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THE CANDIDATES' TAX PLANS: COMPARING THE ECONOMIC AND FISCAL EFFECTS OF THE BUSH AND KERRY TAX PROPOSALS

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Nearly every day, the two major presidential candidates speak about the economic good or ill that stems from the 2001 and 2003 tax cuts. Besides the war in Iraq, few matters so divide the candidates and their supporters as their view of the wisdom of enacting substantial tax cuts in 2001 and again two years later. Indeed, many pundits believe that the election may well turn on whether or not the electorate believes the President's core economic policy is working.

President George W. Bush argues that these two important changes in U.S. tax law turned the tide of recessionary forces, supported the U.S. economy during the dark days following September 11 and the corporate scandals, and now explain a large part of the country's current prosperity and rates of high employment.

Just as vigorously, Senator John F. Kerry (D-MA) condemns the tax cuts for being overly generous to high-income taxpayers, draining revenues from the federal government at a time of war and on the eve of the baby boom retirement, and producing record federal budget deficits. Senator Kerry particularly endorses this last claim, and he is especially galled by the evaporation of budget surpluses that President Bill Clinton handed to his successor.

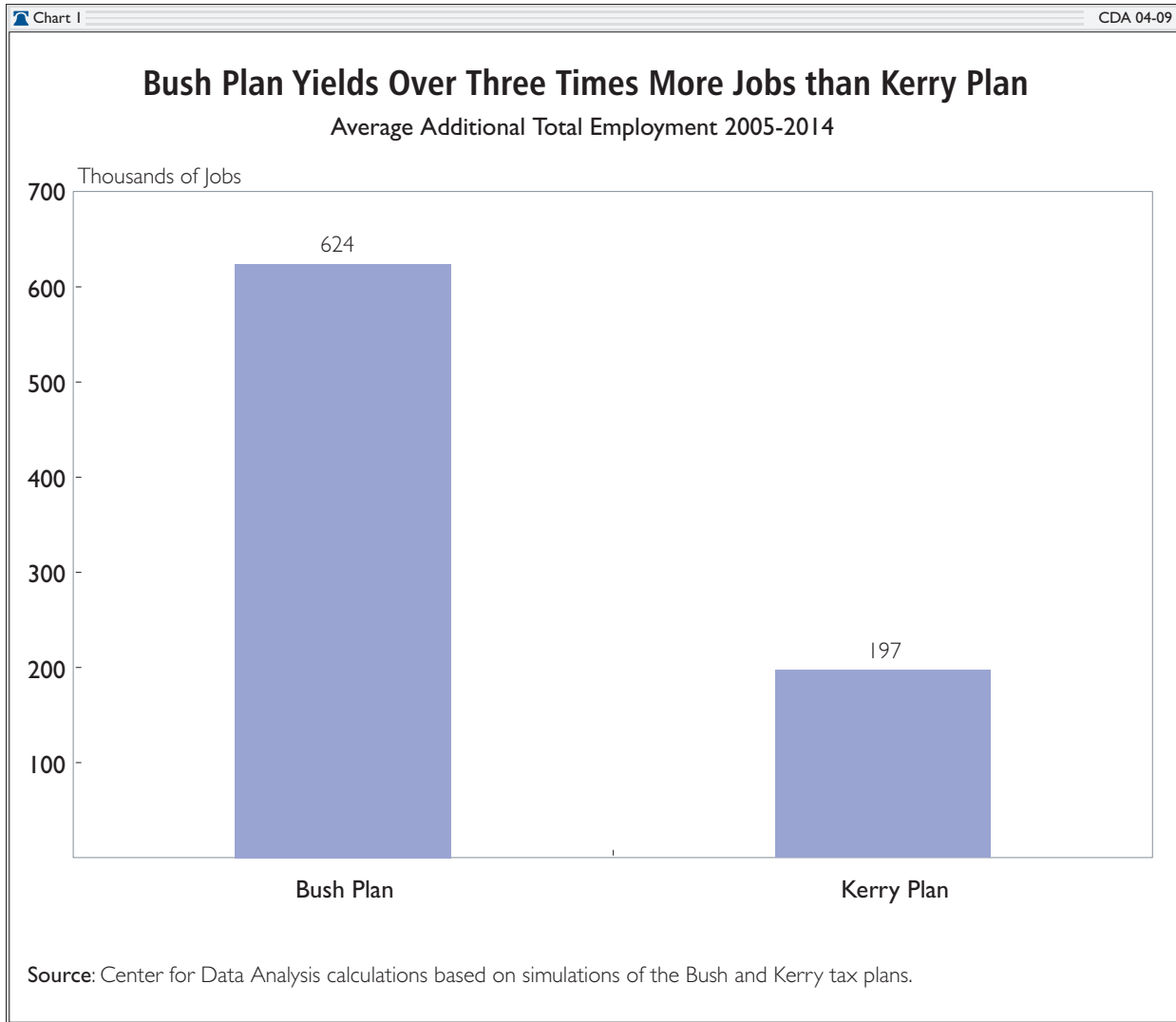
Both candidates have proposed additional changes in current tax law that reflect their views of how the 2001 and 2003 tax cuts affected the economy and federal finances. This

report joins the debate over current economic policy by estimating how each candidate's tax proposal would affect the economy and the government's finances. This report finds that:

- The Kerry tax plan slows economic activity until 2011, when it generally adopts the Bush approach of permanent tax cuts. Even so, the Bush plan consistently outperforms the Kerry plan.
- The two plans reflect sharply different approaches to tax policy: President Bush relies on supply-side tax changes while Senator Kerry focuses much of his attention on demand-side policy moves.
- Senator Kerry's greater reliance on targeted tax policy changes yields the unintended consequence of producing a tax cut for high-income taxpayers after 2011.

The candidates' tax plans join slightly over 30 related pieces of legislation in the U.S. Congress that currently await legislative action. These proposals range across the entire spectrum of initiatives, from making certain elements of the 2001 and 2003 tax cuts permanent to repealing them for specified classes of taxpayers to proposals for adding tax credits and closing tax loopholes.

The welter of claims and counterclaims about the Bush tax cuts and the candidates' new tax proposals present real problems for voters and taxpayers. Without a common met-



ric against which to measure the effects of both proposals, voters and taxpayers may never obtain a good idea about which one is better for the economy and the federal government’s financial future.

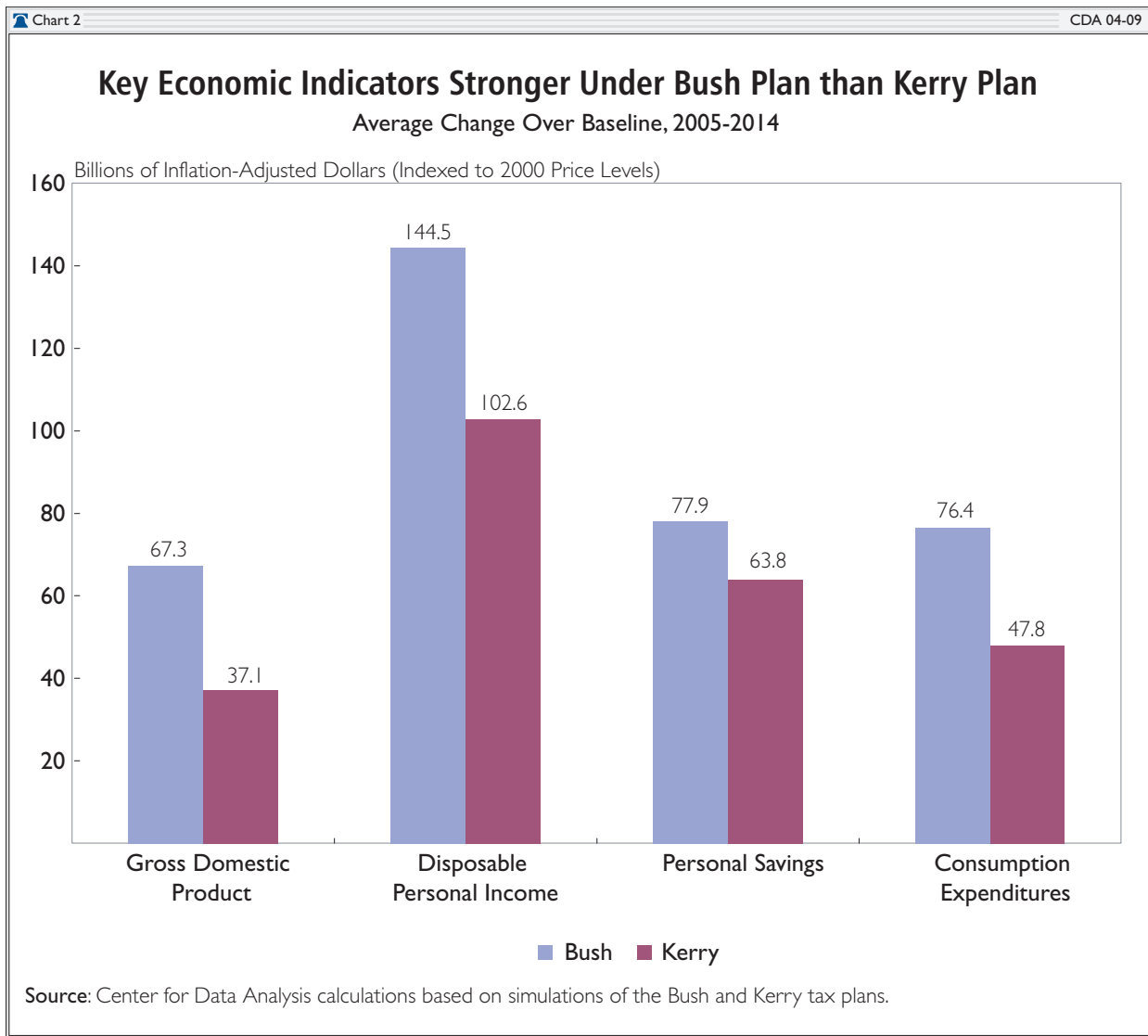
BASIC FINDINGS

This report employs just such a common measuring tool to assess the economic and fiscal prospects of the two plans. Center for Data Analysis (CDA) analysts used CDA tax models and tax information from other sources as inputs to Global

Insight’s U.S. Macroeconomic Model, one of the most widely respected forecasting models.¹ Comparison of the likely economic and fiscal effects of these two competing plans is greatly facilitated by using the same economic model to evaluate both approaches. Among this report’s findings are:

- **Stronger job growth under the Bush plan.** The Bush tax plan leads to significantly stronger employment growth between 2005 and 2014 than is likely under the Kerry plan. In 2009 (or halfway through the 10-year period),

1. Analysts in the Center for Data Analysis used a version of the Global Insight baseline forecast and U.S. Macroeconomic Model to simulate the economic effects of adopting Bush or Kerry tax proposals. This version of the baseline forecast is based on the economic and fiscal assumptions of the Congressional Budget Office’s January 2004 *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*. The methodologies, assumptions, conclusions, and opinions in this *CDA Report* are entirely the work of CDA analysts. They have not been endorsed by and do not necessarily reflect the views of the owners of the Global Insight model. The model is used by leading government agencies and *Fortune* 500 companies to provide indications to decision makers of the probable effects of economic events and public policy changes on hundreds of major economic indicators.



the U.S. economy under the Bush tax plan would likely enjoy 288,000 more jobs than under the current-law baseline. The Kerry tax plan would cause total employment to fall by 202,000. By 2014, total employment under the Bush plan is projected to be 995,000 higher than it would be without the plan, while the Kerry plan is estimated to bring about an employment gain of 658,000 after he generally adopts the Bush policy of making the tax cuts permanent. Both plans would affect the economy most in the last four years of the forecast period, or 2011 through 2014. This is the period when, under current law, all of the 2001 and 2003 tax law changes disappear.

- **Stronger economic growth under the Bush tax proposal.** The Bush tax plan would lead to consistently stronger economic activity

between 2005 and 2014 than would be likely under the Kerry plan. In 2009, the gross domestic product (GDP) is \$39.3 billion higher with the Bush tax plan than it would be without it. In 2009, GDP under the Kerry plan is \$2.4 billion higher than the baseline. By 2014, GDP is \$105.4 billion higher under the Bush plan and \$82.7 billion higher under the Kerry proposal.

- **More spending money after taxes under the Bush plan.** Under the Bush plan, the model shows that disposable income for a family of four is \$872 higher than the baseline in 2009 and \$3,904 higher in 2014. Under the Kerry tax proposals, disposable income for four persons would be \$340 higher than the baseline in 2009 and \$3,448 higher than the baseline in 2014.

A Reader's Guide

This report frequently refers to the “baseline” when describing the effects of each candidate’s tax plan on the economy and federal finances. What exactly does this term mean?

The baseline is a view of the future economy (including federal finances) if no additional tax policy or spending changes are enacted. In other words, the baseline is a forecast of future economic activity under currently enacted law. For example, future economic activity reflects the fact that the entire 2003 tax package expires at the end of 2008 and the 2001 law expires at the end of 2010, thus raising taxes in subsequent years and changing economic activity.

Table 5 and Table 6 in Appendix 2 show a set of forecasts for most of the leading economic

and fiscal indicators. In each case, the effects (or forecasts) of the Bush and Kerry tax plans are compared to the baseline and a difference is shown between that baseline and how the candidate’s tax proposal would affect the economy.

However, this report examines only the candidates’ tax proposals, not their spending plans. Campaigns offer candidates ample opportunities for presenting their tax and spending ideas but very little time for working through the specifics of their proposals. Spending plans are particularly subject to this time constraint.

Details are important to estimating the economic effects of policy change. Campaign tax proposals usually lend themselves to such an analysis, but spending plans rarely do.¹

1. The tax plans described here do not include all of the tax-related proposals made by the candidates. For example, the Kerry proposals to close unspecified tax shelters and loopholes have not been included because they lack the level of detail needed to analyze them at this time. In addition, the analysis omits some of the Bush tax proposals submitted with the President’s 2005 budget because they involve new initiatives rather than the stated primary policy of making the 2001 and 2003 tax cuts permanent.

