CDA
Center for Data Analysis

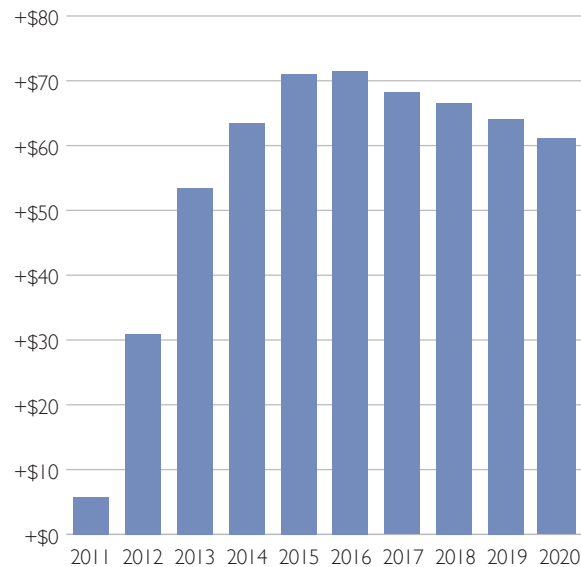# A Free Enterprise Prescription: Unleashing Entrepreneurs to Create Jobs

James Sherk, Karen A. Campbell, Ph.D., and John L. Ligon

CDA10-09 December 14, 2010

Free Enterprise Prescription: $560 Billion in Economic Growth

Annual Change in GDP, in Billions

Note: Figures are in 2010 dollars.

The Heritage Foundation
LEADERSHIP FOR AMERICA

A Report

of The Heritage Center

for Data Analysis

A Free Enterprise Prescription:
Unleashing Entrepreneurs to Create Jobs

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A FREE ENTERPRISE PRESCRIPTION: UNLEASHING ENTREPRENEURS TO CREATE JOBS

JAMES SHERK, KAREN A. CAMPBELL, PH.D., AND JOHN L. LIGON

Abstract: *The Obama Administration's $862 billion stimulus bill was an expensive failure that increased the federal deficit, contributed to America's deteriorating fiscal health, and failed to reduce unemployment. Instead of repeating this mistake, Congress should alleviate business fears and economic uncertainty by maintaining the current tax policy (extending the 2001 and 2003 tax rates) and freezing costly new regulations. Then, Congress should rescind unspent stimulus funds, suspend federal regulations that unnecessarily suppress economic activity, conclude pending free trade agreements, and adopt other pro–free market steps. By enacting these reforms, Congress can unleash substantial economic growth, reduce unemployment, and reduce the deficit without spending a dollar of taxpayer money.*

At the start of his Administration, President Barack Obama pushed through a massive $862 billion stimulus bill. The stimulus increased government spending and has increased the federal deficit. However, it failed to reduce unemployment.

This expensive failure was predictable. Businesses hire workers to produce the goods and services that consumers value, but the stimulus emphasized government spending, which only shifts resources around the economy. Government spending neither increases overall demand nor gives private businesses a reason to invest in new projects.

To reduce unemployment, Congress needs to motivate businesses to invest and expand. First, Congress should alleviate business fears and economic uncertainty by maintaining the current tax policy (i.e., extending the 2001 and 2003 tax rates) and by freezing costly new regulations.

In a speech at The Heritage Foundation, Representative Eric Cantor (R–VA) proposed measures to catalyze economic growth without adding to the deficit.[1] The Heritage Foundation has proposed similar ideas. Congress should adopt a Free Enterprise Prescription to help the economy recover, implementing six steps to eliminate Washington-imposed threats to a recovery and to improve the business climate. Specifically, Congress should:

- Rescind unspent stimulus funds;
- Reform regulations—specifically repealing Section 404 of the Sarbanes–Oxley Act—to reduce unnecessary business costs;
- Remove barriers to domestic energy production;
- Suspend the job-killing Davis–Bacon Act and prohibit Project Labor Agreement (PLA) requirements on federally funded construction projects;
- Conclude the pending free trade agreements (FTAs) with Colombia and Panama, as well as the recently announced agreement with South Korea; and

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1. Eric Cantor, "Does Creating Jobs Have to Cost Money?" Heritage Foundation *Lecture* No. 1137, December 11, 2009, at *http://www.heritage.org/Research/Lecture/Does-Creating-Jobs-Have-to-Cost-Money.*

• Reduce taxes on foreign earnings to encourage companies to repatriate the profits to America.

These measures would encourage hiring in the short term and lay a foundation for long-term economic growth, which is the ultimate goal of "stimulus."[2] These measures are not a panacea for all of America's economic problems. However, they would help the economy. A strong recovery and new hiring depend on improving the business climate. Congress can do this without additional government spending.

Using the IHS Global Insight macroeconomic forecasting model, The Heritage Foundation has simulated how adopting the Free Enterprise Prescription would affect the economy. Compared with the baseline economic forecast,[3] the Free Enterprise Prescription would:

• Increase real gross domestic product (GDP) by $6 billion in 2011 and by an average of $56 billion a year between 2011 and 2020,[4]

• Lead private-sector businesses to hire 52,000 more workers in 2011, an average of 305,000 workers a year between 2011 and 2020,

• Reduce the unemployment rate by an average of 0.1 percent between 2011 and 2020,

• Increase the value of an index of equity holdings by 2.7 percent in 2011 and by an average of 4.9 percent a year between 2011 and 2020,

• Reduce the federal budget deficit by $27 billion in 2011, and

• Reduce the projected level of the national debt by $305 billion by 2020.

FAILED STIMULUS

Unemployment has increased rapidly since the recession began in December 2007. Congress passed President Obama's stimulus bill in February 2009 in an attempt to deal with this problem. Initial estimates placed its price tag at $787 billion, but the Congressional Budget Office subsequently increased its estimated cost to $862 billion.[5]

The stimulus legislation substantially increased government spending, but failed to spur private-

Government Spending Did Not Stimulate Private-Sector Hiring

President Obama promised that government spending would "stimulate" the economy and quell rising unemployment by "creating or saving" millions of jobs. In January 2009, Obama's advisers produced a chart (bottom) visualizing the positive results of his recovery plan. But actual unemployment (below, detail from box at bottom) has far exceeded the White House estimates.
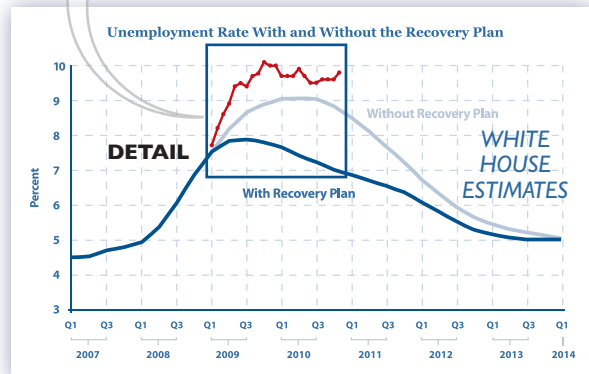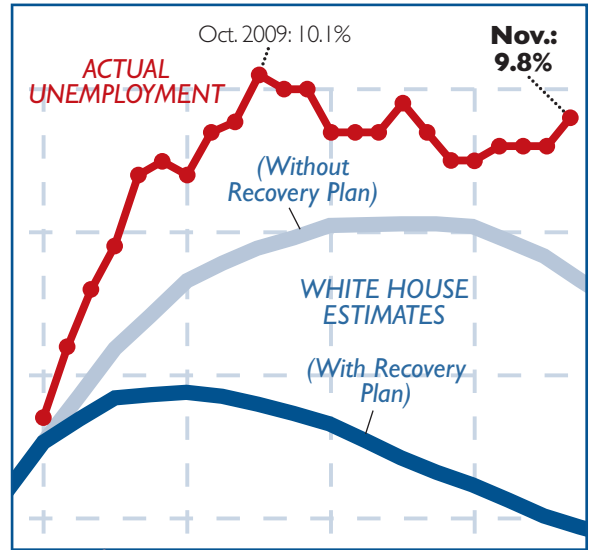
Sources: Christina Romer and Jared Bernstein, "The Job Impact of the American Recovery and Reinvestment Plan," January 9, 2009, p. 4, Figure 1, and U.S. Bureau of Labor Statistics, "The Employment Situation," 2007–2010.

Chart 1 • CDA 10-09 ☎ heritage.org

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2. For more details on steps that Congress can take to speed the recovery, see The Heritage Foundation, "Heritage Prescribes Solutions for America," at *http://www.heritage.org/research/projects/solutions-for-america*.

3. This baseline forecast assumes that Congress maintains the current tax policy. In other words, it assumes that Congress will extend the 2001 and 2003 tax relief and that the tax hikes in the health care legislation will take effect. The baseline forecasts a slowly recovering economy.

4. The amounts are in inflation-adjusted 2010 dollars.

> *Government spending does not increase demand for goods and services. It simply redistributes demand within the economy.*

sector hiring. Unemployment has now risen above the level that the Administration had projected if Congress did not pass anything. By the Administration's own measure, the stimulus has failed.

This failure was predictable because government spending does not give private businesses a reason to invest in new projects and hire new workers. Every dollar the government spends must be borrowed or taxed from somewhere else. Government spending does not increase demand for goods and services. It simply redistributes demand within the economy. Congress should take a new approach of improving business prospects for entrepreneurs.

