	405.6	453.1	514.8	593.8	683.6	4,178.1
Baseline	282.0	313.0	359.8	397.6	432.5	503.5	573.8	635.9	709.8	795.8	889.8	5,611.5
Difference	-4.7	-37.2	-67.8	-93.3	-127.3	-153.6	-168.2	-182.8	-195.0	-202.0	-206.2	-1,433.4
Federal Off-Budget Surplus/Deficit					In Billions of Dollars							
Forecast	156.0	171.9	190.5	205.1	227.1	246.0	266.6	285.8	305.3	326.1	346.3	2,570.6
Baseline	156.0	171.0	188.0	201.0	221.0	238.0	257.0	275.0	293.0	312.0	330.0	2,486.0
Difference	0.0	0.9	2.5	4.1	6.1	8.0	9.6	10.8	12.3	14.1	16.3	84.6
Federal On-Budget Surplus/Deficit					In Billions of Dollars							
Forecast	121.3	103.9	101.5	99.2	78.1	103.9	139.0	167.3	209.5	267.7	337.3	1,607.5
Baseline	126.0	142.0	171.8	196.6	211.5	265.5	316.8	360.9	416.8	483.8	559.8	3,125.5
Difference	-4.7	-38.1	-70.3	-97.4	-133.4	-161.6	-177.8	-193.6	-207.3	-216.1	-222.5	-1,518.0
Medicare Part A Surplus					In Billions of Dollars							
Forecast	28.7	36.2	40.1	42.1	42.4	47.1	45.9	45.9	45.3	44.1	42.4	431.6
Baseline	28.7	35.9	39.3	40.6	40.0	43.7	41.5	40.7	39.3	37.2	34.4	392.6
Difference	0.0	0.3	0.8	1.5	2.4	3.4	4.4	5.2	6.0	6.9	8.0	39.0
On-Budget Surplus Without Medicare					In Billions of Dollars							
Forecast	92.5	67.7	61.5	57.1	35.7	56.8	93.1	121.4	164.1	223.6	294.9	1,175.9
Baseline	97.3	106.1	132.5	156.0	171.5	221.8	275.3	320.2	377.5	446.6	525.4	2,732.9
Difference	-4.8	-38.4	-71.0	-98.9	-135.8	-165.0	-182.2	-198.8	-213.4	-223.0	-230.5	-1,557.0

Note: All years are fiscal year end. Some numbers may not add due to rounding.
Source: Center for Data Analysis at The Heritage Foundation.

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How President Bush's Tax Plan Would Affect Selected Federal Budget Indicators
(Final Results)

More Federal Budget Indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002–2011 (Average)
						In Billions of Dollars						
Publicly Held Federal Debt												
Forecast	3,149.2	2,874.0	2,590.6	2,298.1	1,995.0	1,650.1	1,254.0	1,039.0	939.0	878.0	818.0	1,633.6
Baseline	3,148.0	2,848.0	2,509.0	2,131.0	1,714.0	1,251.0	1,128.0	1,039.0	939.0	878.0	818.0	1,525.5
Difference	1.2	26.0	81.6	167.1	281.0	399.1	126.0	0.0	0.0	0.0	0.0	108.1
						In Billions of Dollars						
Uncommitted Funds												
Forecast	0.0	0.0	0.0	0.0	0.0	0.0	0.0	232.7	645.6	1,174.2	1,794.1	384.7
Baseline	0.0	0.0	0.0	0.0	0.0	28.0	466.0	1,003.0	1,608.0	2,338.0	3,164.0	860.7
Difference	0.0	0.0	0.0	0.0	0.0	-28.0	-466.0	-770.3	-962.4	-1,163.8	-1,369.9	-476.0
						In Billions of Dollars						
Net Publicly Held Federal Debt												
Forecast	3,149.2	2,874.0	2,590.6	2,298.1	1,995.0	1,650.1	1,254.0	806.3	293.4	-296.2	-976.1	1,248.9
Baseline	3,148.0	2,848.0	2,509.0	2,131.0	1,714.0	1,223.0	662.0	36.0	-669.0	-1,460.0	-2,346.0	664.8
Difference	1.2	26.0	81.6	167.1	281.0	427.1	592.0	770.3	962.4	1,163.8	1,369.9	584.1
						Percent of GDP						
Net Publicly Held Federal Debt												
Forecast	30.5	26.4	22.5	18.9	15.6	12.2	8.8	5.4	1.9	-1.8	-5.6	10.4
Baseline	30.5	26.2	21.9	17.7	13.5	9.2	4.8	0.2	-4.4	-9.1	-13.8	6.6
Difference	0.0	0.2	0.6	1.2	2.1	3.0	4.0	5.2	6.3	7.3	8.2	3.8
						In Billions of Dollars						(Total)
Federal Net Interest Paid												
Forecast	205.1	180.2	167.2	151.2	131.4	112.9	90.7	64.7	34.1	-0.8	-39.1	892.5
Baseline	205.0	179.0	163.0	142.0	116.0	90.0	60.0	27.0	-10.0	-51.0	-95.0	621.0
Difference	0.1	1.2	4.2	9.2	15.4	22.9	30.7	37.7	44.1	50.2	55.9	271.5

Note: All years are fiscal year end. Some numbers may not add due to rounding.
Source: Center for Data Analysis at The Heritage Foundation.