THE BUSH TAX PLAN

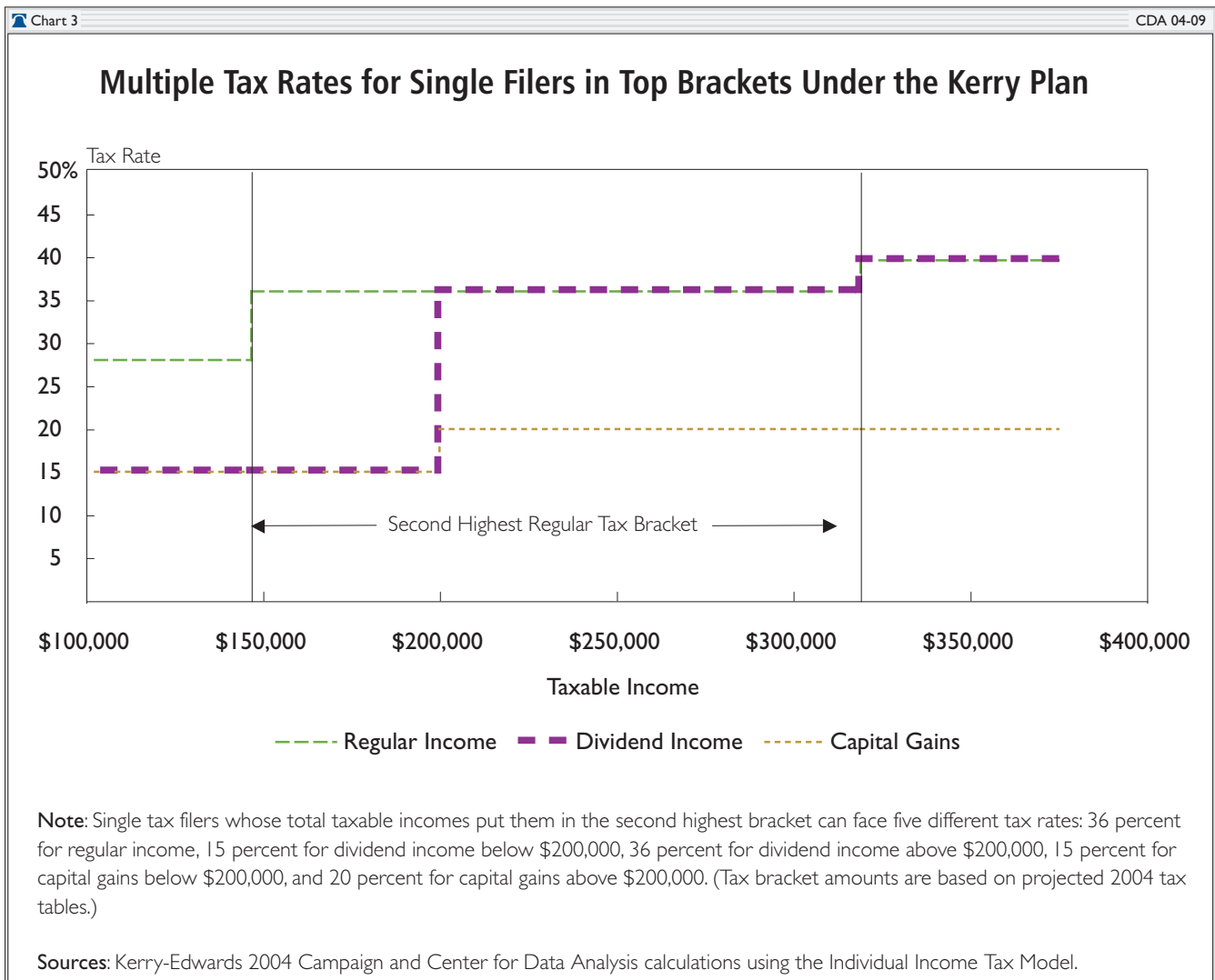
In 2001 and 2003, President Bush signed into law two tax cuts that saved taxpayers billions of dollars: the 2001 Economic Growth and Tax Reduction Reconciliation Act (EGTRRA) and the 2003 Jobs and Growth Tax Reduction and Reconciliation Act (JGTRRA). Due to the political complexities of the budget process, these tax cuts expire between now and 2014. Instead of letting these tax policy changes expire, President Bush proposes that they be made permanent.²

Individual Income Tax. President Bush proposes making many of the individual income tax components from the EGTRRA permanent,³ including:

- The doubled child tax credit (\$1,000 per child);
- The expanded dependent care credit (\$3,000 per dependent, up to \$6,000);
- Marriage penalty relief;
- The earned income credit expansion for married joint filers;
- The 10 percent tax bracket (the lowest tax bracket); and
- The reduction in the marginal tax rates from 39.6 percent to 35 percent, 36 percent to 33 percent, 31 percent to 28 percent, and 28 percent to 25 percent.

Key elements of JGTRRA would also be made permanent. The taxation on dividends and capital

2. This report focuses on the tax proposals identified in “Making Permanent the Tax Cuts Enacted in 2001 and 2003” in Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2005: Analytical Perspectives* (Washington, D.C.: U.S. Government Printing Office, 2004), p. 265, at www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf (September 10, 2004). The CDA analysis does not include proposals involving expensing for small businesses, education incentives, and modifications of pension plans. It does include some provisions that are assumed to be part of the category “Other incentives for families and children.”
3. CDA analysts assumed that the Bush proposal would not extend the elimination of phaseouts for itemized deductions and exemptions, but would instead allow them to sunset in 2011.



gains would continue to decline to 0 percent for filers below the 25 percent bracket. Taxpayers in higher rate brackets would pay lower taxes on dividends and capital gains. The tax rate on capital gains for these taxpayers declined from 20 percent to 15 percent under JGTRRA, which also changed the treatment of dividend income. Dividends are no longer considered ordinary taxable income, but instead receive the same treatment and taxation as long-term capital gains.

An important element of the Bush plan is its treatment of high-income taxpayers. Unlike Senator Kerry, the President does not use income as a test of whether or not a taxpayer is eligible for the 2001 and 2003 tax cuts. Thus, taxpayers with income in the top two income tax brackets are treated the same as taxpayers with incomes below that amount when the 2001 and 2003 tax cuts are made permanent.

Estate Tax. President Bush also differs from Senator Kerry on “death taxes.” The Bush plan calls for the permanent repeal of the estate and generation-skipping taxes in 2011, when these taxes are otherwise scheduled to return to their 2001 levels. Between now and 2011, the President continues current law, which calls for a steady drop in the tax rate culminating in a one-year repeal of estate and generation-skipping taxes in 2010.

THE KERRY TAX PLAN FOR INDIVIDUAL INCOME TAXES

Some Expiring Provisions from 2001 and 2003 Made Permanent. Senator Kerry retains several provisions of the 2001 and 2003 tax bills:

- Marriage penalty relief;
- The doubled child tax credit (\$1,000);
- The earned income credit expansion for married couples;

Multiple Tax Rates for Married Joint Filers in Top Brackets Under the Kerry Plan



Note: Married joint tax filers whose total taxable income puts them in the second highest bracket can face five different tax rates: 36 percent for regular income, 15 percent for dividend income below \$200,000, 36 percent for dividend income above \$200,000, 15 percent for capital gains below \$200,000, and 20 percent for capital gains above \$200,000. (Tax bracket amounts are based on projected 2004 tax tables.)

Sources: Kerry-Edwards 2004 and Center for Data Analysis calculations using the Individual Income Tax Model.

- The 10 percent tax bracket;
- Reductions in all regular income tax rates except the top two; and
- The tax cuts on dividends and capital gains for taxpayers with incomes below \$200,000.

Increased Taxes on High-Income Taxpayers.

Senator Kerry has described his plan as “rolling back” the tax cuts for filers with over \$200,000 in income. While there is some uncertainty about the details of his plan, Kerry campaign materials indicate that the tax rates in the top two brackets would increase to their pre-EGTRRA levels.⁴ Tax rates on capital gains and dividends would also increase, but the higher rates appear to begin

when taxable income exceeds \$200,000. When total taxable income is less than \$200,000, capital gains and dividends would be taxed at the current rates. Only the portion of capital gains and dividend income that exceeds \$200,000 would be taxed at pre-EGTRRA rates.

Because the second highest bracket is below \$200,000, the Kerry plan appears to add a special tax bracket for dividends and capital gains. All regular income in the second highest bracket would be taxed at 36 percent. The portion of capital gains income that, when added to regular income, is at or below \$200,000 would be taxed at 15 percent. However, the remaining amount of capital gains in this bracket would be taxed at 20 percent. A simi-

4. “Restore the top two tax brackets to their levels under President Clinton.... Restore the capital gains and dividend rates for families making over \$200,000 on income earned above \$200,000 to their levels under President Clinton.” Kerry-Edwards 2004, “A Plan to Restore Fiscal Responsibility,” at www.johnkerry.com/issues/economy/fiscal_responsibility.html (September 8, 2004).

A High-Income Taxpayer Under the Kerry Tax Plan

Using the projected 2004 tax tables, a single filer with total taxable income of \$210,000, no capital gains, and \$20,000 of dividends would be in the second to the highest tax bracket. Under the Kerry tax plan, this taxpayer would benefit from tax rate reductions for the portion of income that is below the second highest bracket (\$146,750). The amount of regular taxable income in the second-to-highest bracket (\$43,250) would be taxed at 36 percent.

Because regular taxable income equals \$190,000, the taxpayer's dividend income would be taxed at two different rates. A rate of 15 percent would be applied to the first \$10,000 of qualified dividend income while the remaining \$10,000 would be taxed at the regular rate of 36 percent. Chart 3 and Chart 4 show the various tax rates under the Kerry plan for married joint and single tax filers with incomes in the second highest tax bracket.

lar split occurs for dividend income. The portion of dividend income that, when added to other taxable income, is less than or equal to \$200,000 would be taxed at 15 percent. The remaining amount of dividend income in the bracket would be taxed at 36 percent.⁵

The Kerry plan would tax all regular income in the top tax bracket at 39.6 percent. All dividend income in this bracket would also be taxed at 39.6 percent. The top rate on capital gains income would be 20 percent.

The Kerry campaign anticipates that tax increases in the top two brackets would raise substantial revenue that would pay for other tax cuts and new spending programs. However, compared to the current-law baseline, the Kerry plan would actually reduce receipts after tax year 2010 because the current-law baseline already takes into account the increase in top rates beginning in 2011. After 2010, there is a net reduction in tax liability for taxpayers in the top two brackets. Revenue in these years would be less than currently

projected because taxpayers in the top two brackets benefit from rate reductions in the other tax brackets.

Child and Dependent Care Tax Credit. The Kerry plan would increase the maximum qualified expenses by \$2,000 per child to \$5,000 for one dependent and \$10,000 for two or more.⁶ This change would increase the minimum credit by \$400 for one dependent and \$800 for two or more. In addition, the plan allows some taxpayers to take a credit in excess of their tax and thereby receive a refund.⁷

Higher Education Tax Credit. Senator Kerry has proposed a College Opportunity Tax Credit, a new higher education tax credit that is an expanded version of the existing HOPE tax credit. Currently, the HOPE Credit allows taxpayers to take a nonrefundable tax credit equal to 100 percent of the first \$1,000 of qualified education expenses plus 50 percent of the next \$1,000. This tax benefit permits single filers with incomes below \$41,000 and married filers with incomes

5. It is not clear how the Kerry plan would deal with taxpayers in this bracket who have both capital gains and dividend income. CDA analysts assumed that dividend income would be added to taxable income first, followed by capital gains. This approach allows taxpayers to maximize the advantage of the lower tax rate on dividend income and thereby minimize their overall tax liability.
6. Current law allows working taxpayers to claim a credit for expenses related to the care of children under age 13 and certain other dependents. The credit is calculated by multiplying qualified net expenses (up to \$3,000 for one dependent and \$6,000 for two or more) by a percentage based on the taxpayer's AGI. Taxpayers with an AGI of \$15,000 or less use a 35 percent rate. If they have the \$3,000 of qualified expenses per dependent, they can take the maximum credit of \$1,050 for one or \$2,100 for two or more dependents. Taxpayers with an AGI of \$43,000 or more use a rate of 20 percent and, if they have \$3,000 of qualified expenses per dependent, are eligible for the minimum credit of \$600 for one child and \$1,200 for two or more.
7. Details regarding important aspects of the child and dependent proposal were not available to CDA analysts and have not been included in the economic simulation. In particular, proposals to make the credit partially refundable and to extend the credit to stay-at-home parents with infants were not included.

Comparison of Rate Changes for Taxpayers with Incomes over \$200,000

The conventional revenue estimates in Table 1 and Table 2 include a sub-category detailing the effect that capital gains, dividend, and ordinary tax rate changes have on taxpayers with adjusted gross income (AGI) over \$200,000. The data highlight an important difference in the candidates' plans. The supply-side portion of the Bush plan reduces collections from taxpayers in this class by \$280.4 billion over a 10-year period by extending marginal tax rate reductions. In contrast, the Kerry plan increases taxes for these taxpayers by a total of \$208.3 billion over the six-year period 2005 to 2010. The table also shows how proposed changes in the current-law baseline and the complexity of the tax code can produce unanticipated results.

For example, the Kerry plan increases taxes for those with an AGI over \$200,000 from

2005 through 2010. However, all taxpayers pay the same rate on the amount of taxable income they have in the first tax bracket. As more taxable income is added, taxpayers move into higher tax brackets, and their marginal tax rates rise. Increasing the tax rates in the top two brackets changes the overall tax for higher-income earners, but only for the income that is taxed in these brackets. In 2001, for example, only 31 percent of regular taxable income for taxpayers in the AGI class of \$200,000 to \$500,000 was taxed in the top two brackets. For taxpayers in this AGI class, over 60 percent of the regular tax liability was generated at rates below the top two.¹

As a result, tax plans such as the Kerry plan will reduce the amount of taxes collected from income in the lower brackets, even for those

1. This calculation includes income taxed at ordinary rates only. It does not include income taxed at capital gains rates, kiddie tax rates and alternative minimum tax rates. See Internal Revenue Service, Statistics of Income, 2001 Individual Income Tax Returns, Table 3.5—Returns with Modified Taxable Income: Tax Generated by Rate and by Size of Adjusted Gross Income at <http://www.irs.gov/pub/irs-soi/01in35mt.xls>.

below \$83,000 in 2003 to claim a maximum credit of \$1,500 for each student who had \$2,000 of qualified expenses.⁸

In addition to increasing the maximum credit by \$1,000 to \$2,500, the Kerry education tax credit could be claimed for up to four years of undergraduate study rather than the existing two years. The

proposed credit is “refundable,” which would allow taxpayers to receive a benefit even if they do not owe federal income tax. Based on available information about the plan, it appears that the existing income phaseouts would also apply to the new credit, as would the possibility of a reduction due to the alternative minimum tax (AMT).⁹

8. Qualified expenses are primarily tuition payments but may include other costs if the academic institution requires that they be paid. Room and board and other personal living expenses do not qualify. The HOPE Credit is not refundable and can be reduced if the taxpayer is subject to the alternative minimum tax. Because the value of the credit phases out, it cannot be claimed by single taxpayers with incomes over \$83,000 or married taxpayers with incomes over \$103,000. In addition, the current Hope Credit is available only for students who are enrolled at least half-time in a degree program and who have not yet completed the first two years of post-secondary education.
9. Some taxpayers who would otherwise claim the Lifetime Learning Credit could claim the new education credit. The Lifetime Learning Credit is available for an unlimited number of years and can be claimed by students who have passed their second year of undergraduate work or are not pursuing a degree. However, the credit is limited to \$2,000 per tax return and applies to 20 percent of the first \$10,000 of qualified education expenses. As with the HOPE Credit, the Lifetime Learning Credit is subject to a phaseout, is not refundable, and can be reduced by the AMT. In addition, it is limited by the interaction between the HOPE and Lifetime Learning Credits and other provisions of the tax code such as the Coverdell Education Savings Accounts and qualified tuition plans. Although the Kerry proposal would likely replace the existing HOPE Credit, the Lifetime Learning Credit would continue to be claimed by students who are beyond their fourth year of undergraduate education, in graduate school, or otherwise not eligible for the existing HOPE Credit.

with an AGI over \$200,000. At the same time, higher marginal tax rates for many of these taxpayers will raise the cost of earning additional income and engaging in new business activities.