LOW JOB CREATION, HIGHER UNEMPLOYMENT

The primary factor driving unemployment higher in this recession has been lower job creation. Reduced creation of new jobs accounts for 71 percent of the drop in net employment during the recession. Layoffs account for only 29 percent.[6] While layoffs have now returned to pre-recession levels, business hiring has not. Businesses hired 18 percent fewer workers in September 2010 than they did in the fourth quarter of 2007, the last quarter before the recession.[7]

This drop in hiring is unsurprising. Annual private fixed investment has fallen by 13 percent since the recession began.[8] As long as business investment remains low and entrepreneurs hold back from starting new enterprises or expanding into new operations, job creation will remain low, and unemployment will stay high.

IMPROVING THE BUSINESS CLIMATE

To reduce unemployment Congress should improve the business climate. Reducing or removing barriers to wealth creation would spur entrepreneurs and investors to act. They would invest in new projects to take advantage of these opportunities and create new jobs in the process. Unlike government spending, an improved business climate would lay the foundation for a lasting economic recovery. Congress also can and should implement tax, regulatory, and spending changes that remove barriers to business success. This would boost the economy at no borrowing cost[9] to the U.S. Treasury. The Heritage Foundation's Free Enterprise Prescription includes several such elements.

First, Do No More Harm. Congress can begin to help the economy by doing no more harm. Many items on the federal agenda would significantly raise business costs. For example, uncertainty surrounds the expiration of the 2001 and 2003 tax relief, and Members of Congress regularly propose new taxes. The Environmental Protection Agency is working on carbon regulations that impose considerable expenses on many businesses. Businesses can only guess how much Washington will raise their costs in the near future.

In such a threatening economic environment, companies are wisely choosing to invest less. Indeed, 74 percent of small-business owners say now is not a good time to expand. Of the 74 percent, one in seven gives the political climate as the reason.[10]

Economists have recently studied the effects of uncertainty in the economy. Two recent studies

5. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, at *http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf* (December 10, 2010).

6. Heritage Foundation calculations using data from U.S. Department of Labor, Bureau of Labor Statistics, "Business Employment Dynamics," 4th quarter of 2007 to 4th quarter of 2009.

7. Heritage Foundation calculations using data from U.S. Department of Labor, Bureau of Labor Statistics, "Job Openings and Labor Turnover Survey," October–December 2007 and September 2010.

8. U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Account Tables, Table 5.3.6, revised October 26, 2010.

9. The "cost" in the Free Enterprise Prescription refers to additional cash outlays. Any policy change has an economic opportunity cost. This is why dynamic analysis is conducted to estimate whether the economic opportunity costs outweigh the economic benefits.

10. William Dunkelberg and Holly Wade, "Small Business Economic Trends Survey," National Federation of Independent Business, November 2010, p. 5, at *http://www.nfib.com/Portals/0/PDF/sbet/sbet201011.pdf* (December 10, 2010).

found that both microeconomic and macroeconomic uncertainty reduce business investment, hiring, and subsequent output.[11] Congress and the Administration can remove this job-killing fear overnight. The leaders of both houses of Congress should issue a joint statement announcing that Congress will maintain current tax policy and not allow taxes to rise. The Administration should announce that it will not permit any new regulations to take effect that would cost the economy more than $100 million per year.[12]

Federal Spending. Federal spending has increased markedly during the recession, and the money the federal government is spending does not come out of thin air. When the government borrows, it competes with private businesses for the money that Americans (and people around the world) save. The more the government spends, the less private businesses can borrow and the higher the interest rates that they must pay to secure investment funding.[13] Rather than acting as a stabilizing force, the federal government is increasingly perceived as destabilizing the economy.[14] Countries with higher government spending actually have higher unemployment.[15]

Government spending crowds out private-sector investment in two ways. First, government borrowing competes with the private sector for savings. This puts upward pressure on interest rates, pricing some investments out of the market.[16] Second, government borrowing can increase expectations of

> *When the government borrows, it competes with private businesses for the money that Americans (and people around the world) save.*

higher future taxes. This reduces the benefit of investing today in new productive resources, which can create new sources of income in the future that will likely be taxed at higher rates.

Congress needs to bring federal spending under control. A good first step would be to rescind the uncommitted stimulus funds. Freezing federal spending for the next three years, as proposed in President Obama's 2011 budget,[17] would be a good second step as long as spending is frozen at or below pre-stimulus levels.

Reducing Red Tape. Many government regulations raise business costs while providing little public benefit. If Congress eliminated those regulations, it would reduce costs and encourage business expansion and hiring.

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11. Ruediger Bachmann, Steffen Elstner, and Eric Sims, "Uncertainty and Economic Activity: Evidence from Business Survey Data," National Bureau of Economic Research *Working Paper* No. 16143, February 8, 2010, and Nicholas Bloom, Max Floetotto, and Nir Jaimovich, "Really Uncertain Business Cycles," draft, Stanford University, September 2009, at *http://www.stanford.edu/~nbloom/RUBC_DRAFT.pdf* (December 10, 2010).

12. We do not attempt to model the effect of reduced uncertainty in our analysis. In this regard, the results can be viewed as a lower bound estimate of effects of the Free Enterprise Prescription. A reduction in policy uncertainty reduces risk premiums and therefore would likely boost investment, productivity, hiring, and GDP above the levels presented in our analysis.

13. Nicole V. Crain and W. Mark Crain, "The Impact of Regulatory Costs on Small Firms," Small Business Office of Advocacy, September 2010, at *http://www.sba.gov/advo/research/rs371tot.pdf* (December 10, 2010).

14. The government's role in providing a stable macroeconomic environment is recognized as a key factor for economic growth by economists who study economic development. See William J. Baumol, Robert E. Litan, and Carl J. Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (New Haven, Conn.: Yale University Press, 2007). In developed countries, macroeconomic stability includes (1) managing the fiscal budget of the government to avoid burdening the economy with excessive debt, (2) minimizing distortions from taxes and regulations that can tilt the rules to favor groups of individuals or businesses, and (3) minimizing inefficient rent-seeking incentives with a rule-of-law system that provides a stable expectation of outcomes associated with decisions, which are not subject to arbitrary political or judicial rulings.

15. Yann Algan, Pierre Cahuc, and André Zylberberg, "Public Employment and Labour Market Performance," *Economic Policy*, Vol. 17, No. 34 (April 2002), pp. 7–66; Jim Malley and Thomas Moutos, "Does Government Employment 'Crowd-Out' Private Employment? Evidence from Sweden," *Scandinavian Journal of Economics*, Vol. 98, No. 2 (June 1996), pp. 289–302; and Horst Feldmann, "Government Size and Unemployment: Evidence from Industrial Countries," *Public Choice*, Vol. 127, Nos. 3–4 (June 2006), pp. 443–459, at *http://www.springerlink.com/content/80780u1247g7uk5v/fulltext.pdf* (December 10, 2010).

16. See Alberto Alesina, Silvia Ardagna, Roberto Perotti, and Fabio Schiantarelli, "Fiscal Policy, Profits, and Investment," *The American Economic Review*, Vol. 92, No. 3 (June 2002), pp. 571–589. For additional references, see the Appendix.

For example, Section 404 of the Sarbanes–Oxley Act requires publicly traded firms to conduct an annual external audit of their financial controls and to produce an "internal control report" as part of each annual Exchange Act report. The report affirms "the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting."[18]

The Heritage Foundation has previously written about the problems with Section 404.[19] It provides little benefit to shareholders, but compliance costs small-sized and medium-sized companies an average of 0.5 percent of their revenues ($1.5 million per year).[20] These costs discourage privately held companies from making public stock offerings.

To the extent that Sarbanes–Oxley is discouraging companies from going public, it is deterring savings and investment. Public companies generally have greater access to the debt and equity capital markets, enabling them to undertake larger investments in R&D and expansion. In addition, public companies provide opportunities for ordinary individuals with limited savings to become owners of companies and to reap the benefits of corporate profits and capital gains.

Congress should not needlessly impose regulatory costs on the economy.

Domestic Energy Development. Federal law and regulations heavily restrict domestic energy production. To encourage production and job creation, Congress should:

- Permit environmentally responsible oil and natural gas production in the Arctic National Wildlife Refuge (ANWR),

Many companies would gladly invest in oil and natural gas projects if Congress did not prohibit them from investing.

- Open up off-limits areas of the Outer Continental Shelf for environmentally responsible oil drilling,

- Streamline the licensing of nuclear power plants, and

- Reform the National Environmental Policy Act's environmental and judicial review process to reduce the maximum amount of time to award construction permits on federal lands to 270 days.

Many companies would gladly invest in oil and natural gas projects if Congress did not prohibit them from investing. Such projects can proceed in an environmentally responsible manner. If Congress removed existing federal barriers, it would spur immediate investment in energy production. In the long term, the expanded energy production would lower energy costs and benefit the entire economy.

Suspending the Davis–Bacon Act and Ending PLA Requirements. Congress can better leverage federal spending by suspending antiquated labor laws. Two provisions of federal law needlessly inflate the cost of federal construction projects.