The reduction in tax for those with incomes above \$200,000 can be seen most clearly in the revenue estimates beginning in 2011. Since the current-law baseline includes the sunset provisions of EGTRRA and JGTRRA, and because the Kerry plan restores the top tax rates to pre-EGTRRA levels, no additional revenue is generated in the top two tax brackets. However, taxpayers in these brackets do benefit from tax reductions for the part of their taxable income that is generated at the lower marginal rates. The effect of the lower tax rates, even for those with an AGI over \$200,000, can be seen in Table 2. After 2010, the rate reductions in the Kerry tax plan would reduce collections for this group by over \$30 billion.

The Kerry plan has a slightly different effect on dividends and capital gains because income from these sources is added to regular taxable income to determine the applicable tax rates. In addition, the tax rates under current law and

rates under the Kerry plan move closer to one another due to the expiration of JGTRRA at the end of 2008 and EGTRRA at the end of 2010. In other words, for high-income taxpayers, the difference between current law and Kerry tax rates for dividends and capital gains narrows beginning in 2009, as shown in Table 2.

The effect can be seen in the larger tax increase for those with an AGI over \$200,000 in 2008 as compared to 2009. Beginning in 2011, for those with regular taxable income over \$200,000, there is no difference between the Kerry plan and current-law tax rates on dividend and capital gains income, so no additional revenue is collected from these taxpayers. However, some taxpayers with an AGI above \$200,000 can still benefit from the lower tax rates on capital gains and dividends in the Kerry plan. The benefit occurs in part because tax deductions and exemptions may put the taxable income for these taxpayers below the threshold for the second highest tax bracket. Also, some of the capital gains and dividend income in the second highest regular tax bracket continues to qualify for the lower tax rates.

Health Tax Credits.¹⁰ The Kerry tax plan offers an incentive for small businesses to purchase health insurance through pools that offer health plans, similar to the Federal Employees Health Benefits Program (FEHBP). Health insurance premiums would be paid by the workers and their employers. The plan uses tax credits to reduce the costs to employers.

Employers who participate in the FEHBP-like pools and fund 50 percent or more of the cost of premiums would receive a 25 percent refundable tax credit. Businesses could also treat the premium as a deductible expense. The net cost to an average

employer has been estimated at 25 percent of the overall premium.¹¹ However, the proportion of the credit that could actually be used depends on the employee's income. Employers can claim the full credit for premiums for single workers whose income is 150 percent of poverty or less. The value of the credit declines as the employee's income increases, until it reaches zero for single employees whose income is 300 percent of poverty (\$28,179 in 2003).¹²

Newly covered employees could pay their premium through a deduction in their wages. Workers

10. The description of the Kerry health care tax credit plan is based on CDAs' interpretation of information in Kenneth E. Thorpe, "Estimated Federal Costs and Newly Insured Under Senator Kerry's Health Insurance Plan," May 16, 2003, and Kenneth E. Thorpe, "Federal Costs and Savings Associated with Senator Kerry's Health Care Plan," April 2, 2004. These papers provide both a broad overview and selected details about the plan. CDA has attempted to provide an accurate summary of the health care tax proposals based on the available information. However, because of differences in interpretation and the possibility of future modifications to the plan, the summary may not reflect the current version of this proposal.

11. Thorpe, "Estimated Federal Costs and Newly Insured Under Senator Kerry's Health Insurance Plan."

12. This is a weighted average for 2003. The poverty threshold for one person is \$9,393. See U.S. Bureau of the Census, "Poverty Thresholds 2003," revised August 26, 2004, at www.census.gov/hhes/poverty/threshld/thresh03.html (September 8, 2004).

might also see a slower increase in their wages as employers offset the premium payments and increased administrative costs. Alternatively, business owners could pay for the new premiums by hiring fewer workers, reducing their profits, or passing the costs on to consumers through higher prices on goods and services.

The plan also allows employers who are already offering health insurance to shift coverage to the FEHBP-like pools. The new tax credits would tend to reduce existing health care expenses for these employers. However, the plan would also increase costs for these business owners by imposing an application fee equal to 10 percent of the premiums.

Workers who are eligible for unemployment insurance benefits would be allowed to purchase an employer-provided FEHBP-like plan; alternatively, they could purchase it on their own if none is provided by their former employer. The plan would also provide tax benefits to workers aged 55 to 65 who purchase a health policy, are not covered by Medicaid, and do not have access to employer-provided insurance. All others who are uninsured could purchase an FEHBP-like health policy and claim a tax credit that would cap their payments at an amount that varies between 6 percent and 12 percent of their income. The cap is phased out for incomes greater than or equal to 300 percent of the poverty level.

Death Tax. The Kerry plan would not repeal the death tax, but it would raise the unified exemption level to \$2 million (or \$4 million per couple) by 2005 and thereafter. However, Senator Kerry does not lower the top rate from the current rate of 48 percent. This is a higher exemption level than was passed under EGTRRA for the year 2005, the same as for the years 2006–2008, and lower than for the year 2009. The Kerry plan, however, would make exceptions: The plan raises the exemption to \$10 million per couple for returns containing a family-owned business or farm.

KERRY PLAN FOR BUSINESS TAXES

Reducing the Corporate Tax Rate. The Kerry plan would reduce the corporate income tax by 5 percent, dropping the marginal rate from 35 percent to 33.25 percent.

Tax Repatriation Holiday. Senator Kerry plans a one-time tax break for companies that repatriate foreign income. Instead of paying the full tax on these profits, companies would pay a special 10 percent tax on profits that they bring back to the United States. The lower tax rate would apply only to repatriations that exceed a base amount that represents the normal amount of income that would have been repatriated without this tax change. The base amount would be determined by averaging the amounts that were repatriated in prior years. In addition, CDA analysts assumed that corporations would be permitted to reduce their U.S. tax liability by using a modified version of the foreign tax credit.

Partial Repeal of Tax Deferral on Overseas Income. The Kerry plan would also reduce the tax deferral of corporate income earned overseas. The objective is to tax profits from foreign subsidiaries in the same way that domestic profits are taxed even though domestic profits have not been subject to tax by foreign governments, which is the case with foreign-source income. The repeal is partial because the plan includes exemptions for some multinational companies that sell their products abroad. The tax plan allows these companies to defer income if they sell a product in the country in which it is produced. An estimated two-thirds of foreign income would qualify for deferral under the Kerry plan.¹³

Targeted New Jobs Tax Credit. The Kerry tax plan includes a tax credit that would offset the employer's portion of the payroll taxes for new employees in certain business sectors. Small businesses, manufacturers, and businesses in outsourcing-related industries would receive a credit toward the amount of payroll taxes that they pay if their payroll taxes increase due to more employees. This credit is designed to boost hiring and employment in these sectors and would expire after two years.

CONVENTIONAL ANALYSIS OF THE CANDIDATES' TAX PLANS¹⁴

Revenue Effects Before Accounting for the Economy. Using conventional estimating methods, the Bush plan is estimated to reduce revenue by \$1.1 trillion over a 10-year period from fiscal

13. Martin Sullivan, "Good Politics, Yes, But Can Kerry's Plan Create Jobs?" *Tax Notes*, April 5, 2004, at [www.taxanalysts.com/www/freefiles.nsf/Files/Sullivan.pdf/\\$file/Sullivan.pdf](http://www.taxanalysts.com/www/freefiles.nsf/Files/Sullivan.pdf/$file/Sullivan.pdf) (September 8, 2004).

Conventional Scoring of the Bush Tax Plan

Provisions	Fiscal Years (Billions of Dollars)											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005–2009	2005–2014
Supply Side												
Capital Gains, Dividend, and Ordinary Income Tax Rates and Estate and Corporate Tax												
Personal Income Tax ¹	0.0	0.0	0.0	0.0	-27.7	-34.1	-84.6	-105.9	-111.5	-117.0	-27.7	-480.9
Corporate Income Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Estate Tax ²	-0.9	-1.1	-1.5	-1.9	-1.7	-2.4	-29.0	-51.0	-55.3	-60.8	-7.1	-205.6
Total Supply Side	-0.9	-1.1	-1.5	-1.9	-29.4	-36.5	-113.6	-156.9	-166.8	-177.8	-34.8	-686.4
<i>Effect of personal tax rate changes on taxpayers with an AGI over \$200,000</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>-11.7</i>	<i>-16.4</i>	<i>-49.7</i>	<i>-63.5</i>	<i>-67.6</i>	<i>-71.5</i>	<i>-11.7</i>	<i>-280.4</i>
Demand Side												
All non-rate changes plus extension of 10% bracket												
Personal Income Tax ³	-37.9	-30.1	-22.2	-18.2	-12.5	-4.2	-65.1	-86.0	-85.8	-85.7	-120.9	-447.7
Corporate Income Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Demand Side	-37.9	-30.1	-22.2	-18.2	-12.5	-4.2	-65.1	-86.0	-85.8	-85.7	-120.9	-447.7
Total Fiscal Year Amounts	-38.8	-31.2	-23.7	-20.1	-41.9	-40.7	-178.7	-242.9	-252.6	-263.5	-155.7	-1,134.1

¹ Extension of EGTRRA marginal rates and JGTRRA capital gains taxation and dividend tax rates for all taxpayers. Does not include extension of 10 percent tax bracket.

² Extension past 2010 of currently scheduled repeal of federal estate tax.

³ Extension of EGTRRA non-rate changes and EGTRRA 10 percent tax bracket.

Sources: Office of Management and Budget, *Fiscal Year 2005 Budget* and Center for Data Analysis calculations using the Individual Income Tax Model. See Appendix I for more details.

year (FY) 2005 to FY 2014. (See Table 1.) About 60 percent of this reduction comes from tax reductions associated with supply-side economic incentives. These incentive effects result from changes in the marginal tax rates on ordinary income and capital income.

In contrast to the Bush tax plan, the revenue effects of the Kerry proposal are smaller and a greater proportion is associated with demand-side economic effects. Based on conventional estimating techniques, the Kerry tax plan would reduce revenues by an estimated \$686 billion over 10 years. (See Table 2.) Of this amount, over 75 percent is attributable to demand-side tax reductions.

DYNAMIC ANALYSIS OF THE CANDIDATES' TAX PLANS¹⁵

Table 5 and Table 6 (Appendix 2) contain year-by-year (in fiscal years) results for key economic indicators from the CDA's dynamic analysis of the Bush and Kerry tax plans. All figures reported here are adjusted for inflation and referenced relative to projected U.S. economic performance under current law (the baseline).

The Bush Tax Plan. The CDA analysis found that the Bush tax plan would:

- **Expand output.** GDP averages \$38.0 billion higher than the baseline during the first six years (through 2010) and an average of \$111.3

14. Some analysts would call this type of revenue estimating or modeling "static." A model produces static revenue results if it does not consider how economic activity would affect the revenue estimate. For example, if taxes are cut, many analysts argue that economic activity is likely to expand. Such an expansion might increase the pool of wages and business income from which taxes are drawn. A static model would not include this growth in the tax base in its estimates of revenue change. Conventional revenue estimates recognize that certain types of tax policy change will affect taxpayer behavior, such as tax minimization. Thus, conventional models are somewhere in between purely static models and fully dynamic models of tax revenues.
15. Dynamic analysis assumes that most tax and spending changes affect the general or macro economy. Thus, dynamic models, such as the one employed in this report, explicitly connect changes in public policy (e.g., taxes and spending) with changes in the pool of income from which taxes are drawn.

Table 2

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Conventional Scoring of the Kerry Tax Plan

Provisions	Fiscal Years (Billions of Dollars)											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005–2009	2005–2014
Supply Side												
Capital Gains, Dividend, and Ordinary Income, Corporate and Estate Tax Rates												
Personal Income Tax ¹	29.4	39.4	40.7	41.5	18.9	10.5	-35.7	-52.7	-55.1	-57.3	169.9	-20.4
Corporate Income Tax and Small Business ²	-5.7	-13.3	-14.8	-15.1	-15.2	-15.4	-15.9	-16.4	-16.7	-17.5	-64.1	-146.0
Estate Tax ³	0.5	1.0	1.5	2.0	1.5	8.0	5.0	-5.0	-5.8	-6.0	6.5	2.7
Total Supply Side	24.2	27.2	27.4	28.4	5.2	3.1	-46.6	-74.1	-77.6	-80.8	112.4	-163.7
<i>Effect of personal tax rate changes on taxpayers with an AGI over \$200,000</i>	<i>29.4</i>	<i>39.4</i>	<i>40.6</i>	<i>41.5</i>	<i>30.6</i>	<i>26.7</i>	<i>-0.8</i>	<i>-10.5</i>	<i>-11.1</i>	<i>-11.6</i>	<i>181.6</i>	<i>174.3</i>
Demand Side												
All non-rate changes plus extension of 10% bracket												
Personal Income Tax ⁴	-19.8	-34.7	-38.2	-32.3	-29.1	-19.5	-92.6	-119.3	-121.5	-123.7	-154.1	-630.7
Corporate Income Tax and Small Business ⁵	3.0	4.9	9.2	10.9	11.3	12.0	12.8	13.7	14.7	16.0	39.3	108.5
Total Demand Side	-16.8	-29.8	-29.0	-21.4	-17.8	-7.5	-79.8	-105.6	-106.8	-107.7	-114.8	-522.2
Total Fiscal Year Amounts	7.4	-2.6	-1.6	7.0	-12.6	-4.4	-126.4	-179.7	-184.4	-188.5	-2.4	-685.9

¹ Extension of EGTRRA marginal rates and JGTRRA capital gains taxation and dividend tax rates for taxpayers with an AGI under \$200,000. Does not include extension of 10 percent tax bracket.