The Davis–Bacon Act requires federal construction contractors to pay "prevailing wage" rates that average 22 percent above market rates,[21] forcing the government to hire four construction workers for the price of five. This added $11.4 billion to federal construction costs in 2010. Suspending the law

17. See U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2011* (Washington, D.C.: U.S. Government Printing Office, 2010), at *http://www.whitehouse.gov/omb/budget/Overview http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/budget.pdf* (December 10, 2010). The proposal for a spending freeze on the budget is not modeled in this simulation.

18. 15 U.S. Code § 7262(a).

19. David C. John and Nancy Marano, "The Sarbanes-Oxley Act: Do We Need a Regulatory or Legislative Fix?" Heritage Foundation *Backgrounder* No. 2035, May 16, 2007, at *http://www.heritage.org/Research/Reports/2007/05/The-Sarbanes-Oxley-Act-Do-We-Need-a-Regulatory-or-Legislative-Fix*. The Heritage Foundation has called for the repeal of Sarbanes–Oxley. See The Heritage Foundation, "Heritage Prescribes Solutions for America," August 17, 2010, at *http://www.heritage.org/Research/Reports/2010/08/Restoring-the-US-to-a-Free-Economy*.

20. Jiamin Wang, "Sarbanes-Oxley Section 404 Places Disproportionate Burden on Smaller Public Companies," Heritage Foundation, Center for Data Analysis, August 2008, at *http://www.heritage.org/About/Staff/Departments/Center-for-Data-Analysis/~/media/CDA/CDA_features/SOXCDAedited3.ashx*.

21. Sarah Glassman, Michael Head, David G. Tuerck, and Paul Bachman, "The Federal Davis–Bacon Act: The Prevailing Mismeasure of Wages," Beacon Hill Institute, February 2008, at *http://www.beaconhill.org/BHIStudies/PrevWage08/DavisBaconPrevWage080207Final.pdf* (December 10, 2010).

would allow the government to build more infra-structure for the same amount of money, employing many additional workers in the process.

An executive order from President Obama encourages federal agencies to use project labor agreements (PLAs) on large federal construction projects. A PLA requires contractors to sign a collective bargaining agreement with construction unions before beginning work. These bargaining agreements require contractors to hire all workers through union hiring halls. PLAs discriminate against non-union construction workers and raise construction costs between 12 percent and 18 percent.[22]

Federal policy should not artificially inflate some workers' wages, while leaving others unemployed. Congress should repeal the Davis–Bacon Act and prohibit PLA requirements on all federally funded construction projects. This would allow construction appropriations to pay for more projects, giving taxpayers better value for their money and increasing construction employment.

Concluding the Free Trade Agreements. The *Index of Economic Freedom*, published by The Heritage Foundation and *The Wall Street Journal*, illustrates the essential role that free trade plays in economic growth.[23] Nearly all economists agree that removing trade barriers helps the economy. However, the Obama Administration has not submitted the free trade agreements negotiated with Panama and Colombia to Congress, and Congress has not ratified the recently announced FTA with South Korea. The U.S. International Trade Commission has estimated that these three trade agreements would increase U.S. GDP by $12.6 billion to $14.4 billion.

Despite changes by the Obama Administration—such as extending a 25 percent tax on pickup trucks made in South Korea for eight more years—the Korea FTA will still eliminate tariffs on 95 percent of industrial and consumer goods over the next five years. The trade pact would be the second-largest free trade area for the U.S. (in dollar value) after the North American Free Trade Agreement (NAFTA).

Repatriating Foreign Profits. Unlike most countries, which only tax profits earned within their borders, U.S. multinational companies that earn money in foreign countries must pay U.S. taxes on those earnings if they bring them into the U.S. As a result, many firms leave profits overseas rather than repatriating them to America.

Congress should allow multinational corporations to bring their earnings into the U.S. without paying prohibitive tax rates. This would benefit the economy through several channels. First, repatriated funds would provide additional liquidity, allowing corporations to make investments that raise the value of the firm. Shareholders would realize this value through stock price appreciation. Second, firms could pass on the earnings as a dividend to shareholders, who could then use the wealth to increase their household spending and make new

> *Unlike most countries, which only tax profits earned within their borders, U.S. multinational companies that earn money in foreign countries must pay U.S. taxes on those earnings if they bring them into the U.S.*

investments. Third, firms could use the added liquidity to finance current operations, such as paying workers and suppliers, reducing their need to borrow working capital. This would also reduce firms' interest expenses, increasing profits and stockholder value. Fourth, firms could use the repatriated earnings to reduce outstanding loans, which would reduce interest payments and increase profits.[24] Dividend repatriation has dynamic effects that increase overall household wealth in ways that can be leveraged for higher growth, leading to improved job and wage opportunities.[25]

22. David G. Tuerck, Sarah Glassman, and Paul Bachman, "Project Labor Agreements on Federal Construction Projects: A Costly Solution in Search of a Problem," Beacon Hill Institute, August 2009, at *http://www.beaconhill.org/BHIStudies/PLA2009/PLAFinal090923.pdf* (December 10, 2010).

23. Elaine L. Chao, "Trading for Prosperity," Chap. 2, in Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), at *http://www.heritage.org/index/PDF/2010/Index2010_Chapter2.pdf* (December 10, 2010).

24. For an empirical analysis of how repatriated profits have been allocated, see Allen Sinai, "Macroeconomic Effects of Reducing the Effective Tax Rate on Repatriated Foreign Subsidiary Earnings in a Credit-and-Liquidity-Constrained Environment," Decision Economics *Economic Studies Series* No. 66, December 11, 2008.

HOW PRO-GROWTH POLICY WOULD EXPAND THE ECONOMY

Congress should take these steps to put the economy on a sounder footing. To quantify the economic effects of these proposals, analysts in The Heritage Foundation's Center for Data Analysis (CDA) used a version of the IHS Global Insight July short-term structural model of the U.S. economy. This version of the model uses an adjusted baseline forecast of the economy representing current policy.[26] In other words, the baseline model assumes that Congress extends the 2001 and 2003 tax relief and allows the tax hikes contained in the health care legislation to go forward.[27]

Congress needs to look for long-term solutions, not simply short-term stimulus.

Given these assumptions, the baseline forecast is the most probable path the economy will follow absent any unforeseen shocks to the economy. This was compared to a counterfactual scenario in which the Free Enterprise Prescription proposals were implemented.

The difference between the current policy forecast and this alternative forecast represents the net economic effect of implementing the Free Enterprise Prescription. Because making entrepreneurial, consumer, and firm decisions and realizing the results of these decisions take time, a dynamic analysis is necessary to estimate the full impact of the policy. Heritage Foundation analysts used a 10-year forecast to evaluate this proposal.

The analysis estimated[28] that, compared with the baseline, the Free Enterprise Prescription proposal would:

- **Increase private-sector employment.** Private-sector businesses would hire 52,000 more workers in 2011. Over 2011 to 2020, private-sector employment would average 305,000 more workers per year than the baseline.

- **Reduce government employment.** Government employment would fall by 56,000 in 2011. Over 2011 to 2020, government employment would average 66,000 fewer positions per year.

- **Reduce unemployment.** Unemployment would fall by an average 0.1 percent over 2011 to 2020.

- **Increase private-sector investment.** With reduced government crowding out of private investment, gross private domestic investment would average $20.1 billion more per year over 2011 to 2020.

- **Expand the economy.** Gross domestic product would rise by $5.8 billion in 2011 and average $55.6 billion more per year over 2011 to 2020.

- **Increase incomes.** On average, the typical family of four would have $666 more in after-tax income to spend or save each year.

- **Increase the value of stock portfolios.** The value of the Standard and Poor's 500 would rise by 2.7 percent in 2011 and average 4.9 percent higher over 2011 to 2020.

- **Increase net wealth.** The increased growth in the economy helps raise asset values, such as the stocks, which helps increase household net worth by an average $594 million more per year over 2011 to 2020.[29]

The Free Enterprise Prescription is not a panacea for America's economic problems. America faces many economic challenges in the next decade with or without the Free Enterprise Prescription, but

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25. For a recent discussion of these channels for repatriation, see Frank Aquila, "Stimulus of $1 Trillion Adds Nothing to the Deficit," Bloomberg, October 12, 2010, at *http://www.bloomberg.com/news/2010-10-12/stimulus-of-1-trillion-adds-nothing-to-deficit-frank-aquila.html* (December 10, 2010).

26. For a description of the baseline, see the Appendix.

27. The Heritage Foundation has separately modeled the economic effects of letting the 2001 and 2003 tax rates expire for upper-income individuals versus a current policy baseline of extending all the 2001 and 2003 tax rates. See William W. Beach, Rea S. Hederman, Jr., John L. Ligon, Guinevere Nell, and Karen A. Campbell, "Obama Tax Hikes: The Economic and Fiscal Effects," Heritage Foundation *Center for Data Analysis Report* No. CDA10–07, September 20, 2010, at *http://www.heritage.org/Research/Reports/2010/09/Obama-Tax-Hikes-The-Economic-and-Fiscal-Effects*.

28. All dollar amounts are inflation-adjusted to 2010 price levels unless otherwise noted.

29. Household net wealth is total assets minus total liabilities. Thus, it can fluctuate from year to year based on the value of assets, interest rates, additional borrowing, and other factors.

these policy proposals would improve the economy. They would provide short-term benefits and measurably improve long-term economic growth.

Policymakers should remember that nonpartisan forecasts project prolonged economic pain. Congress needs to look for long-term solutions, not simply short-term stimulus.

STIMULATING PRIVATE INVESTMENT

The Free Enterprise Prescription would induce these results through multiple dynamic channels. Investment spending would rise because the expected return on an investment depends in part on the projected operating costs of the new operations or expansion. These include the costs of financing, permitting, licensing, ongoing tariff barriers, complying with financial regulations, and business liability insurance. The Free Enterprise Prescription proposal would lower some of the regulatory costs and help to put downward pressure on borrowing and financing costs, thereby increasing the expected after-tax return on investments.

Expediting energy permits would spur investment in the energy sector by lowering the cost of obtaining permits and increasing the present value of the investment by hastening the time when the investment would begin paying off.[30] Suspending the Davis–Bacon wage requirements would increase the number of projects that could employ private construction firms. Suspending the requirements would also help smaller construction companies, previously hampered by Davis–Bacon compliance costs, to bid for government contracts. Repealing Section 404 of Sarbanes–Oxley would lower the risk premium on investment decisions and encourage greater investment.

Allowing the repatriation of profits at a 5.25 percent rate would boost investment spending in the U.S. by increasing the availability of liquid

Free Enterprise Prescription Promotes Private Investment

Private investment would increase by an average of $20.1 billion from 2011 to 2020.

Annual Difference in Gross Private Investment with Free Enterprise Prescription, in Billions
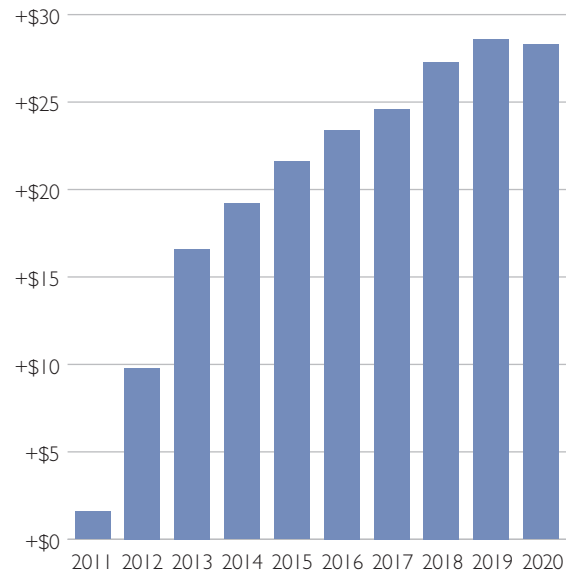
Note: Figures are in 2010 dollars.

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Chart 2 • CDA 10-09 ☎ heritage.org

funds for investment. The cap on government spending[31] and rescission of unspent stimulus funds would also ease the crowding out of private investment,[32] stimulating the current hiring of productive resources through higher private investment spending.[33]

All of these factors would boost investment, yielding an average of $20.1 billion greater investment per year between 2011 and 2020.

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30. Future revenue streams from an investment are discounted to the present. The further in the future a revenue stream occurs, the more it is discounted, thus lowering the expected value. The discounting of future payments accounts for inflation risks and other risks associated with an uncertain future.

31. The simulation of the Free Enterprise Prescription proposal did not explicitly assume government spending freezes. Instead, we allowed spending to remain endogenous as other parts of the proposal would help to ease discretionary spending and bring them under the cap. Allowing this dynamic to unfold according to historical patterns rather than an imposed assumption produces a more conservative estimate of the policy effect, but is also more realistic given the political constraints associated with spending reductions.

32. Alesina *et al.*, "Fiscal Policy, Profits, and Investment," pp. 571–589. For additional references, see the Appendix.

33. Corporate Triple-A interest rates are lower each year through 2017, when increased investment demand from businesses begins to catch up with savings and when competition for funds tightens.

Concluding the FTAs negotiated with South Korea, Colombia, and Panama would reduce costs for businesses and consumers by reducing the deadweight losses due to tariffs and quotas. U.S. net exports are projected to increase more with these FTAs than without them.

Importing more goods and raw materials at lower costs frees domestic resources to expand businesses through investing and hiring. U.S. demand for imports allows the economies of U.S. trading partners to expand and, in turn, demand more U.S. exports. This expands opportunities for economies of scale in the U.S., and it can increase U.S. productivity by enabling America to specialize in producing goods and services in which the U.S. has a comparative advantage.

Increased levels of investment spending would help to spur economic growth. As these investments begin to pay off over the 10-year forecast, they would boost personal and business earnings. Higher incomes would build greater household and business asset values,[34] increasing the "pool" of private dollars to finance new investment spending in the economy.

Unsurprisingly, GDP is higher for every year in the Free Enterprise Prescription forecast. In 2011, GDP is $5.8 billion above the baseline. By 2020, the economy is $61.1 billion above the baseline.[35]

Furthermore, the time value, due to compound growth, of creating more goods and services sooner and reinvesting some of the value now would allow households to build their nest eggs more quickly. Total household net wealth averages $594 billion higher for each year. This increases household financial security during unforeseen economic events and provides a larger base of assets on which to generate income for retirement, pay college tuition for children, or meet other financial goals.

JOB GROWTH

Under the Free Enterprise Prescription, the private sector would drive the additional job growth. The public sector would shed jobs, and the private sector would absorb the displaced government workers. Government employment has grown during this recession while the private sector has fallen

Free Enterprise Prescription: $560 Billion in Additional Economic Growth

The prescription would spur strong economic growth in the U.S. economy, including additional increases of at least $50 billion every year beginning in 2013 and a total of $556 billion by 2020.

Annual Change in GDP Due to Free Enterprise Prescription, in Billions
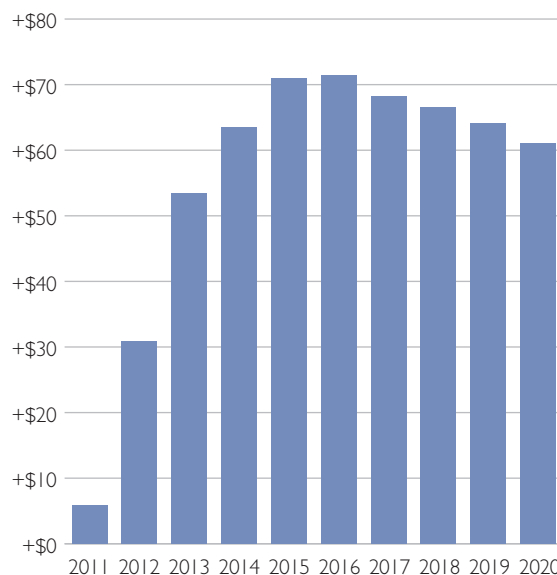
Note: Figures are in 2010 dollars.

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Chart 3 • CDA 10-09 ☎ heritage.org

sharply. Implementing the Free Enterprise Prescription would both create jobs and help to rebalance employment toward the private sector.

The forecast shows that private-sector hiring would rise as investment, private-sector corporate business profits, and small business income increase. Under the Free Enterprise Prescription, employers would add an estimated 172,000 net new private-sector jobs by 2012. However, total employment would rise by a net 104,000 jobs because government employment would shrink by 68,000 jobs.

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34. The results show the value of the S&P 500 index averages 4.9 percent higher during the forecast period.
35. All dollar values are in 2010 inflation-adjusted dollars unless otherwise noted.

Free Enterprise Prescription a Boost to Private-Sector Hiring

Annual employment would expand by an average of 239,000 jobs over the next decade.
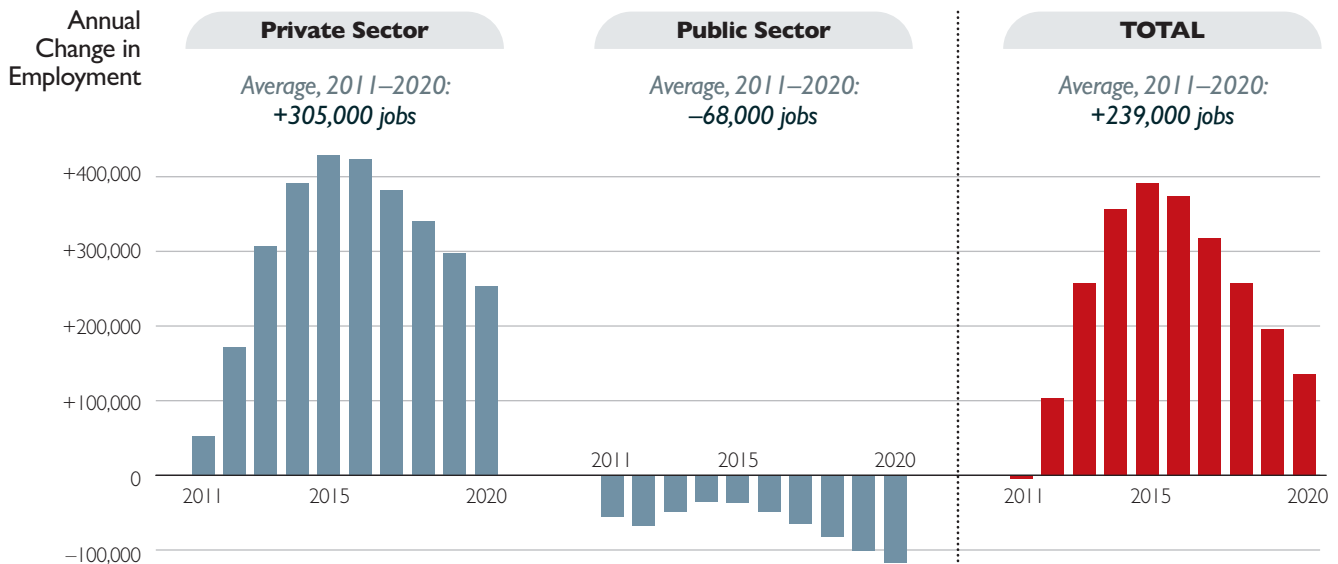
Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Chart 4 • CDA 10-09 ☎ heritage.org

These job growth estimates extend beyond the first two years. The dynamic forecast of this proposal estimates that private employment would average 305,000 more private-sector jobs over the 2011 to 2020 period and 68,000 fewer government jobs.