² Reduction of top corporate income tax rate from 35 percent to 33.25 percent and tax repatriation holiday.

³ Top estate tax rate set at 48 percent, estate tax exemption increased to \$2 million per individual, and expansion of the family-owned business and the family farm exemption.

⁴ Health insurance credits, higher education credits, extension of EGTRRA non-rate changes to personal income tax, and extension of EGTRRA 10 percent tax bracket.

⁵ Partial ending of deferral and jobs credit plan.

Sources: Kerry-Edwards 2004 and Center for Data Analysis calculations using the Individual Income Tax Model. See Appendix 1 for more details.

billion per year thereafter. The early stimulus to GDP comes from accelerating demand-side provisions such as the \$1,000 child credit, which operates mainly by boosting total consumption in the model. By 2011, the full effects of the Bush supply-side policy changes are evident: The GDP growth rate increases by nearly half of a percentage point in 2011 alone, principally as a result of retaining the improved incentives to work, save, and invest that were enacted in 2001 and 2003 but are scheduled to expire at the end of 2010.

- **Increase employment.** The employment level is higher than the baseline by 155,000 jobs in 2005, then 430,000 in 2006. The peak job increase over the baseline is 1.34 million additional jobs in 2012. The Bush plan, with its heavy emphasis on expanding the supply of labor and capital, raises the employment level by an average of 624,000 jobs per year during 2005–2014. Over the same time period, the average unemployment rate would be reduced by only 0.2 percentage points, mainly because lower tax rates cause labor force participation to rise almost as fast as employment.

- **Increase disposable personal income.** If the Bush tax plan is enacted, aggregate personal income is projected to average \$58.0 billion above the baseline during the 2005–2010 period and \$274.2 billion per year thereafter. After-tax income for a family of four would average \$1,848 per year higher than the baseline according to the model.

The real key to the Bush plan is the reduction of tax burdens on capital, which should enhance total investment in new equipment. The Bush plan accomplishes this reduction by making permanent the tax cuts on capital (estate tax repeal, the lower tax on dividend income, and lower marginal tax rates generally) that are currently scheduled to expire.

If Congress permits these tax cuts to expire, per capita capital costs can be expected to rise, thus reversing the positive economic effects of their recent decline. The experience of the most recent quarters following JGTRRA shows that investment is expanding by over twice the historical average following the 2003 dividend and capital gain tax reductions.¹⁶

Reductions in per capita labor costs are nearly as important to the economic results shown on

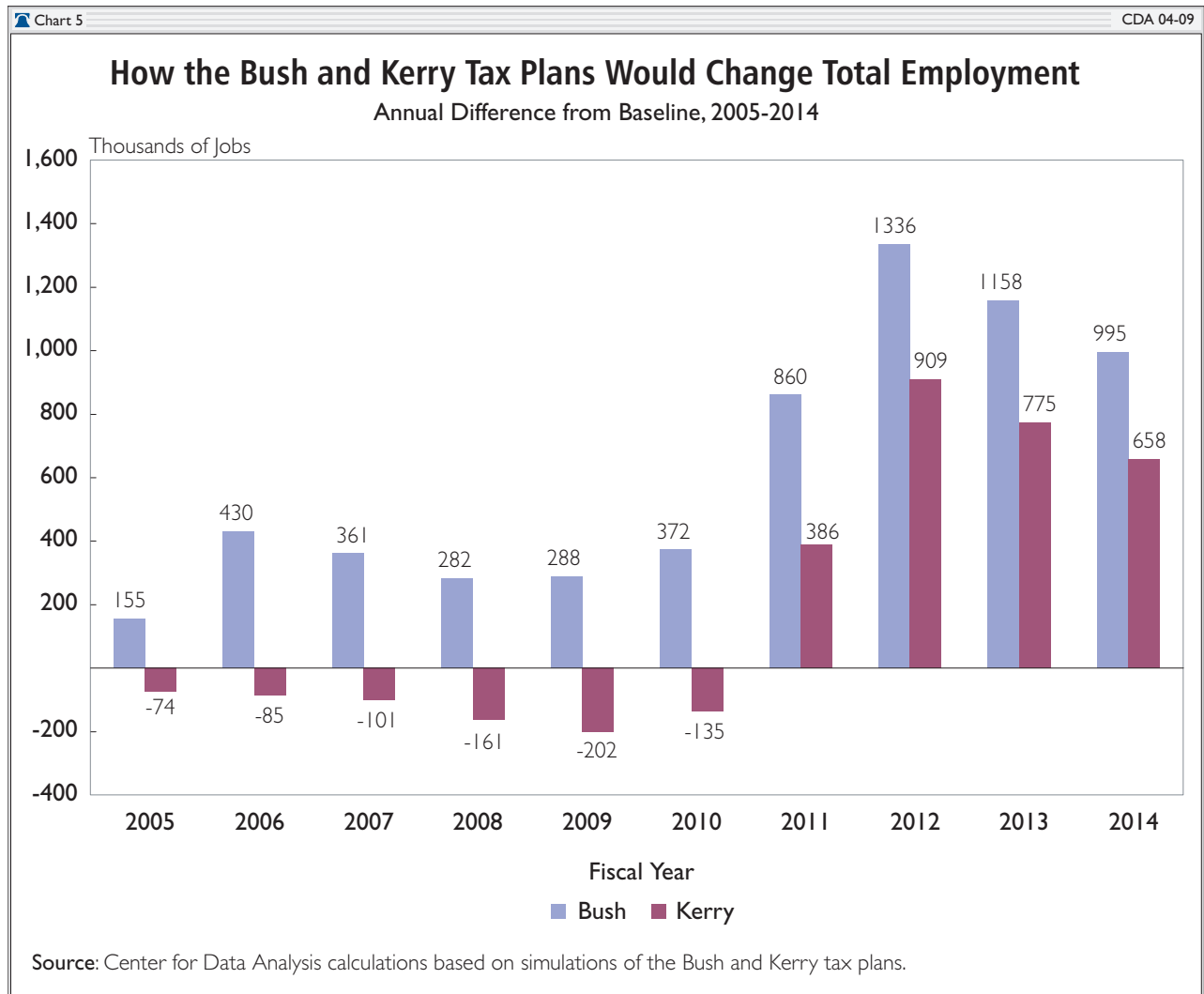


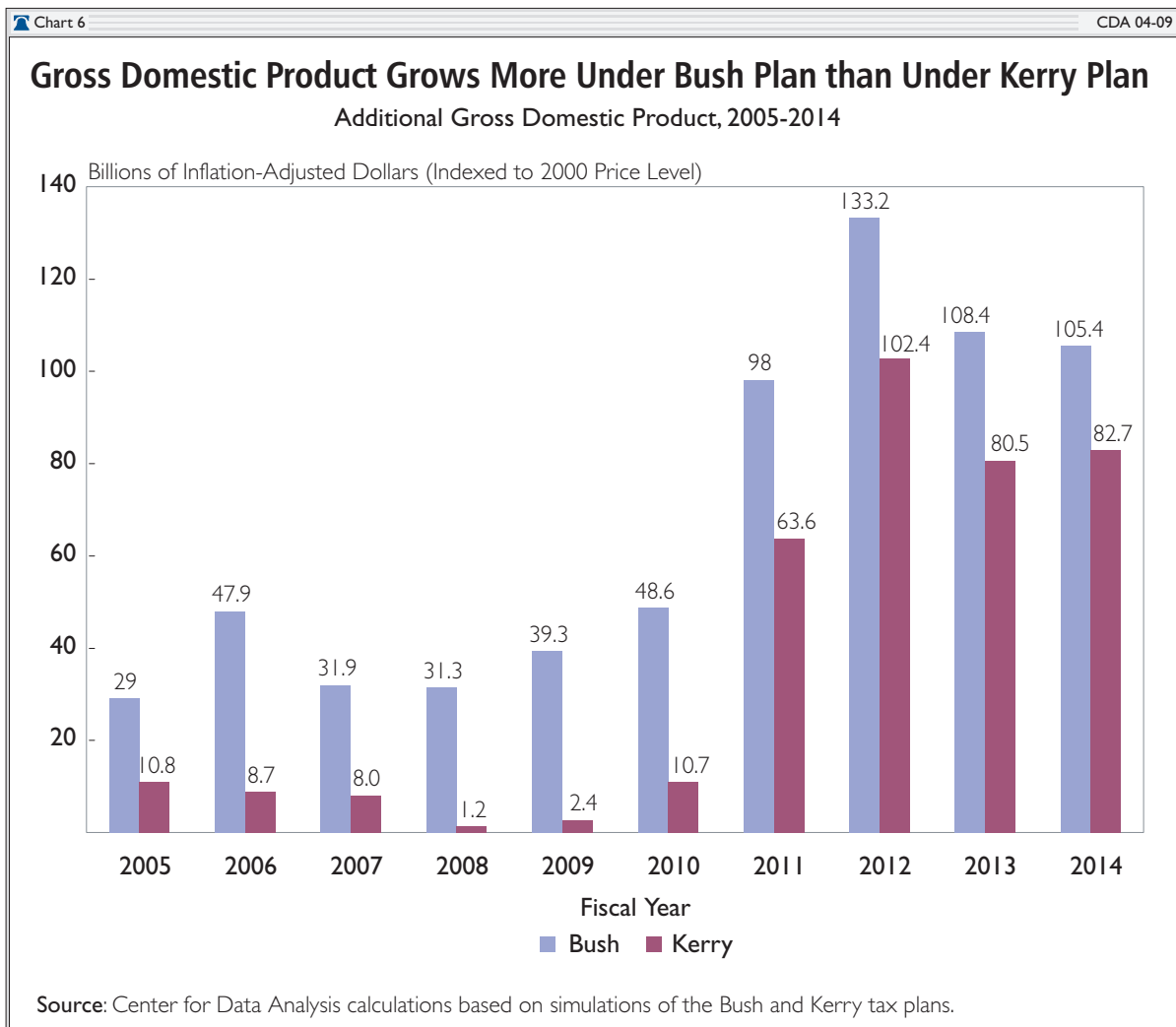
Table 5 as the falling capital costs starting in 2011. Taxpayers received a reduction in the tax cost of additional labor in 2001. That meant that the trade-off between labor and leisure (where taking less leisure occurs when labor costs fall) changed in favor of labor. Not only does the fall in the costs of working tend to increase the supply of labor hours in the economy, but it also calls workers out of non-employment settings (e.g., home, school, and retirement) and into full-time or part-time employment.

The growth in household income that additional labor and lower taxes brings also stimulates household demand for goods and services. As Table 5 shows, household consumption expenditures rise significantly if the Bush economic plan is

implemented. Not only does the growth of demand expand the level of gross domestic product and the income shares associated with a growing GDP, but it also boosts state and federal revenues. As noted on Table 5, federal revenues grow by \$266.2 billion above the conventional revenue estimates due to increased economic activity. The Bush tax plan enjoys a feedback effect on federal revenues from increased economic activity of 23.5 percent over 10 years.

In sum, the simulation results indicate that the Bush plan would provide a strong stimulus to both the demand and supply sides of the economy, resulting in rapid GDP and employment growth with no significant inflationary pressure. Publicly held debt would grow by \$987.1 billion over 10

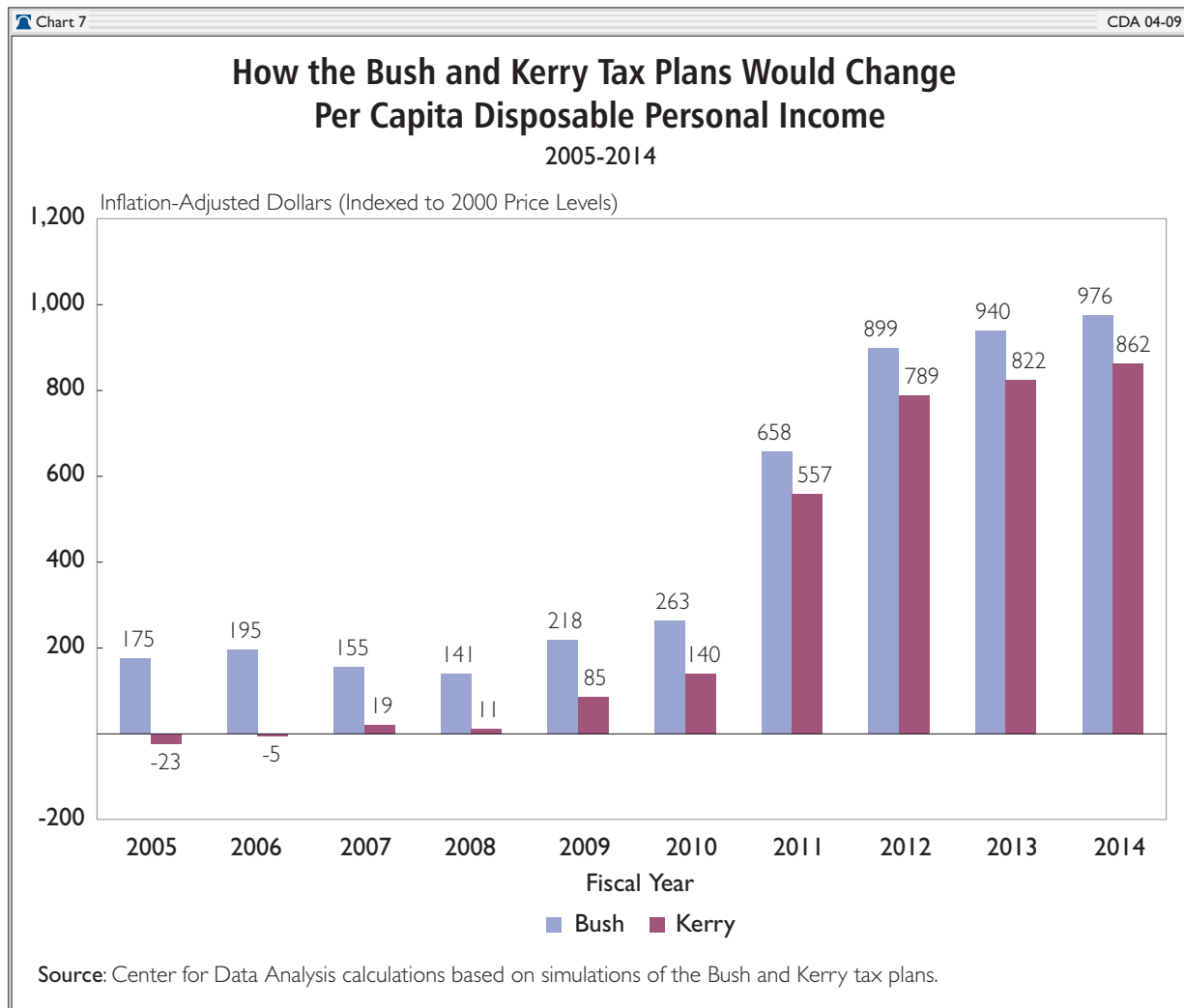
16. According to U.S. Commerce Department data, the historical average growth in non-residential fixed investment over the past 30 years has been 4.78 percent. The growth in investment since passage of JGTRRA has averaged 10.75 percent. These calculations are available upon request.



years from 2005 through 2014, but long-term interest rates would increase by only 0.1 percentage point as a result. On balance, the simulation results demonstrate the positive impact that lower tax rates could have on the incomes of everyone residing and working in the United States.

The Kerry Tax Plan. Dynamic simulation of the Kerry tax and economic proposals, applying the same methodologies used in modeling the Bush plan, yields the following findings:

- Negligible impact during 2005–2010.** The Kerry plan slows the U.S. economy, principally in employment and capital growth, and does nothing to improve GDP. The Kerry plan increases the \$11 trillion annual GDP during the period by an annual average of \$7 billion. Non-residential investment, inflation, and interest rates are also essentially unchanged during the period before 2011. The Kerry plan begins to exert its effect after 2010, when the
- Large impact after 2010.** The Kerry plan would make many elements of JGTRRA and EGTRRA tax cuts permanent rather than let them expire during 2009–2011, thus extending some aggregate supply-side benefits of lower marginal rates on labor and capital income. In addition, these permanent provisions stimulate disposable personal income and personal consumption. In inflation-adjusted terms, both consumption and personal savings rise relative to the baseline during 2011–2014 by an average of \$111.6 billion and \$150.3 billion, respectively.



Real disposable income per family of four would be \$3,030 higher per year in 2011–2014. The net result is that GDP grows above the baseline by \$63.6 billion in 2011, a sixfold increase over the impact in 2010. The average GDP improvement over the baseline during 2011–2014 is \$82.3 billion.

- Employment seesaws.** Employment surges after 2011 due to the factors discussed above, but the Kerry plan reduces potential employment growth in prior years. For the first six years (2005 to 2010), average total employment is below the baseline by 126,000. That average annual amount is equal to a 7.1 percent drop in the average annual increase in forecasted employment of 1,769,000 between 2005 and 2010. Once the permanent tax cuts become effective in 2011, employment levels rise by an annual average of 682,000 jobs over the baseline.
- Expanding budget deficit.** The Kerry plan cuts tax revenue and results in a \$637.8 billion increase in publicly held debt over the period 2005 through 2014. While this growth in federal government debt held by the public is 65 percent as large as that produced by the Bush plan (which comes in at \$987.1 billion over 10 years), increasing debt has a limited impact on the economy according to the model. Long-term 10-year Treasury bond rates rise by slightly more under the Kerry plan than they do under the Bush plan (both during the full 10 years and after 2010), but that increase is due principally to lower productivity growth under the Kerry plan than under the Bush plan.

The Kerry plan, like the Bush plan, stimulates additional economic activity from 2011 onward by making the 2001 and 2003 tax cuts permanent for taxpayers with incomes below \$200,000. That is, the Kerry plan reaps economic benefits once it

Provisions in the Tax Plans

	Summary	Supply-Side Policies	Demand-Side Policies
Current Law (Baseline)	The tax cuts of 2001 (EGTRRA) and 2003 (JGTRRA) will be phased out by 2010, which effectively raises marginal tax rates, resumes full double taxation of capital, and eliminates many demand-side cuts and credits.	In 2009, raises tax rates on capital gains and dividends to 2000 levels. In 2011, raises marginal rate brackets to 28, 31, 36, and 39.6 percent from the current 25, 28, 33, and 35 percent.	From 2005 to 2009, the child tax credit is \$700. In 2011, repeals the 10 percent bracket, ends phase-out of itemized deductions and exemptions for high-income taxpayers, reduces child tax credit to \$500, reduces dependent care credit, and repeals the earned income tax credit (EITC). Temporarily eliminates the "marriage penalty" by increasing the standard deduction for married couples and expanding the 15 percent bracket, but for only 2009 and 2010.
Bush Plan	Makes EGTRRA and JGTRRA individual tax cuts permanent. Eliminates the estate and gift tax.	Makes permanent lower rates on regular income, capital gains, and dividends.	Makes permanent the 10 percent bracket, the child tax credit (at \$1,000), tax relief for married couples including increased standard deduction and expanded 15 percent bracket, dependent care credit, and EITC for married couples. The alternative minimum tax (AMT) exemption is raised in 2005.
Kerry Plan	Makes EGTRRA and JGTRRA individual tax cuts permanent, except for the highest-income earners. Adds health and education tax credits. Modifies the estate tax. Makes multiple changes to corporate taxes.	Same as the Bush plan, except immediately raises top two individual rates to 36 and 39.6 percent on regular income as well as on capital gains and dividends. However, lower rates still apply to all taxpayers for income taxed in lower brackets.	Same as the Bush plan, except the AMT exemption is not raised in 2005. Also, tax credits for children, higher education, and health care.
		Corporate income tax rate reduced from 35 to 33.25 percent.	The new jobs tax credit subsidizes payroll taxes for selected new hires. Foreign source deferral is eliminated for one-third of such income (imports to the U.S. and third countries). One-year tax holiday rate of 10 percent on deferred foreign income brought back to U.S. in 2005.

Sources: Based on materials from Bush-Cheney '04 and Kerry-Edwards 2004.

embraces some of the supply-side tax reductions. As a result, the Kerry plan yields additional federal revenues beyond the conventional estimates. Increased economic activity reduces the 10-year change in revenues by \$121.5 billion, or by 17.7 percent of the conventional costs. This means that the Kerry plan reduces federal revenues by \$564.4 billion instead of \$685.9 billion over the 10-year period 2005 through 2014. The Bush plan, on the

other hand, results in an economic feedback in additional revenues of \$266 billion, which reduces the static cost of the Bush plan by 23.5 percent.

While a portion of the Kerry tax proposals bears a strong resemblance to the Bush proposal (specifically, in dealing with permanency of the 2001 and 2003 tax legislation), Senator Kerry relies elsewhere on targeted tax increases and reductions to achieve his policy ends. For example, the Kerry two-year

jobs credit is designed to boost short-term employment by extending a tax credit to small businesses. However, the two-year jobs credit Kerry proposes is economically dubious, although CDA analysts give it the benefit of the doubt by assuming it generates thousands of net new jobs. The jobs credit will be both expensive and inefficient because companies will be paid for new hires even when those hires would have happened anyway.¹⁷

The jobs credit is emblematic of an approach that uses temporary rate reductions, credits, and deductions to boost household and business purchases. While tax policy changes like the education and health care tax credits in the Kerry plan boost short-term output and employment, they leave unchanged the incentives to work, save, and invest. By leaving long-term costs of working and investing the same after the temporary tax cuts as they were before, they also leave workers and investors with no tax-related reason to change their behavior. Thus, the growth rate of the economy remains virtually unaffected by demand-side tax cuts. As in the Bush plan, only the supply-side changes in the Kerry plan affect output and employment in a significant and sustained way.

The Kerry tax plan begins with two tax policy changes that are not well calculated to boost employment or the rate of economic activity. First, the tax increases on taxpayers with high incomes may well choke off the high rate of investment growth of recent years. This investment growth is one factor—perhaps even the major factor—behind the remarkable increases in per-worker productivity. Indeed, productivity growth and the income and wealth effects that stem from such growth may be the chief victims of the Kerry tax increase.

Table 4		CDA 04-09	
Average Number of Additional Jobs Created for 2005-2014			
	Bush Tax Plan	Kerry Tax Plan	
Alabama	8,959	2,828	
Alaska	1,441	455	
Arizona	11,162	3,524	
Arkansas	5,482	1,731	
California	69,170	21,837	
Colorado	10,294	3,250	
Connecticut	7,852	2,479	
Delaware	1,998	631	
District of Columbia	3,197	1,009	
Florida	35,435	11,187	
Georgia	18,492	5,838	
Hawaii	2,752	869	
Idaho	2,785	879	
Illinois	27,710	8,748	
Indiana	13,890	4,385	
Iowa	6,913	2,182	
Kansas	6,290	1,986	
Kentucky	8,533	2,694	
Louisiana	9,106	2,875	
Maine	2,908	918	
Maryland	12,013	3,793	
Massachusetts	15,135	4,778	
Michigan	20,965	6,619	
Minnesota	12,755	4,027	
Mississippi	5,359	1,692	
Missouri	12,945	4,087	
Montana	1,936	611	
Nebraska	4,305	1,359	
Nevada	5,388	1,701	
New Hampshire	2,983	942	
New Jersey	19,248	6,077	
New Mexico	3,765	1,189	
New York	40,355	12,740	
North Carolina	18,356	5,795	
North Dakota	1,591	502	
Ohio	25,689	8,110	
Oklahoma	6,985	2,205	
Oregon	7,588	2,395	
Pennsylvania	26,809	8,464	
Rhode Island	2,325	734	
South Carolina	8,742	2,760	
South Dakota	1,826	577	
Tennessee	12,818	4,047	
Texas	45,057	14,225	
Utah	5,176	1,634	
Vermont	1,434	453	
Virginia	17,088	5,395	
Washington	12,884	4,068	
West Virginia	3,448	1,088	
Wisconsin	13,457	4,248	
Wyoming	1,204	380	
Total	624,000	197,000	

Source: Center for Data Analysis calculations based on simulations of the Bush and Kerry tax plans.

The second move, targeted demand-side tax cuts, fails to counter the economically dulling effects of the tax increases. Not until 2011 does the Kerry plan begin to produce economic gains comparable to the Bush plan, and then it does so only

17. For more information, see Appendix 1.

by adopting the key element of the Bush plan—making the 2001 and 2003 tax cuts permanent.

CONCLUSION

This analytical comparison of the competing tax plans underscores the common objectives and sharp policy differences between the two candidates. On one hand, President Bush and Senator Kerry share a desire for expanded economic activity and for achieving income goals: President Bush argues for giving all taxpayers a tax cut while Senator Kerry would essentially exclude upper-income taxpayers from most tax cut benefits.

On the other hand, the two candidates have advanced distinctively different approaches to tax policy. President Bush devotes the largest part of his 10-year tax reduction to changing the incentives to work and invest. Senator Kerry, however, devotes a much larger share of his tax cut to sup-

porting the demand or consumption side of the economy. This emphasis is evident in the number of targeted tax cuts designed to reallocate tax cuts toward household and government spending and away from high-income taxpayers who also own the majority of resources available for investment. These supply-side and demand-side differences account for the distinctive economic and fiscal effects of the two plans.

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APPENDIX 1 METHODOLOGY

Overview

This appendix discusses how Center for Data Analysis analysts at The Heritage Foundation performed simulations to estimate the economic and fiscal impact of the Bush and Kerry tax proposals. CDA analysts assumed that all the proposals except the Kerry higher education and health care tax credits would take effect on January 1, 2005, and that the Kerry education and health care credits would take effect on January 1, 2006.¹⁸ In some cases, information currently available about the proposals did not provide enough details for CDA economists to conduct a quantitative analysis. In such cases, they made assumptions on how the proposals would be implemented.

Economic Models

CDA analysts used a version of the Global Insight (GI) U.S. Macroeconomic Model¹⁹ to analyze the macroeconomic fiscal and economic effects of each candidate's tax proposal. The model was adjusted so that its baseline fiscal and economic projections would be consistent with projections from the January 2004 Congressional Budget Office (CBO) budget and economic report.²⁰ The CBO baseline forecast assumes that current law will be unchanged during the 10-year budget window. For example, the baseline assumes that tax-law changes resulting from EGTRRA will expire after 2010 because of the sunset provisions contained in the law. As a result, the CBO baseline serves as a neutral point against which to compare the effects of the two tax proposals.

CDA analysts also used the CDA personal income tax microsimulation model to estimate the

change in year-to-year federal revenues for most of the individual income tax proposals. The model simulates the effect of tax law changes for a representative sample of taxpayers. Data for these taxpayers are extrapolated or "aged" to reflect detailed taxpayer characteristics through 2014. The data are aged so that they are consistent with the CBO baseline forecast from the GI model. For purposes of this analysis, the microsimulation produced conventional revenue estimates. In addition, some behavioral changes resulting from the change in capital gains and dividends tax rates have not been included. (Other forms of tax minimization behavior were included.)

Revenue estimates were calculated by comparing estimated federal receipts under current law to the estimated revenues that would be collected assuming that the candidate's proposals were adopted and the economy under the new law did not differ from the CBO baseline forecast. In general, CDA analysts converted the calendar year static revenue estimates, including those produced by the microsimulation model, into annualized quarterly estimates for use in the GI model.

Changing Regular Tax Rates

Revenue Estimate. The average effective personal income tax rate variable in the GI model was adjusted to produce static revenue estimates equal to those generated by the microsimulation tax model.

Economic Effects. Changes in marginal personal tax rates alter the after-tax return on the marginal dollar of labor income. Microeconomic

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18. For these two elements, CDA researchers assumed a program start date of January 1, 2006, following Kenneth E. Thorpe in his analysis of the Kerry health plan and Steve Robblee, Simone Berkowitz, and Isabel Sawhill in their analysis of the higher education plan. See Thorpe, "Federal Costs and Savings Associated with Senator Kerry's Health Care Plan," and Steve Robblee, Simone Berkowitz, and Isabel Sawhill, "Education Proposals in the 2004 Presidential Campaign: A Preliminary Assessment," Brookings Institution *Working Paper*, June 23, 2004, at www.brook.edu/views/papers/sawhill/20040623.htm (September 8, 2004).
19. This version of the baseline forecast is based on the economic and fiscal assumptions in Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*, January 2004. The methodologies, assumptions, conclusions, and opinions in this *CDA Report* are entirely the work of CDA analysts. They have not been endorsed by and do not necessarily reflect the views of the owners of the Global Insight model. The model is used by leading government agencies and *Fortune* 500 companies to provide indications to decision makers of the probable effects of economic events and public policy changes on hundreds of major economic indicators.
20. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*, January 2004, at www.cbo.gov/ftpdoc.cfm?index=4985&type=1 (August 13, 2004).

theory suggests that increases in the marginal after-tax return on labor also increase the incentive to work and, therefore, labor force participation. CDA analysts simulated how changes in personal income tax rates would affect work incentives by estimating the amount that the labor force participation rate in the model would change in response to the individual income tax proposals.