IMPROVED FISCAL HEALTH

Increased tax revenues, reduced spending, less debt, and greater overall economic growth contribute to a positive feedback cycle of investment, productivity growth, job creation, and subsequent income growth.[36] This income growth and increased employment increase total tax revenues

and reduce government spending for unemployment insurance and related benefits for the jobless. This also reduces the deficit, helping to keep inflation and tax expectations stable, feeding back positively into investment decisions and government fiscal health.

The forecast estimates a $209 billion increase in federal tax revenues for 2011 to 2020.[37] The additional tax revenue would further reduce the deficit and reinforces the positive growth effects of alleviating some of the projected debt burden.[38]

Total federal spending would fall by $104 billion over the period. In total, privately held national debt would grow by $305 billion less by 2020.[39]

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36. The federal unified budget reflects the increase in federal tax receipts and the reduction in federal government spending. The increase in receipts is a dynamic effect resulting from higher employment and wages, which also means higher payroll taxes and business income. Likewise, the reduction in federal spending is a dynamic result in addition to the direct effects of suspending Davis–Bacon and rescinding the stimulus. Lower interest rates and lower debt principle reduce the interest payments and further reduce deficits. A stronger economy also means less spending on transfer payments, such as unemployment benefits. For the simulation results relating to the Federal Unified Budget Surplus/Deficit, see the Appendix.

37. These figures are in nominal dollars.

38. See Carmen Reinhart and Kenneth Rogoff, "Growth in a Time of Debt," *American Economic Review*, Vol. 100, No. 2 (May 2010), pp. 573–578.

U.S. Debt Burden: $305 Billion Less by 2020

Annual Change in Federal Budget Deficits Due to Free Enterprise Prescription, in Billions
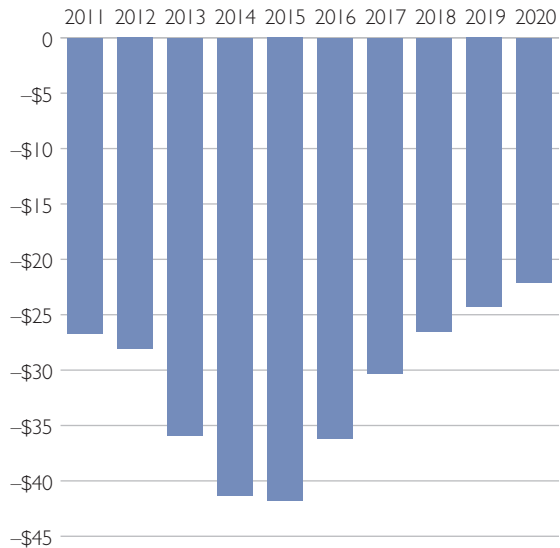
Note: Figures are not adjusted for inflation.

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Chart 5 • CDA 10-09 ☎ heritage.org

no additional cost to the U.S. Treasury. This Free Enterprise Prescription would include:

- Rescinding uncommitted federal stimulus spending;
- Eliminating unnecessarily costly regulations, such as Section 404 of the Sarbanes–Oxley Act;
- Reducing restrictions on domestic energy development;
- Ending Davis–Bacon restrictions and Project Labor Agreement mandates on federally funded construction projects;
- Concluding the pending FTAs with South Korea, Colombia, and Panama; and
- Permitting multinational corporations to repatriate foreign earnings to the United States at reduced rates.

These are only first steps. The Heritage Foundation has outlined additional steps that Congress should implement.[41] The Free Enterprise Prescription is not a panacea for America's economic malaise. In particular, America desperately needs entitlement reform and tax reform to continue to be the land of opportunity in the 21 century.

The American economy will not immediately regain its health. With or without the Free Enterprise Prescription, the economy will remain weak for several years. However, these policies would measurably accelerate America's economic recovery.

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CONCLUSION

Despite the official end of the recession in June 2009, the economy remains stagnant.[40] Large increases in government spending have failed to stimulate private-sector job creation. Congress should not continue to increase spending and expect a different result. Instead, Congress should maintain the current tax policy and freeze costly new regulations. It should then take six positive steps to improve the business climate and encourage private-sector investment and job creation at

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39. Note that the change in privately held federal debt is not precisely equal to the change in the deficit over this period. In any given time window, changes in the total debt level (a stock variable) is not exactly the same as the total changes in deficits (a flow variable) due to the Treasury's cash flow management practices (e.g., issuing debt in bond markets to meet current budget obligations).

40. Recessions are dated by a committee of economists at the National Bureau of Economic Research, which declares the end of a recession when the economy ceases to contract according to a host of metrics that the committee tracks. Of course, most Americans will not notice an end to economic hardship for months, sometimes years after the official end of the contraction. For more on the recession dating, see National Bureau of Economic Research, "The NBER's Business Cycle Dating Committee," September 20, 2010, at *http://www.nber.org/cycles/recessions.html* (November 4, 2010).

41. See The Heritage Foundation, "Heritage Prescribes Solutions for America."

APPENDIX
MACROECONOMIC SIMULATION METHODOLOGY

The IHS Global Insight July Short-Term Model

Analysts in the Center for Data Analysis at The Heritage Foundation used a version of the IHS Global Insight July 2010 short-term model of the U.S. economy to estimate the net economic effects of the Free Enterprise Prescription policy proposal. This version of the model used an adjusted baseline representing the most likely path of the U.S. economy if the government extends the current policies over the next 10 years.

The relationships in the model were calibrated by historical U.S. data and mainstream economic theory. The model is a tool that provides insight into the likely magnitudes and directions of economic variables due to policy changes. A dynamic analysis of a policy change is important because obtaining a true estimate of the likely overall economic impact in an ever-changing and market-based economy requires accounting for indirect and feedback effects.

For example, direct effects occur when many individuals make small changes in their labor and leisure trade-off decisions. These changes, in turn, change capital–labor trade-offs made by businesses. The macroeconomic model dynamically estimates these changes in relative prices and the effects of these price changes on investment and output levels. Tax rate changes also affect disposable income and demand variables.

These have further feedback effects on supply variables and interact with the fiscal revenues and spending variables. The feedback effects further increase or decrease the longer-term impact of the policy, providing a quantitative picture of whether implementing the proposal would tend to strengthen or weaken the economy compared to the baseline.

The Adjusted Baseline

This version of the IHS Global Insight July 2010 short-term model of the U.S. economy baseline reflects—as closely as possible—current policy, after CDA analysts adjusted it to assume extensions of the 2001 and 2003 tax rates for all income earners.[42] Moreover, this adjusted baseline also reflects an economy growing faster than the unadjusted July 2010 short-term model. Thus, the benefits of tax extensions are already built into the baseline and are not reflected in the policy effects of the Free Enterprise Prescription plan.

To reflect a continuation of current policy, CDA analysts made the following adjustments to the July 2010 short-term model:

1. The effective personal income tax rate was lowered by removing assumed tax increases on high-income earners beginning in 2011 and by removing the assumed gradual increase in effective federal tax rates on all income earners beginning in 2012.[43]

2. The maximum marginal tax rate on personal capital gains was lowered by removing the assumed 5 percent increase from the current maximum rate of 15 percent to 20 percent, which includes the 3.8 percent increase in the Medicare investment tax scheduled to take effect on January 1, 2013.

3. The maximum marginal capital gains tax rate was lowered by removing the 0.5 percentage point increase set to take effect in 2011 (15 to 20 percent). The 3.8 percent Medicare investment tax that takes effect January 1, 2013, is still assumed.[44]

4. A flat revenue amount was subtracted from the adjustment variable GFRCPTUNIADJ (a recon-

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42. The model makes estimates based on likely future law. Thus, the simulation first required adjusting the baseline forecast to approximate current policy. This was done by reverting to assumptions in the July 2010 forecast that relate to likely policy changes in the next 10 years. These assumptions were obtained from the IHS Global Insight staff. The methodologies, assumptions, conclusions, and opinions in this report are entirely the work of Heritage Foundation analysts. They have not been endorsed by and do not necessarily reflect the views of the owners of the IHS Global Insight model. The model is used by leading government agencies and Fortune 500 companies to indicate to decision makers the probable effects of economic events and public policy changes on hundreds of major economic indicators.

43. This adjustment still allows the changes made to the effective personal income tax rate due to the tax credits in the health care reform law, which take effect in 2014. The July 2010 short-term model assumes that the health care tax credits will reduce this rate each quarter starting in 2014, and this change is not removed in the adjusted baseline.

ciliation item between the National Income and Product Accounts (NIPA) and unified federal outlays) in the July 2010 short-term model because this model assumes an increase in revenue of $32 billion to $33 billion per year from 2011 to 2020 due to the renewal of the estate tax. While the revenue adjustment follows a seasonal pattern—primarily reflecting the difference in timing between cash receipts in the unified budget accounts and tax accruals in the National Income and Product Accounts—no seasonal variation was assumed in the estate tax receipts.

Description of the Macroeconomic Simulation. Whenever possible, CDA analysts used peer-reviewed academic studies to make assumptions about a proposal's direct effects on an economic variable. Government agency reports were also used to make assumptions on how FTAs would affect trade and how provisions for expedited permits and additional drilling sources would affect energy investment.

Overview. To conduct the simulation, each component of the proposal was analyzed to check whether the implemented changes produced effects, holding all else constant, consistent with effects postulated from empirical studies and economic theory. These robustness checks involved identifying goal variables that should change by certain magnitudes according to existing research.

After simulating the effects of each individual component, CDA analysts estimated the net effect of the Free Enterprise Prescription by modeling the effects of all of the components in one simulation.[45] This is necessary because the various components could indirectly offset the direct effects of other components. For example, lowering energy investment barriers increases the demand for investment borrowing, which places upward pressure on interest rates, while rescinding uncommitted stimulus spending reduces the demand for borrowing by allowing allocation of more scarce funds to private investment, which eases pressure on interest rates. Thus, by allowing the proposal's components to interact, the relative strength of supply and demand incentives can be estimated as well as the overall change effected in the economy.

Dynamic analysis is crucial when accounting for policy changes, but particularly when the economic impact is expected over a longer period. Dynamic analysis is a tool for estimating changes in behavior across the economy that can take time to occur as new decisions and adjustments are made. In a world of finite resources, changes in one market can ripple across the economy over time. In other words, changes in one market can indirectly affect other economic variables by altering the relative opportunity costs of goods and services in other markets of the economy. This affects decision making at the household and firm level. The macroeconomic model estimates the total relative price effects, thus estimating the overall effects of the policy proposal.

Implementation of the Government Spending Proposal. The amounts of federal government stimulus spending added to the variables in the baseline forecast were obtained from IHS/Global Insight. This amount was then subtracted from those variables to simulate the repeal of stimulus money beginning in 2011.[46] In the July 2010 short-term baseline, no further stimulus was assumed, including any extension of Medicaid aid to states.

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44. The adjusted baseline uses baseline projection values for average federal marginal tax rates estimated by the CDA personal income tax microsimulation model. This tax microsimulation model provides estimates of annual tax rates through 2016, so the adjusted baseline incorporates these baseline values and then flatly extends the 2016 rate through the end of 2020.

45. The overall simulation was implemented by solving the different components in the following order: (1) repatriation component adjustments; (2) energy component adjustments; (3) trade component adjustments; (4) Sarbanes–Oxley component adjustments; (5) rescinding government stimulus component adjustments; (6) Davis–Bacon component adjustments. Solving after each policy change allowed the model to reach a solution rather than implementing many shocks that can lead to indeterminate solutions. After step 6, CDA analysts re-included the three variables that had been excluded during the simulation: JCSMICH, RMFFRES, and UTLB00004, which reflect in the GI model the Consumer Sentiment Index, the effective rate on federal funds, and the Factory Operating Rate, respectively.

46. Heritage analysts assumed that the amount of federal stimulus funds "committed" to 2009 and 2010 were fully "spent" and there was not a direct adjustment to the government spending variable for 2010. See IHS/Global Insight, "Economic Outlook," July 2010.

Suspension of Davis–Bacon and End of PLA Mandates. Research shows that the Davis–Bacon Act raises the price of federal construction by approximately 10 percent.[47] PLAs raise construction costs by 12 percent to 18 percent.[48] The Global Insight variables that include public construction spending are federal non-defense gross investment, federal defense gross investment, and state and local gross investment in structures. The Heritage Foundation estimated the amount by which Davis–Bacon and Project Labor Agreements inflate these variables. The price index of these variables was then deflated by the amount of the cost savings from eliminating the Davis–Bacon and PLA requirements. However, it was assumed that that nominal spending (the budgeted amount) would be maintained, so the real spending variable was also increased to simulate the effect that more investment and employment could be supported with the same level of nominal spending.[49]

The calculations of the amount that the Davis–Bacon and PLA requirement inflate the GI variables proceeded as follows.[50] For the federal government it was first necessary to estimate the portion of gross investment spent on construction. This was done by using Bureau of Economic Analysis data from 2003 to 2008 to calculate the ratio of gross investment in structures to total gross investment spending.[51] These ratios were calculated separately for defense and non-defense gross investment. The current values of federal defense and non-defense gross investment were multiplied by these ratios to yield the level of federal construction spending in these sectors. This federal construction spending was deflated by 10 percent to account for the cost savings from suspending the Davis–Bacon Act and Project Labor Agreements. Total federal defense and non-defense gross investment was re-calculated using these deflated values of construction spending. The new federal gross investment costs were compared to the original figures. This yields estimates that the Davis–Bacon Act and PLAs inflate the cost of federal defense gross investment by 1.0 percent and non-defense gross investment by 2.4 percent.

The Davis-Bacon Act raises the cost of federally financed state and local construction projects. This raises the costs of some but not all state and local construction projects. The cost of the portion of state and local gross investment in structures covered by Davis-Bacon Act restrictions was deflated by 10 percent. The reduced cost of Davis-Bacon Act covered state and local construction spending was added to the remaining state and local construction spending, and compared to the initial figures. This yields estimates that the Davis-Bacon Act inflates the cost of total state and local gross investment in structures by 3.2 percent.

Implementation of Energy Permit Expediting. The two immediate sources of economic benefit from expanded drilling for domestic oil are the aggregate net value created (price minus production costs) and then the net level of investment.

The profit-per-barrel parameter was calculated from the petroleum price projections from Global Insight, and the parameter estimates on production costs came from the Energy Information Administration estimate of "upstream costs for petroleum."[52] The parameter estimates for quantity of additional petroleum from the Outer Continental

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47. Glassman *et al.*, "The Federal Davis-Bacon Act."

48. Paul Bachman, Darlene C. Chisholm, Jonathan Haughton, and David G. Tuerck, "Project Labor Agreements and the Cost of School Construction in Massachusetts," Beacon Hill Institute *Policy Study*, September 2003, at *http://www.beaconhill.org/BHIStudies/PLApolicystudy12903.pdf* (December 10, 2010), and Paul Bachman, Jonathan Haughton, and David G. Tuerck, "Project Labor Agreements and the Cost of Public School Construction in Connecticut," Beacon Hill Institute, September 2004, at *http://www.beaconhill.org/BHIStudies/PLA2004/PLAinCT23Nov2004.pdf* (December 10, 2010).

49. These real variables in the model are exogenous and therefore would not have adjusted on their own to produce this effect. The price decrease would have been interpreted entirely as a "nominal" shock in the model.

50. The following GI variables were changed for the Davis-Bacon component of the macroeconomic simulation: JPGSLGIS (chained price index—state and local structures spending); GSLGISR (real state and local investment in structures); GFOGIR (real federal nondefense gross investment); JPGFMLGI (chained price index—federal defense gross investment); JPGFOGI (chained price index—federal nondefense gross investment); GFMLGIR (real federal defense gross investment).

51. Bureau of Economic Analysis, National Income and Products Accounts Table 3.9.5. These years were chosen because they occurred before the stimulus inflated federal construction spending.

52. U.S. Energy Information Administration, "Performance Profiles of Major Energy Producers 2008," Table 11, March 24, 2010, at *http://www.eia.doe.gov/emeu/perfpro/tab11.html* (December 10, 2010).

Shelf, the Arctic National Wildlife Refuge, and additional Lower 48 production came from a study completed for the American Petroleum Institute.[53]

Gross investment was estimated by multiplying the finding costs by the leading 20-quarter running average for petroleum production. The finding costs came from the Energy Information Administration.[54]

The gross investment estimates were then used to adjust real gross private investment in mines and wells, investment in utilities, and domestic production of energy.[55] The variables' add-factors were adjusted so that the variables remained endogenous and therefore could be influenced by the effects of the other policies. Check variables were investments in power plants and the manufacturing index in energy industries (both expected to increase).

Repeal of Section 404 of Sarbanes–Oxley. In estimating the effects of Sarbanes–Oxley on business risk taking, Bargeron, Lehn, and Zutter (BLZ) found that companies subject to Sarbanes–Oxley significantly reduced risk taking after the law took effect. They measured corporate risk taking by the allocation of corporate funds.[56] Holding relatively more cash is less risky than investing funds or spending on research and development.