A meta-study performed by the Congressional Budget Office found elasticity estimates ranging from 0.1 to 0.2.²¹ In other words, a 1 percent increase in after-tax labor compensation could cause a 0.1 percent to 0.2 percent increase in labor force participation. For this simulation, a 0.15 percent adjustment (measured as a share of the overall baseline labor compensation) was used to estimate the change in labor force participation.

Changing Capital Gains and Dividend Tax Rates

Revenue Estimate. CDA analysts used the microsimulation tax model to estimate differences in collections resulting from changes in tax rates on capital gains and dividend income for each candidate's proposal. The revenue effects of changing the capital gains and dividends tax rates were simulated in the GI model by adjusting the average personal income tax rate.

Economic Effects. Although the capital gains and dividend tax rates are applied to individual income, these proposals change the tax rate on income generated by the corporate sector of the economy. However, the GI model lacks a variable that measures personal taxation of corporate income. To simulate this provision, CDA analysts incorporated the economic effects of changes in personal taxation of corporate income by adjusting the top federal tax rate on corporate income without altering the average tax rate on corporate income. This approach allowed the revenue change resulting from each candidate's proposal to be represented accurately as a change in personal income tax collections; yet it also allowed the model to capture the effect that each tax change

proposal would exert on the after-tax return to capital in the economy.

Separate percentage changes in capital gains and dividend tax rates were calculated by dividing the estimated revenue differences by the appropriate tax base. A weighted average of the change in the two rates was computed to represent the overall increase or decrease in taxation of corporate income resulting from personal income tax proposals. This weighted average took into account the share of each type of corporate income in total corporate income, the proportion of each type of corporate income that is taxable as individual income, and the estimates of the effective tax rate on each type of corporate income.²² Changes in this tax rate have a direct effect on the after-tax return to capital in the economy.²³

Extending Expiring Provisions and Creating New Tax Credits

CDA economists used the microsimulation tax model to estimate differences in collections resulting from making permanent the new 10 percent individual income tax bracket, the higher child tax credit, the expanded earned income credit for married joint filers, and marriage penalty relief.

Estimates for the revenue differences resulting from the Kerry health care tax credits were based on calculations by Professor Kenneth E. Thorpe of Emory University.²⁴ Estimates for the revenue differences resulting from the Kerry higher education tax credit were based on calculations by Steve Robblee, Simone Berkowitz, and Isabel Sawhill of the Brookings Institution.²⁵ For each of these proposals, CDA analysts modified the average effective personal income tax rate variable in the GI model to reflect the differences in receipts.

Changing the Corporate Income Tax Rate

The Kerry proposal to reduce the top federal corporate tax rate was simulated in the GI model by reducing the top statutory federal corporate tax rate and the average corporate tax rate variables.

21. Congressional Budget Office, *Labor Supply and Taxes*, January 1996, p. 11, at www.cbo.gov/ftpdocs/cfm?index=3372&type=1 (August 13, 2004).

22. In these calculations, CDA analysts used Brookings Institution economist William G. Gale's estimates of the share of corporate dividends taxed as personal income, as well as generally accepted methods of calculating the effective capital gains tax rate. See William G. Gale, "About Half of Dividend Payments Do Not Face Double Taxation," *Tax Notes*, November 11, 2002, reposted at www.brookings.edu/views/articles/gale/20021111.pdf, and Leonard E. Burman, *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed* (Washington, D.C.: Brookings Institution Press, 1999), pp. 51–52, at brookings.nap.edu/books/0815712707/html/R1.html#pagetop (September 8, 2004).

Enacting a Tax Repatriation Holiday

Revenue Estimate. The revenue effects of the tax repatriation holiday were estimated by first projecting total stranded profits using independently produced estimates.²⁶ Next, calculations were made to estimate the amount of offshore profits that would qualify for treatment under the Kerry plan and the amount that could feasibly be repatriated within the time period allowed by the plan.²⁷ This amount was then reduced to account for estimated profits that would normally be repatriated within the year even without the proposal. The net amount of repatriated profits resulting from the Kerry tax plan was then adjusted by adding back the amount of foreign tax paid on these profits. The amount after the add-back represents income subject to the federal corporate income tax before the foreign tax credit is deducted. A base dividend amount—an estimate of corporate profits earned abroad that would normally have been repatriated within the year, even in the absence of the proposal—was subtracted from the net amount.

The effect on corporate income tax liabilities before credits was computed by multiplying taxable income (including the add-back) by the special 10 percent tax rate. The tax before credits was then reduced to take into account foreign tax credits

used against U.S. corporate tax liabilities incurred on repatriated profits. The amount of these credits was estimated by assuming a weighted average foreign tax rate of 20 percent and an adjustment factor equal to the ratio of the repatriation tax holiday rate divided by the top corporate statutory tax rate. Estimates were also made to reflect the fact that some of the additional tax from repatriated profits reflects a timing decision. That is, some of the profits would eventually have been taxed within the budget window. This adjustment used the same assumptions as those used to estimate profits repatriated as a result of the tax holiday. The adjustment lowered the estimate of corporate tax collections slightly as compared to the baseline receipts for fiscal years 2007 through 2014.

Because the domestic corporate tax base is not affected by the proposal, CDA analysts accounted for the change in tax collections by modifying a variable in the GI model that takes account of differences between unified budget receipts and tax revenues collected on income flows as defined in the National Income and Product Accounts.

Economic Effects. CDA researchers took account of the additional after-tax income resulting from the repatriation holiday by estimating how corporations would use the amounts. Following the

23. For example, Kevin Hassett of the American Enterprise Institute, James B. Mackie of the Office of Tax Analysis, and Robert Carroll of the U.S. Treasury write that “current law ‘double taxes’ corporate profits, [taxing them] once under the corporation income tax rate...and again under the individual income tax when distributed as a dividend or realized as a capital gain upon sales of shares.... [T]he double tax adds to the overall tax burden on a typical investment in the U.S. economy and so may discourage saving and investing in the aggregate, [potentially reducing] capital formation and saving and slow[ing] economic growth.” Kevin A. Hassett, James B. Mackie, and Robert Carroll, “The Effect of Dividend Tax Relief on Investment Incentives,” American Enterprise Institute, September 1, 2003, at www.aei.org/include/news_print.asp?newsID=19440 (August 13, 2004). A number of studies indicate that a reduction in taxation of corporate dividends would spur non-residential investment by reducing the cost of capital. See Ervin L. Black, Joseph Legoria, and Keith F. Sellers, “Capital Investment Effects of Dividend Imputation,” *Journal of the American Taxation Association*, Vol. 22, No. 2 (2000), pp. 40–59; James M. Poterba, “Tax Policy and Corporate Saving,” *Brookings Papers on Economic Activity*, No. 2 (1987), pp. 455–515; Peter Birch Sorensen, “Changing Views of the Corporate Income Tax,” *National Tax Journal*, Vol. 48, No. 2 (June 1995), pp. 279–294; and James M. Poterba and Lawrence H. Summers, “New Evidence That Taxes Affect the Valuation of Dividends,” *Journal of Finance*, Vol. 39, No. 5 (December 1984), pp. 1397–1415. The Joint Economic Committee published an overview of studies finding that a reduction in taxation of capital gains would reduce the cost of capital and spur capital spending. See Shahira ElBogdady Knight, “The Economic Effects of Capital Gains Taxation,” Joint Economic Committee, U.S. Congress, June 1997, at www.house.gov/jec/fiscal/tx-grwth/capgain/capgain.pdf (August 13, 2004).

24. Thorpe, “Federal Costs and Savings Associated with Senator Kerry’s Health Care Plan,” p. 4.

25. Robblee *et al.*, “Education Proposals in the 2004 Presidential Campaign,” p. 24.

26. Peter Merrill, “Memorandum: Revenue Estimating Model for Homeland Investment Act,” PricewaterhouseCoopers, April 30, 2003.

27. CDA analysts incorporated assumptions from PricewaterhouseCoopers economist Peter Merrill’s analysis in formulating CDA’s own estimates of accumulated profits that could be repatriated. See Merrill, “Memorandum: Revenue Estimating Model for Homeland Investment Act.” CDA analysts then applied estimates of the scope of the Kerry plan as calculated in Sullivan, “Good Politics,” p. 21.

results of a survey taken by the Bank of America relating to a similar proposal,²⁸ CDA analysts assumed that about 30 percent of the additional income would be used for non-residential investment, approximately 30 percent would be used to reduce corporate debt, and the remaining portion would be used in asset transfers and financial adjustments that are not taken into account in the model. Slight reductions in non-residential investment and slight increases in corporate debt were made for 2006–2014 to reflect the loss of repatriated profits assumed to be included in the baseline projections.

Partially Repealing the Deferral of Overseas Income

The Kerry proposal to partially end deferral of corporate income earned abroad would alter the income subject to the domestic corporate tax rate but not necessarily the amount of domestic profits. After consulting with representatives of Global Insight, CDA researchers simulated the revenue effects of the proposal by altering the corporate tax base equation in the GI model. The adjustment increased the corporate income tax base, and therefore the tax liability, by increasing the portion of income earned abroad that is included in the tax base. The estimated change in the portion of income included in the tax base was derived from calculations performed by Martin Sullivan in his *Tax Notes* analysis of the Kerry corporate tax change proposals.²⁹

Enacting a New Jobs Credit

Revenue Estimate. The Department of Labor's new series on business employment dynamics indicates that from 1992 through 2003, an average of 8.1 million new private-sector jobs were created on a gross basis every quarter, while 7.7 million were lost on average.³⁰ CDA analysts used the gross number of private-sector jobs created to estimate the number of jobs generated under the baseline forecast at newly opened establishments and manufacturing establishments that are expanding their workforce.³¹ In addition, CDA analysts estimated the number of jobs at expanding small businesses.³² An adjustment was made so that jobs at expanding small businesses that are engaged in manufacturing would not be double-counted.

Because the credit reduces the cost of labor to business, there is the expectation that additional jobs will be created. Economists express the relationship between a percentage reduction in labor costs and the percentage of increased demand for labor as the wage elasticity of demand, which the literature suggests can range between -0.4 and -0.5 .³³ For example, with an elasticity of -0.5 and a 10 percent reduction in labor costs, the quantity of labor demanded would rise by 5 percent.

However, previous experience with earlier jobs tax credit laws suggests that this elasticity overstates the effect of such credits. This may be because the credits did not apply to the entire

28. Arnold Miyamoto and Martin Gonzalez, "Alert: Homeland Investment Act; An Update," Bank of America, Risk Management Advisory, July 11, 2003, p. 2.

29. In regard to U.S.-based corporations, U.S. law makes no distinction between the profits earned from domestic operations and profits earned by operations abroad. Both types of profits are taxed at the applicable U.S. corporate tax rate, with credits given for any foreign corporate taxes paid. Profits from U.S.-based corporations are subject to taxation as soon as these corporations transfer the money from their foreign operations to the United States for domestic disposal. The practice of delaying the payment of corporate taxes by not transferring to the U.S. immediately is called deferral. The Kerry proposal to partially end deferral would make taxes on earnings from foreign operations payable immediately on profits related to final sales made in a country other than the one that originated the good sold. Sullivan estimated that local foreign economy sales amounted to 66 percent total sales by foreign subsidiaries of U.S. corporations. Thus, by partially ending deferral, the Kerry plan would end deferral on approximately 34 percent of U.S. corporate profits earned abroad. See Sullivan, "Good Politics."

30. The data cover the period from July 1, 1992, to December 31, 2003. See U.S. Department of Labor, Bureau of Labor Statistics, "Business Employment Dynamics: Fourth Quarter 2003," updated August 03, 2004, Table 1, at www.bls.gov/news.release/cewbd.t01.htm (September 8, 2004).

31. See U.S. Department of Labor, "Business Employment Dynamics, Fourth Quarter 2003," at www.bls.gov/news.release/cewbd.toc.htm (September 8, 2004).

32. Small Business Administration, *The Small Business Economy 2002–2003: A Report to the President* (Washington, D.C.: U.S. Government Printing Office, 2004), Table A.5, at www.sba.gov/advo/stats/sb_econ02-03.pdf (September 8, 2004).

33. George J. Borjas, *Labor Economics*, 2nd ed. (Boston: McGraw Hill, 2000), p. 125.

labor force and wages for all existing workers are unaffected. Moreover, the job credits brought about only a temporary reduction in the price of labor, causing employers to resist making permanent hires at levels above those already planned. As a result, hiring response expressed as an elasticity would likely be far closer to zero than -0.5 . For example, the U.S. General Accounting Office (GAO) reports that the 1981 Targeted Jobs Tax Credit indicates that the credit “in all likelihood had zero net impact on the employment levels of the target group members.”³⁴

Instead of using a zero response as could be indicated from the GAO study, CDA analysts used an elasticity near -0.1 . The elasticity was applied to a typical qualifying job that pays wages of \$28,500 annually. An employer with this job qualifies for a savings of \$2,180 on the employer portion of the payroll tax. An additional assumption is that wages for qualifying employees constitute slightly more than 70 percent of the total cost of labor.

If fully taken up by employers, CDA analysts estimate that about 13.3 million jobs would be eligible for the new credit. This total includes qualifying jobs that would have been created even without the jobs tax credit and some that were created in response to the credit. The Kerry campaign has said that the program would be funded by revenues generated from the one-year corporate tax repatriation holiday, which it estimates at \$22 billion.³⁵ Thus, the campaign projects that the jobs tax credit would cost \$11 billion per year for two years—roughly a third lower than the maximum potential cost.

CDA analysts also assume that the take-up rate by employers would be far lower than 100 percent. Employers would need to be aware of the credit, learn about its provisions, and produce,

maintain, and process the necessary paperwork. Such awareness and take-up issues have limited the effectiveness of jobs incentive programs in the past,³⁶ often because the government sets up high paperwork hurdles in order to limit program cost.

Due to limited awareness, compliance burdens, and non-applicability to firms without taxable profits, CDA analysts assumed a take-up rate of approximately 17 percent. This take-up rate implies that the credit would be claimed for about 2.3 million workers and would reduce revenues by about \$5 billion per year for two years.