To account for the assumed repeal of Section 404, Heritage analysts adjusted the add-factor of the variable that captures R&D spending funded by industry (RADINDR) beginning in 2011. This add-factor adjustment was made using the BLZ estimates on business risk taking based on corporate spending allocations (and research and development). The check variables were corporate net cash holdings (expected to decrease) and investment spending (expected to increase).

Implementation of Free Trade Agreements. CDA analysts, with the help of analysts in the Center for International Trade and Economics at The Heritage Foundation, simulated the effects of implementing the three FTAs by adjusting the economic variables in the model that corresponded to prices and values of imports and exports likely to be traded. They were adjusted using estimates for nominal changes to the values of the import and export variables cited in a 2008 U.S. International Trade Commission (USITC) report.[57]

The real change to these values was calculated by dividing the estimated nominal change by the baseline chained-price index. This real change was then added to the forecasted baseline values of the real exports and imports corresponding to the same variables.[58]

The USITC estimates of the change in U.S. GDP resulting from the FTAs is a good robustness check of the forecast values in this CDA simulation. The

53. Harry Vidas and Bob Hugman, "Strengthening Our Economy: The Untapped U.S. Oil and Gas Resources," ICF International, December 5, 2008, at *http://www.heartland.org/custom/semod_policybot/pdf/24280.pdf* (December 10, 2010).

54. U.S. Energy Information Administration, "Performance Profiles of Major Energy Producers 2008," Table 10, at *http://www.eia.doe.gov/emeu/perfpro/tab10.html* (December 10, 2010).

55. The following GI add-factor or variable adjustments were made in conducting the simulation: IFNRESPUOR (add-factor adjustment); IFNRESMIR (add-factor adjustment); ENGDOMPETANG (variable adjustment); ENGRESID (variable adjustment).

56. Leonce Bargeron, Kenneth Lehn, and Chad Zutter, "Sarbanes–Oxley and Corporate Risk-Taking," *Journal of Accounting and Economics*, Vol. 49, Issues 1–2 (February 2010), pp. 34–52.

57. The nominal changes to the targeted export and import variables in this simulation were calculated from U.S. International Trade Commission, *U.S.–Colombia Trade Promotion Agreement: Potential Economy-Wide and Selected Sectoral Efforts*, December 2006, pp. G-13–G-14, Table G-4, at *http://www.usitc.gov/publications/332/pub3896.pdf* (December 10, 2010); *U.S.–Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects*, September 2007, pp. 2-15–2-15, Table 2.3, *http://www.usitc.gov/publications/pub3949.pdf* (December 10, 2010); and *U.S.–Panama Trade Promotion Agreement: Potential Economy-Wide and Selected Sectoral Effects*, September 2007, p. 2-7, Table 2.4, at *http://www.usitc.gov/publications/docs/pubs/2104f/pub3948.pdf* (December 10, 2010). The changes were phased into the simulation beginning with 10 percent of the full adjustment for 2010 and 2011, 40 percent for 2012, 60 percent for 2013 and 2014, and 90 percent for 2015. The full nominal adjustment was applied for 2016–2020.

58. The variables reflecting real import or export values that were changed in this simulation are MGOR (the real import of other goods to the U.S. in billions of dollars); XGINR (the real exports of industrial materials and supplies in billions of chained 2005 dollars); XGFFBR (the real exports of foods, feeds, and beverages in billions of chained 2005 dollars); XGCR (real exports of non-automotive consumer goods in billions of chained 2005 dollars); and XGAUTOR (the real exports of motor vehicles and parts in billions of chained 2005 dollars).

USITC report estimated that U.S. GDP would increase by $10.1 billion to $11.9 billion (approximately 0.1 percent) under the South Korea FTA and by $2.5 billion (less than 0.5 percent) under the Colombia FTA. A simulation of the FTAs only increased U.S. GDP by roughly $10 billion in 2011 and $14.5 billion in 2012. On average, annual GDP increased by $14.8 billion over 2011 to 2020.

Repatriation of Profits. Based on a study of the previous temporary tax reduction on repatriated profits, an estimated $565 billion of foreign profits would be repatriated.[59] Currently, firms expect this to have an after-tax value of approximately $367 bil-lion. If this policy is enacted, the after-tax value would instead be $535 billion. This means firms and their shareholders would have an estimated $168 billion higher value.

The repatriation was simulated by revaluing (with add-factor adjustments) the overseas assets by the $565 billion available for repatriation (i.e., taking $565 billion out of overseas assets and reinvesting the net profit domestically).[60] The check variable was the value of household assets, which was expected to increase by $168 billion between 2010 and 2011.

59. Sinai, "Macroeconomic Effects of Reducing the Effective Tax Rate."

60. The GI variables reflecting this revaluation were net U.S. international investment position (IPAUSCCNETADJ) and the GI add-factor measuring the rest-of-world corporate profits including inventory value adjustment (IVA) and capital consumption adjustment (ZBIVARW).

Free Enterprise Prescription: Key Economic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average 2011–2020
Gross Domestic Product *(in Billions of 2010 Dollars)*											
Forecast	15,444.3	15,990.0	16,490.5	17,023.9	17,544.0	18,086.0	18,583.9	19,082.1	19,608.5	20,156.4	17,801.0
Baseline	15,438.5	15,959.0	16,437.2	16,960.4	17,473.0	18,014.5	18,515.7	19,015.5	19,544.4	20,095.3	17,745.3
Difference	5.8	30.9	53.4	63.5	71.0	71.5	68.2	66.6	64.1	61.1	55.6
Real GDP Growth Rate *(Percent)*											
Forecast	3.0	3.5	3.1	3.2	3.1	3.1	2.8	2.7	2.8	2.8	3.0
Baseline	2.9	3.4	3.0	3.2	3.0	3.1	2.8	2.7	2.8	2.8	3.0
Difference	0.0	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Employment *(in Thousands)*											
Forecast	132,078.0	135,833.4	139,286.6	141,927.4	144,050.4	146,001.3	147,664.0	149,048.8	150,368.6	151,788.1	143,804.7
Baseline	132,082.6	135,729.3	139,028.3	141,570.7	143,658.0	145,627.2	147,346.2	148,791.8	150,172.6	151,652.6	143,565.9
Difference	−4.6	104.1	258.3	356.7	392.4	374.1	317.8	257.0	196.0	135.6	238.7
Private Employment *(in Thousands)*											
Forecast	109,889.1	113,536.4	116,698.8	119,022.8	120,855.4	122,600.9	124,045.5	125,263.7	126,443.0	127,576.4	120,593.2
Baseline	109,837.3	113,364.6	116,392.0	118,631.1	120,426.0	122,178.2	123,663.1	124,923.6	126,146.3	127,323.9	120,288.6
Difference	51.8	171.8	306.8	391.7	429.4	422.7	382.4	340.1	296.7	252.6	304.6
Unemployment Rate *(Percent)*											
Forecast	9.2	8.3	7.4	6.7	6.1	5.6	5.1	4.7	4.4	3.9	6.1
Baseline	9.2	8.3	7.5	6.9	6.3	5.7	5.2	4.8	4.4	4.0	6.2
Difference	0.0	−0.1	−0.1	−0.2	−0.2	−0.1	−0.1	−0.1	−0.1	0.0	−0.1
Disposable Personal Income *(in Billions of 2010 Dollars)*											
Forecast	11,682.0	11,983.2	12,249.6	12,782.7	13,330.7	13,896.1	14,399.5	14,884.7	15,414.1	15,998.4	13,662.1
Baseline	11,681.2	11,968.5	12,217.9	12,737.6	13,274.4	13,831.4	14,330.2	14,812.5	15,341.6	15,927.4	13,612.3
Difference	0.8	14.7	31.7	45.1	56.4	64.7	69.3	72.2	72.5	71.0	49.8
Disposable Income Per Capita *(in 2005 Dollars)*											
Forecast	37,222.9	37,816.8	38,286.7	39,570.1	40,871.9	42,199.1	43,312.3	44,348.5	45,493.7	46,777.0	41,589.9
Baseline	37,220.5	37,770.5	38,187.7	39,430.6	40,699.1	42,002.6	43,104.0	44,133.4	45,279.8	46,569.4	41,439.8
Difference Per Person	2.4	46.3	99.0	139.6	172.9	196.5	208.3	215.1	213.9	207.6	150.2
Difference for Family of Four	9.6	185.2	396.0	558.2	691.5	786.0	833.3	860.5	855.6	830.4	666.3
Personal Consumption Expenditures *(in Billions of 2010 Dollars)*											
Forecast	10,929.1	11,252.5	11,500.1	11,813.2	12,195.3	12,583.2	12,925.7	13,257.8	13,612.6	14,008.4	12,407.8
Baseline	10,925.7	11,236.5	11,467.2	11,767.3	12,141.4	12,525.1	12,867.6	13,201.0	13,558.6	13,958.6	12,364.9
Difference	3.3	16.0	32.9	45.9	53.9	58.0	58.1	56.8	53.9	49.8	42.9
Personal Savings *(in Billions of 2010 Dollars)*											
Forecast	386.5	350.1	342.3	534.5	669.4	816.6	956.3	1,093.6	1,252.8	1,425.8	782.8
Baseline	388.7	351.5	344.5	536.9	668.7	811.7	946.7	1,079.2	1,234.6	1,404.1	776.7
Difference	−2.2	−1.4	−2.2	−2.4	0.7	4.8	9.6	14.4	18.2	21.8	6.1