Economic Effects. CDA analysts computed the ratio of new jobs that potentially could be created as a result of the tax credit to the total number that potentially would qualify for the credit. If a similar ratio is applied to the estimated 2.3 million workers for whom the credit would be claimed, the new credit would raise the employment level by about 35,000 for two years. The variable in the GI model representing non-farm establishment employment was increased to reflect the net new jobs resulting from the jobs tax credit.

Modifying the Estate Tax

Revenue Estimate. CDA analysts used a Congressional Budget Office estimate of the revenue differences resulting from permanent abolition of the estate tax to simulate the revenue effects of the Bush estate tax proposal. This estimate assumed that the scheduled repeal of the estate tax would continue past 2010.³⁷

CDA researchers applied a set of equations to approximate the revenue differences caused by the Kerry estate tax proposals. Because the estate tax is a tax on wealth, not on income, CDA researchers reflected the revenue differences by adjusting a variable in the GI model that represents tax collec-

34. See the letter submitted as a follow-up to hearings on employment tax credits held by the Senate Finance Committee on April 3, 1981. Morton A. Myers, Director, U.S. General Accounting Office, letter to John Heinz, Chairman, Subcommittee on Economic Growth, Employment, and Revenue Sharing, Committee on Finance, U.S. Senate, June 5, 1981, at archive.gao.gov/f0102/115427.pdf (September 8, 2004).

35. Jim VandeHei, “Kerry to Offer Cut in Corporate Taxes,” *The Washington Post*, March 26, 2004, p. A1, at www.washingtonpost.com/ac2/wp-dyn/A25175-2004Mar25?language=printer (September 8, 2004).

36. A 1979 assessment of the New Jobs Tax Credit of 1977–1978 by Jeffrey M. Perloff and Michael L. Wachter found that “relatively few firms knew about the program and even fewer” responded to it. Small firms were three times less likely to be aware of the credit. Jeffrey M. Perloff and Michael L. Wachter, “New Jobs Tax Credit: An Evaluation of the 1977–78 Wage Subsidy Program,” *American Economic Review*, Vol. 69, No. 2, papers and proceedings of the 91st Annual Meeting of the American Economic Association, May 1979, pp. 173–179.

37. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*, p. 93.

tions not related to income flows captured in the National Income and Products Accounts.

Economic Effects. CDA researchers estimated two behavioral effects associated with the estate tax proposals. First, CDA analysts estimated the economic effects of amounts spent on tax avoidance activities by owners of estates that might be subjected to the estate tax. It was assumed that tax avoidance spending by the individuals was a response to long-run rather than short-run changes in the estate tax law. Taking into account the longer time period reflects the assumption that tax avoidance activity related to the estate tax is optimized for the estate tax law prevailing in the year the estate owner expects to die, not for any year before that.³⁸

CDA analysts adjusted the GI model's price index for miscellaneous business services in order to reflect changes in the demand for estate tax avoidance services resulting from changes in the estate tax law. The business services price deflator variable was adjusted so that nominal spending on miscellaneous business services changed by 30 cents for every dollar of change in the long-run projection of federal estate tax collections.³⁹ The inflation-adjusted consumption of miscellaneous business services was not assumed to change under either candidate's proposal for the estate tax.

A change in the cost of capital was also assumed to occur as a result of changes in the estate tax. Because it is a tax on capital, the estate tax increases the minimum rate of return sought by investors. This minimum return is assumed to be a factor in the decision to engage in new projects.

All other things being equal, projects that do not have projected returns above the minimum will not be initiated.

Previous research indicates that if the estate tax had been repealed prior to 1997, the required return on investments would have fallen approximately 3 percent.⁴⁰ CDA analysts reduced this estimate to reflect the 1997 reduction in top federal estate tax rates. The percentage was further adjusted in the simulation of the Kerry proposal to reflect the continued, albeit somewhat diminished, existence of the estate tax under his proposal. A variable in the model representing the 10-year Treasury bond rate was reduced to reflect a reduction in the minimum required rate of return on capital.

Federal Funds Rate

Variables in the GI model were set so as to allow actions by the monetary authority, as simulated in the model, to adjust the federal funds rate. With these settings, the federal funds rate tends to increase (decline) when the unemployment rate declines (increases), the Consumer Price Index increases (declines), or the Consumer Price Index accelerates (decelerates).

Employment Effects by State

Estimates for the number of new jobs by state were determined by taking the change in employment as determined by the CDA macroeconomic model and distributing them according to Bureau of Labor Statistics data on the level of state employment.⁴¹

38. This forward-looking aspect of estate tax avoidance is the reason why the current-law phasing out of the estate tax and repeal for only one year is unlikely to significantly reduce spending on estate tax avoidance activities by estate owners expecting to live past 2010.

39. This adjustment follows the method used in Richard Fullenbaum and Marianna McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," Research Institute for Small and Emerging Business *Working Paper Series* No. 98-01, pp. A1-A2.

40. For example, see William W. Beach, "The Case for Repealing the Estate Tax," Heritage Foundation *Backgrounder* No. 1091, August 21, 1996, at www.heritage.org/Research/Taxes/BG1091.cfm.

41. See U.S. Department of Labor, Bureau of Labor Statistics, "Regional and State Employment and Unemployment: July 2004," Table 3, modified August 27, 2004, at stats.bls.gov/news.release/laus.t03.htm (September 8, 2004).

APPENDIX 2
MACROECONOMIC MODELING RESULTS

Economic and Fiscal Effects of the Bush Proposal to Make the 2001 and 2003 Tax Cuts Permanent

Economic Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Fiscal Year Average	
												2005-2014	Average, 2005-2014
Gross Domestic Product (billions of inflation-adjusted dollars, indexed to the 2000 price level)													
Forecast	10,774.9	11,273.5	11,681.5	11,984.9	12,312.7	12,667.2	13,011.0	13,387.5	13,754.7	14,071.1	14,417.8	12,856.2	
Baseline	10,774.9	11,244.5	11,633.6	11,953.0	12,281.4	12,627.9	12,962.4	13,289.5	13,621.5	13,962.7	14,312.4	12,788.9	
Difference	0.0	29.0	47.9	31.9	31.3	39.3	48.6	98.0	133.2	108.4	105.4	67.3	
Real GDP Growth Rate (percent change from previous year)													
Forecast	4.7	4.6	3.6	2.6	2.7	2.9	2.7	2.9	2.7	2.3	2.5	3.0	
Baseline	4.7	4.4	3.5	2.7	2.7	2.8	2.6	2.5	2.5	2.5	2.5	2.9	
Difference	0.0	0.2	0.1	-0.1	0.0	0.1	0.1	0.4	0.2	-0.2	0.0	0.1	
Total Employment (thousands of jobs)													
Forecast	130,246	133,041	136,430	138,046	139,185	140,555	142,102	143,948	145,460	146,181	147,036	141,198	
Baseline	130,246	132,886	136,000	137,685	138,903	140,267	141,730	143,088	144,124	145,023	146,041	140,575	
Difference	0	155	430	361	282	288	372	860	1,336	1,158	995	624	
Unemployment Rate (percent of civilian labor force)													
Forecast	5.8	5.4	4.8	4.9	5.1	5.1	5.0	5.0	4.9	5.1	5.1	5.0	
Baseline	5.8	5.5	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	
Difference	0.0	-0.1	-0.2	-0.2	-0.1	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1	-0.2	
Disposable Personal Income (billions of inflation-adjusted dollars, indexed to the 2000 price level)													
Forecast	8,044.0	8,403.4	8,663.0	8,861.7	9,078.3	9,331.0	9,557.8	9,805.1	10,049.4	10,286.4	10,527.9	9,456.4	
Baseline	8,044.0	8,351.5	8,604.7	8,815.0	9,035.4	9,264.1	9,476.4	9,599.9	9,767.1	9,988.7	10,216.4	9,311.9	
Difference	0.0	51.9	58.3	46.7	42.9	66.9	81.4	205.2	282.3	297.7	311.5	144.5	
Disposable Income per Capita (inflation-adjusted dollars, indexed to the 2000 price level)													
Forecast	27,395	28,357	28,985	29,403	29,874	30,454	30,942	31,486	32,010	32,500	32,994	30,701	
Baseline	27,395	28,182	28,790	29,248	29,733	30,236	30,679	30,828	31,111	31,560	32,018	30,239	
Difference Per Person	0	175	195	155	141	218	263	658	899	940	976	462	
Difference for Family of Four	0	700	780	620	564	872	1,052	2,632	3,596	3,760	3,904	1,848	
Consumption Expenditures (billions of inflation-adjusted dollars, indexed to the 2000 price level)													
Forecast	7,577.3	7,906.1	8,163.5	8,359.3	8,574.0	8,799.4	9,017.3	9,264.9	9,512.3	9,725.9	9,935.4	8,925.8	
Baseline	7,577.3	7,879.2	8,118.3	8,324.4	8,542.9	8,761.9	8,972.4	9,167.7	9,369.0	9,577.8	9,780.0	8,849.4	
Difference	0.0	26.9	45.2	34.9	31.1	37.5	44.9	97.2	143.3	148.1	155.4	76.4	
Personal Savings (billions of inflation-adjusted dollars, indexed to the 2000 price level)													
Forecast	206.8	232.4	229.9	229.4	225.1	247.9	247.2	236.1	221.8	249.3	293.5	241.3	
Baseline	206.8	207.2	218.7	219.3	214.7	217.3	208.2	112.4	61.8	71.8	102.2	163.4	
Difference	0.0	25.2	11.2	10.1	10.4	30.6	39.0	123.7	160.0	177.5	191.3	77.9	
Personal Savings Rate (percent of disposable personal income)													
Forecast	2.4	2.6	2.4	2.3	2.2	2.3	2.2	2.0	1.8	1.9	2.2	2.2	
Baseline	2.4	2.3	2.3	2.2	2.1	2.0	1.9	1.0	0.5	0.6	0.8	1.6	
Difference	0.0	0.3	0.1	0.1	0.1	0.3	0.3	1.0	1.3	1.3	1.4	0.6	

Table 5

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Economic and Fiscal Effects of the Bush Proposal to Make the 2001 and 2003 Tax Cuts Permanent (cont.)

	Fiscal Year Average											
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Average, 2005-2014
Economic Indicators												
Total Unemployment (thousands)												
Forecast	8,583	8,082	7,297	7,523	7,878	7,934	7,947	7,944	7,916	8,125	8,265	7,891
Baseline	8,583	8,202	7,600	7,755	8,063	8,137	8,208	8,277	8,316	8,354	8,395	8,131
Difference	0	-120	-303	-232	-185	-203	-261	-333	-400	-229	-130	-240
Nonresidential Investment (billions of inflation-adjusted dollars, indexed to the 2000 price level)												
Forecast	1,206.1	1,322.2	1,440.7	1,527.2	1,585.1	1,672.4	1,778.7	1,890.8	2,020.1	2,110.7	2,227.4	1,757.5
Baseline	1,206.1	1,318.5	1,429.5	1,523.1	1,583.4	1,668.0	1,767.6	1,874.2	1,986.8	2,096.3	2,222.4	1,747.0
Difference	0.0	3.7	11.2	4.1	1.7	4.4	11.1	16.6	33.3	14.4	5.0	10.6
Net Capital Stock, Nonresidential (billions of inflation-adjusted dollars, indexed to the 2000 price level)												
Forecast	12,042.8	12,481.1	12,970.2	13,489.1	14,015.3	14,557.3	15,144.1	15,766.6	16,439.9	17,127.6	17,834.3	14,982.6
Baseline	12,042.8	12,479.0	12,955.7	13,469.3	13,996.5	14,536.4	15,111.0	15,721.3	16,369.3	17,046.2	17,756.9	14,944.2
Difference	0.0	2.1	14.5	19.8	18.8	20.9	33.1	45.3	70.6	81.4	77.4	38.4
User Cost of Capital (1996, second quarter = 100)												
Forecast	110.0	117.0	121.0	122.0	123.0	124.0	125.0	126.0	128.0	129.0	130.0	124.5
Baseline	110.0	118.0	121.0	123.0	124.0	124.0	125.0	125.0	126.0	127.0	128.0	124.1
Difference	0.0	-1.0	0.0	-1.0	-1.0	0.0	0.0	1.0	2.0	2.0	2.0	0.4
Consumer Price Index (percent change from previous year)												
Forecast	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.2	2.2	2.3	2.3	2.1
Baseline	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.1	2.2	2.2	2.3	2.1
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0
Treasury Bill, 3 Month (annualized percent)												
Forecast	1.1	2.6	4.1	4.6	4.7	4.8	4.8	4.9	5.1	4.9	4.8	4.5
Baseline	1.1	2.5	3.9	4.5	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.3
Difference	0.0	0.1	0.2	0.1	0.1	0.2	0.2	0.3	0.5	0.3	0.2	0.2
Treasury Bond, 10 Year (annualized percent)												
Forecast	4.4	5.2	5.5	5.4	5.4	5.5	5.5	5.6	5.8	5.7	5.7	5.5
Baseline	4.4	5.3	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Difference	0.0	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.1	0.3	0.2	0.2	0.1

Economic and Fiscal Effects of the Bush Proposal to Make the 2001 and 2003 Tax Cuts Permanent (cont.)