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Appendix Table I • CDA 10-09 ⬥ heritage.org

Free Enterprise Prescription: More Economic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average 2011–2020
Personal Savings Rate (Percent)											
Forecast	3.3	2.9	2.8	4.2	5.0	5.8	6.6	7.3	8.1	8.8	5.5
Baseline	3.3	2.9	2.8	4.2	5.0	5.8	6.6	7.2	8.0	8.7	5.5
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0
Gross Private Domestic Investment (in Billions of 2010 Dollars)											
Forecast	2,122.8	2,410.9	2,644.0	2,806.9	2,897.5	3,019.2	3,094.3	3,173.9	3,269.1	3,365.9	2,880.5
Baseline	2,121.2	2,401.1	2,627.4	2,787.8	2,875.8	2,995.8	3,069.7	3,146.7	3,240.4	3,337.6	2,860.4
Difference	1.6	9.8	16.6	19.2	21.6	23.4	24.6	27.3	28.6	28.3	20.1
Nonresidential Fixed Investment (in Billions of 2010 Dollars)											
Forecast	1,614.4	1,781.9	1,954.3	2,079.6	2,162.5	2,244.9	2,326.0	2,408.0	2,500.8	2,595.6	2,166.8
Baseline	1,613.3	1,776.4	1,943.0	2,065.1	2,146.2	2,225.5	2,303.2	2,381.5	2,471.6	2,565.4	2,149.1
Difference	1.1	5.5	11.4	14.4	16.3	19.4	22.7	26.5	29.2	30.1	17.7
Residential Fixed Investment (in Billions of 2010 Dollars)											
Forecast	453.1	564.0	630.4	673.6	688.5	708.3	713.6	714.5	717.3	720.9	658.4
Baseline	453.5	564.0	628.4	670.2	684.5	704.4	710.6	712.6	716.5	721.0	656.6
Difference	-0.5	0.0	2.0	3.5	4.1	3.9	3.0	1.9	0.9	-0.1	1.9
Change in the Stock of Business Inventories (in Billions of 2010 Dollars)											
Forecast	59.3	70.0	65.5	61.0	54.6	74.0	64.4	63.0	64.6	65.7	64.2
Baseline	58.4	66.0	62.5	59.8	53.4	73.8	65.3	63.8	65.5	66.8	63.5
Difference	0.9	4.0	3.1	1.2	1.2	0.2	-0.8	-0.8	-0.9	-1.1	0.7
Full-Employment Capital Stock (in Billions of 2010 Dollars)											
Forecast	16,630.4	17,013.1	17,539.9	18,132.6	18,726.2	19,299.7	19,885.6	20,481.2	21,096.1	21,730.7	19,053.5
Baseline	16,629.3	17,005.7	17,518.6	18,093.7	18,670.7	19,227.7	19,797.3	20,376.1	20,973.3	21,590.8	18,988.3
Difference	1.2	7.4	21.3	38.8	55.5	72.0	88.4	105.1	122.8	140.0	65.2
Consumer Price Index (Index: 1982–1984=1.00)											
Forecast	1.5	2.0	2.2	2.3	2.4	2.5	2.7	2.9	3.1	3.3	2.5
Baseline	1.5	2.1	2.3	2.3	2.4	2.5	2.6	2.9	3.0	3.2	2.5
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0
Standard & Poor's 500 Index of Common Stocks											
Forecast	1,205	1,352	1,474	1,548	1,617	1,707	1,784	1,850	1,915	2,002	1,645
Baseline	1,173	1,286	1,379	1,446	1,521	1,618	1,705	1,776	1,845	1,934	1,568
Percentage Difference	2.7%	5.1%	6.9%	7.0%	6.3%	5.5%	4.6%	4.1%	3.8%	3.5%	4.9%
Treasury Bond, 10-Year (Percent)											
Forecast	3.4	4.4	5.0	5.6	6.3	6.5	6.7	7.0	7.3	7.6	6.0
Baseline	3.5	4.4	5.0	5.6	6.3	6.5	6.7	6.9	7.2	7.5	6.0
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Appendix Table 2 • CDA 10-09 ⬛ heritage.org

Free Enterprise Prescription: Federal Budget Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total 2011–2020
Unified Federal Tax Revenue *(in Billions of Dollars Not Adjusted for Inflation)*											
Forecast	2,424.2	2,564.4	2,885.0	3,033.6	3,201.8	3,347.1	3,518.3	3,733.1	3,969.8	4,269.2	32,946.4
Baseline	2,425.9	2,556.7	2,866.4	3,008.0	3,173.9	3,321.7	3,495.4	3,709.4	3,942.5	4,237.4	32,737.3
Difference	–1.7	7.7	18.6	25.6	27.8	25.5	22.9	23.7	27.3	31.8	209.0
Unified Federal Spending *(in Billions of Dollars Not Adjusted for Inflation)*											
Forecast	3,550.9	3,557.7	3,719.1	3,973.0	4,258.8	4,574.7	4,885.6	5,268.4	5,715.0	6,254.4	45,757.6
Baseline	3,579.3	3,578.2	3,736.3	3,988.7	4,272.7	4,585.4	4,893.0	5,271.3	5,712.0	6,244.7	45,861.6
Difference	–28.3	–20.4	–17.2	–15.8	–14.0	–10.7	–7.4	–2.9	3.0	9.7	–104.1
Unified Federal Surplus/Deficit *(in Billions of Dollars Not Adjusted for Inflation)*											
Forecast	–1,126.7	–993.4	–834.1	–939.4	–1,057.0	–1,227.6	–1,367.3	–1,535.3	–1,745.2	–1,985.2	–12,811.2
Baseline	–1,153.3	–1,021.5	–870.0	–980.7	–1,098.8	–1,263.8	–1,397.7	–1,561.8	–1,769.5	–2,007.3	–13,124.3
Difference	26.7	28.1	35.9	41.3	41.8	36.2	30.3	26.5	24.3	22.1	313.1
Federal On-Budget Surplus/Deficit *(in Billions of Dollars Not Adjusted for Inflation)*											
Forecast	–928.7	–823.6	–673.6	–759.3	–872.5	–1,001.6	–1,092.7	–1,204.1	–1,347.0	–1,532.0	–10,235.1
Baseline	–950.2	–849.5	–706.3	–793.6	–905.3	–1,029.8	–1,115.4	–1,223.3	–1,364.8	–1,548.6	–10,486.9
Difference	21.5	25.9	32.7	34.3	32.7	28.2	22.7	19.3	17.7	16.7	251.8
Privately Held Federal Debt *(in Billions of Dollars Not Adjusted for Inflation)*											Average
Forecast	10,062.8	11,071.9	11,954.2	12,829.0	13,830.8	14,979.4	16,284.2	17,745.9	19,398.7	21,291.4	14,944.8
Baseline	10,080.0	11,115.9	12,030.8	12,945.1	13,989.1	15,176.3	16,513.5	18,002.9	19,680.7	21,596.1	15,113.0
Difference	–17.2	–44.0	–76.7	–116.1	–158.3	–196.9	–229.3	–257.0	–282.0	–304.7	–168.2
Privately Held Federal Debt Share *(Percentage of GDP)*											Average
Forecast	65.1	68.0	69.9	71.1	72.8	74.7	77.0	79.5	82.0	84.8	74.5
Baseline	65.1	68.4	70.5	71.9	73.8	75.9	78.4	81.0	83.7	86.5	75.5
Difference	–0.1	–0.3	–0.6	–0.8	–1.1	–1.3	–1.4	–1.5	–1.6	–1.7	–1.0
Real Household Net Wealth *(Not Adjusted for Inflation)*											Average
Forecast	57,528.3	60,750.1	63,805.4	66,041.7	68,642.9	71,327.1	74,231.2	77,055.5	79,995.2	83,235.5	70,261.3
Baseline	57,209.9	60,131.4	62,942.4	65,155.2	67,855.2	70,644.6	73,670.8	76,582.1	79,589.8	82,891.8	69,667.3
Difference	318.3	618.7	862.9	886.5	787.7	682.5	560.3	473.4	405.4	343.7	594.0

Source: Heritage Foundation calculations based on data from the IHS Global Insight U.S. macroeconomic model.

Appendix Table 3 • CDA 10-09 ⌂ heritage.org

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The Heritage Center for Data Analysis

The Heritage Foundation's Center for Data Analysis provides timely and accurate analytical products intended to help advance public policy debates. To carry out this work, the Center employs the highest quality databases and maintains a set of customized and peer-reviewed analytical models.

The Center has created one of the largest collections of privately held public policy databases in the United States. The Center constructs these databases largely from publicly available federal data on important economic, social, and cultural aspects of American life. These databases frequently are used to estimate the likely effects of policy changes on such key dimensions of everyday life as marriage rates, income growth, educational attainment, and retirement decisions.

Center economists use specially developed models of the federal tax system, Social Security, welfare, and a wide range of other major programs to estimate how large and small policy changes will affect the federal budget, the pocketbooks of ordinary Americans, and behavioral changes among individuals. The Center shares its analysis of proposed legislation with policymakers in and out of government, members of Congress and their staffs, officials within the executive branch, and the public policy community.