Economic Indicators	Fiscal Year Average													
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Average, 2005-2014		
Federal Tax Revenue (billions of dollars, not adjusted for inflation)														
Forecast	1,817.0	2,017.1	2,240.3	2,373.4	2,497.7	2,616.1	2,760.2	2,895.0	3,085.5	3,230.4	3,413.6	27,129.3		
Baseline	1,817.0	2,048.9	2,254.3	2,385.4	2,505.6	2,642.7	2,785.9	3,036.9	3,272.7	3,437.2	3,627.6	27,997.2		
Difference	0.0	-31.8	-14.0	-12.0	-7.9	-26.6	-25.7	-141.9	-187.2	-206.8	-214.0	-867.9		
Change in Federal Tax Revenue (billions of dollars, not adjusted for inflation)														
Static Change to Tax Revenue	0.0	-38.8	-31.2	-23.7	-20.1	-41.9	-40.7	-178.7	-242.9	-252.6	-263.5	-1,134.1		
Dynamic Change to Tax Revenue	0.0	-31.8	-14.0	-12.0	-7.9	-26.6	-25.7	-141.9	-187.2	-206.8	-214.0	-867.9		
Revenue Feedback	0.0	7.0	17.2	11.7	12.2	15.3	15.0	36.8	55.7	45.8	49.5	266.2		
Feedback Percent	--	18.0%	55.1%	49.4%	60.7%	36.5%	36.9%	20.6%	22.9%	18.1%	18.8%	23.5%		
Federal Spending (billions of dollars, not adjusted for inflation)														
Forecast	2,296.1	2,411.9	2,526.6	2,653.5	2,787.4	2,920.5	3,061.8	3,221.6	3,339.2	3,517.3	3,695.0	30,134.8		
Baseline	2,296.1	2,411.7	2,524.4	2,650.9	2,783.2	2,913.2	3,048.6	3,199.0	3,296.5	3,456.7	3,615.9	29,900.1		
Difference	0.0	0.2	2.2	2.6	4.2	7.3	13.2	22.6	42.7	60.6	79.1	234.7		
Federal Surplus/Deficit (billions of dollars, not adjusted for inflation)														
Forecast	-479.2	-394.8	-286.4	-280.1	-289.7	-304.4	-301.6	-326.6	-253.7	-286.9	-281.4	-3,005.6		
Baseline	-479.2	-362.8	-270.1	-265.5	-277.6	-270.5	-262.7	-162.1	-23.8	-19.4	11.6	-1,902.9		
Difference	0.0	-32.0	-16.3	-14.6	-12.1	-33.9	-38.9	-164.5	-229.9	-267.5	-293.0	-1,102.7		
Net Publicly Held Federal Debt (billions of dollars, not adjusted for inflation)														
Forecast	4,189.0	4,481.9	4,655.6	4,766.0	4,884.5	5,013.5	5,156.3	5,297.0	5,410.4	5,498.1	5,590.7	5,075.4		
Baseline	4,189.0	4,465.9	4,611.6	4,709.1	4,813.9	4,920.9	5,023.3	5,060.7	4,960.9	4,794.8	4,603.6	4,796.5		
Difference	0.0	16.0	44.0	56.9	70.6	92.6	133.0	236.3	449.5	703.3	987.1	278.9		
Net Publicly Held Federal Debt Share (percent of GDP)														
Forecast	36.5	37.0	36.6	35.9	35.1	34.4	33.7	33.0	32.1	31.3	30.4	34.0		
Baseline	36.5	36.9	36.4	35.6	34.7	33.9	33.1	31.9	29.9	27.7	25.5	32.6		
Difference	0.0	0.1	0.2	0.3	0.4	0.5	0.6	1.1	2.2	3.6	4.9	1.4		

Note: Estimates are for fiscal years. Numbers may not sum due to rounding.

Sources: August 2004 simulations by the Center for Data Analysis (CDA) using the Global Insight U.S. Macroeconomic Model. Forecasts are based on CDA calculations and static estimates calculated by the CDA and others. Baselines are based on Congressional Budget Office's January 2004 budget and economic projections.

Economic and Fiscal Effects of Senator Kerry's Tax Proposals

	(Fiscal Year Average)										(Ten-year Budget Average)	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005 - 2014
Economic Indicators												
Gross Domestic Product			In Billions of Inflation-adjusted Dollars (Indexed to the 2000 Price Level)									
Forecast	10,774.9	11,255.3	11,642.3	11,961.0	12,282.6	12,630.3	12,973.1	13,353.1	13,723.9	14,043.2	14,395.1	12,826.0
Baseline	10,774.9	11,244.5	11,633.6	11,953.0	12,281.4	12,627.9	12,962.4	13,289.5	13,621.5	13,962.7	14,312.4	12,788.9
Difference	0.0	10.8	8.7	8.0	1.2	2.4	10.7	63.6	102.4	80.5	82.7	37.1
Real GDP Growth Rate			Percent Change from Year Ago									
Forecast	4.7	4.5	3.4	2.7	2.7	2.8	2.7	2.9	2.8	2.3	2.5	2.9
Baseline	4.7	4.4	3.5	2.7	2.7	2.8	2.6	2.5	2.5	2.5	2.5	2.9
Difference	0.0	0.1	-0.1	0.0	0.0	0.0	0.1	0.4	0.3	-0.2	0.0	0.1
Total Employment			In Thousands of Jobs									
Forecast	130,246	132,812	135,915	137,584	138,742	140,065	141,595	143,474	145,033	145,798	146,699	140,772
Baseline	130,246	132,886	136,000	137,685	138,903	140,267	141,730	143,088	144,124	145,023	146,041	140,575
Difference	0	-74	-85	-101	-161	-202	-135	386	909	775	658	197
Unemployment Rate			Percent of Civilian Labor Force									
Forecast	5.8	5.4	4.9	4.9	5.1	5.1	5.1	5.0	4.9	5.0	5.1	5.1
Baseline	5.8	5.5	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Difference	0.0	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.2	-0.3	-0.2	-0.1	-0.2
Disposable Personal Income			In Billions of Inflation-adjusted Dollars (Indexed to the 2000 Price Level)									
Forecast	8,044.0	8,344.6	8,603.1	8,820.6	9,038.8	9,290.0	9,519.7	9,773.5	10,014.6	10,248.9	10,491.5	9,414.5
Baseline	8,044.0	8,351.5	8,604.7	8,815.0	9,035.4	9,264.1	9,476.4	9,599.9	9,767.1	9,988.7	10,216.4	9,311.9
Difference	0.0	-6.9	-1.6	5.6	3.4	25.9	43.3	173.6	247.5	260.2	275.1	102.6
Disposable Income Per Capita			In Inflation-adjusted Dollars (Indexed to the 2000 Price Level)									
Forecast	27,395	28,159	28,785	29,267	29,744	30,321	30,819	31,385	31,900	32,382	32,880	30,564
Baseline	27,395	28,182	28,790	29,248	29,733	30,236	30,679	30,828	31,111	31,560	32,018	30,239
Difference Per Person	0	-23	-5	19	11	85	140	557	789	822	862	326
Difference for Family of Four	0	-92	-20	76	44	340	560	2,228	3,156	3,288	3,448	1,303
Consumption Expenditures			In Billions of Inflation-adjusted Dollars (Indexed to the 2000 Price Level)									
Forecast	7,577.3	7,877.6	8,123.7	8,330.2	8,544.1	8,767.7	8,986.9	9,238.2	9,488.4	9,702.0	9,912.4	8,897.1
Baseline	7,577.3	7,879.2	8,118.3	8,324.4	8,542.9	8,761.9	8,972.4	9,167.7	9,369.0	9,577.8	9,780.0	8,849.4
Difference	0.0	-1.6	5.4	5.8	1.2	5.8	14.5	70.5	119.4	124.2	132.4	47.8
Personal Savings			In Billions of Inflation-adjusted Dollars (Indexed to the 2000 Price Level)									
Forecast	206.8	201.3	210.4	217.6	215.4	238.4	239.1	230.9	208.9	232.9	276.6	227.2
Baseline	206.8	207.2	218.7	219.3	214.7	217.3	208.2	112.4	61.8	71.8	102.2	163.4
Difference	0.0	-5.9	-8.3	-1.7	0.7	21.1	30.9	118.5	147.1	161.1	174.4	63.8
Personal Savings Rate			Percent of Disposable Personal Income									
Forecast	2.4	2.3	2.3	2.2	2.1	2.2	2.1	2.0	1.7	1.8	2.0	2.1
Baseline	2.4	2.3	2.3	2.2	2.1	2.0	1.9	1.0	0.5	0.6	0.8	1.6
Difference	0.0	0.0	0.0	0.0	0.0	0.2	0.2	1.0	1.2	1.2	1.2	0.5

Note: Estimates are for fiscal years. Numbers may not sum due to rounding.

Source: August 2004 simulations by the Center for Data Analysis of The Heritage Foundation using the Global Insight U.S. Macroeconomic Model. Forecast Based on CDA calculations and static estimates calculated by CDA and others. Baseline based on Congressional Budget Office January 2004 Budget and Economic projections.

Table 6

CDA 04-09

Economic and Fiscal Effects of Senator Kerry's Tax Proposals (cont.)

	(Fiscal Year Average)										(Ten-year Budget Average) 2005 - 2014	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
More Economic Indicators												
Total Unemployment												
Forecast	8,583	8,095	7,379	7,532	7,870	7,963	7,982	7,952	7,884	8,067	8,180	7,890
Baseline	8,583	8,202	7,600	7,755	8,063	8,137	8,208	8,277	8,316	8,354	8,395	8,131
Difference	0	-107	-221	-223	-193	-174	-226	-325	-432	-287	-215	-240
Non Residential Investment												
Forecast	1,206.1	1,335.3	1,434.3	1,522.5	1,582.4	1,667.1	1,772.0	1,886.9	2,018.8	2,111.4	2,230.3	1,756.1
Baseline	1,206.1	1,318.5	1,429.5	1,523.1	1,583.4	1,668.0	1,767.6	1,874.2	1,986.8	2,096.3	2,222.4	1,747.0
Difference	0.0	16.8	4.8	-0.6	-1.0	-0.9	4.4	12.7	32.0	15.1	7.9	9.1
Net Capital Stock - Nonresidential												
Forecast	12,042.8	12,493.2	12,987.3	13,492.6	14,012.7	14,546.8	15,125.1	15,743.5	16,417.3	17,109.9	17,822.4	14,975.1
Baseline	12,042.8	12,479.0	12,955.7	13,469.3	13,996.5	14,536.4	15,111.0	15,721.3	16,369.3	17,046.2	17,756.9	14,944.2
Difference	0.0	14.2	31.6	23.3	16.2	10.4	14.1	22.2	48.0	63.7	65.5	30.9
User Cost of Capital												
Forecast	11.00	11.80	12.10	12.30	12.40	12.40	12.50	12.60	12.80	12.80	12.90	12.46
Baseline	11.00	11.80	12.10	12.30	12.40	12.40	12.50	12.50	12.60	12.70	12.80	12.41
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0	1.0	1.0	0.5
Consumer Price Index												
Forecast	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.2	2.2	2.3	2.3	2.1
Baseline	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.1	2.2	2.2	2.3	2.1
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0
Treasury Bill, 3 Month												
Forecast	1.1	2.6	4.0	4.6	4.7	4.7	4.8	4.9	5.1	4.9	4.9	4.5
Baseline	1.1	2.5	3.9	4.5	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.3
Difference	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.5	0.3	0.3	0.2
Treasury Bond, 10 Year												
Forecast	4.4	5.3	5.5	5.5	5.5	5.6	5.6	5.7	5.8	5.7	5.7	5.6
Baseline	4.4	5.3	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Difference	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.3	0.2	0.2	0.1

Note: Estimates are for fiscal years. Numbers may not sum due to rounding.

Source: August 2004 simulations by the Center for Data Analysis of The Heritage Foundation using the Global Insight U.S. Macroeconomic Model. Forecast: Based on CDA calculations and static estimates calculated by CDA and others. Baseline based on Congressional Budget Office January 2004 Budget and Economic projections.

Table 6

Economic and Fiscal Effects of Senator Kerry's Tax Proposals (cont.)

	(Fiscal Year Average)										(Ten-year Budget Total) 2005 - 2014	
More Economic Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
Federal Tax Revenue												
Forecast	1,817.0	2,059.9	2,257.8	2,385.7	2,509.9	2,625.1	2,772.5	2,925.9	3,134.5	3,286.1	3,475.4	27,432.8
Baseline	1,817.0	2,048.9	2,254.3	2,385.4	2,505.6	2,642.7	2,785.9	3,036.9	3,272.7	3,437.2	3,627.6	27,997.2
Difference	0.0	11.0	3.5	0.3	4.3	-17.6	-13.4	-111.0	-138.2	-151.1	-152.2	-564.4
Change in Federal Tax Revenue												
Static Change to Tax Revenue	0.0	7.4	-2.7	-1.6	7.0	-12.6	-4.4	-126.4	-179.7	-184.4	-188.5	-685.9
Dynamic Change to Tax Revenue	0.0	11.0	3.5	0.3	4.3	-17.6	-13.4	-111.0	-138.2	-151.1	-152.2	-564.4
Revenue Feedback	0.0	3.6	6.2	1.9	-2.7	-5.0	-9.0	15.4	41.5	33.3	36.3	121.5
Feedback Percent	--	48.6%	231.1%	118.7%	-38.6%	-39.7%	-204.5%	12.2%	23.1%	18.1%	19.3%	17.7%
Federal Spending												
Forecast	2,296.1	2,411.3	2,522.0	2,648.0	2,781.9	2,914.6	3,055.5	3,214.2	3,329.3	3,503.5	3,677.8	30,058.1
Baseline	2,296.1	2,411.7	2,524.4	2,650.9	2,783.2	2,913.2	3,048.6	3,199.0	3,296.5	3,456.7	3,615.9	29,900.1
Difference	0.0	-0.4	-2.4	-2.9	-1.3	1.4	6.9	15.2	32.8	46.8	61.9	158.0
Federal Surplus/Deficit												
Forecast	-479.2	-351.4	-264.1	-262.2	-272.0	-289.5	-283.0	-288.3	-194.8	-217.4	-202.4	-2,625.1
Baseline	-479.2	-362.8	-270.1	-265.5	-277.6	-270.5	-262.7	-162.1	-23.8	-19.4	11.6	-1,902.9
Difference	0.0	11.4	6.0	3.3	5.6	-19.0	-20.3	-126.2	-171.0	-198.0	-214.0	-722.2
Net Publicly Held Federal Debt												
Forecast	4,189.0	4,460.4	4,594.8	4,690.0	4,790.2	4,903.2	5,028.5	5,138.6	5,202.5	5,223.9	5,241.4	49,274
Baseline	4,189.0	4,465.9	4,611.6	4,709.1	4,813.9	4,920.9	5,023.3	5,060.7	4,960.9	4,794.8	4,603.6	47,965
Difference	0.0	-5.5	-16.8	-19.1	-23.7	-17.7	5.2	77.9	241.6	429.1	637.8	1,309
Net Publicly Held Federal Debt Share												
Forecast	36.5	36.9	36.3	35.4	34.6	33.7	33.0	32.1	31.0	29.8	28.6	33.1
Baseline	36.5	36.9	36.4	35.6	34.7	33.9	33.1	31.9	29.9	27.7	25.5	32.6
Difference	0.0	0.0	-0.1	-0.2	-0.1	-0.2	-0.1	0.2	1.1	2.1	3.1	0.6

Note: Estimates are for fiscal years. Numbers may not sum due to rounding.

Source: August 2004 simulations by the Center for Data Analysis of The Heritage Foundation using the Global Insight U.S. Macroeconomic Model Forecast Based on CDA calculations and static estimates calculated by CDA and others. Baseline based on Congressional Budget Office January 2004 Budget and Economic projections.