BACKGROUNDER

The Economic and Fiscal Effects of the Obama Tax Plan
William W. Beach, John L. Ligon, and Guinevere Nell

Abstract

On January 1, 2013, the Bush tax cuts will expire and other new taxes that congressional leaders have recognized would damage the economy will take effect. President Barack Obama's proposal to increase taxes on only "high-income earners" would also be economically destructive, reducing economic output by an average of $196 billion per year over 2013–2022 relative to current tax policy. Congress and the President would better serve the country by reforming the tax code in a pro-growth, revenue-neutral way and by reducing federal spending.

Nearly historic increases in federal personal income and payroll taxes combined with modest reductions in federal spending are set to begin on January 1, 2013. This is the "fiscal cliff": a combination of fiscal policy changes that many analysts believe will send the U.S. economy into a recession.

Understandably, President Barack Obama and congressional leaders in both political parties are seeking a way to avoid this policy-driven cliff. In addressing the fiscal cliff, President Obama and Democratic leaders in Congress have taken the peculiar tack of pushing to increase taxes primarily on "high-income earners" and small businesses,[1] even though these same leaders argue that raising taxes on all earners would damage the economy. Somehow, raising taxes only on high-income earners is supposedly not economically destructive.

This line of reasoning is simply mistaken. The economy will slow significantly whether the federal government raises tax rates on everyone or only on high-income earners.[2] The analysis of the Obama tax plan presented in this paper indicates that the U.S. economy would slow significantly if tax rates on ordinary income, dividend income, and capital

KEY POINTS

- The U.S. faces a fiscal cliff whether the expiration of certain tax rates falls on all income earners or only on high-income earners.

- The increased tax rates on small-business, investment, and labor income would raise the cost of capital investment, reduce hiring and small-business expansion, and reduce the incentive to work and supply labor in the U.S. economy.

- The Obama tax plan would create an average slowdown of $196 billion in real annual output, leading to nearly 1.1 million fewer private-sector jobs per year and an average of 2 billion fewer hours worked.

- After accounting for the economic effects of the Obama tax plan, the federal government would collect only 44 percent (about $700 billion) of the $1.6 trillion assumed by the President.

- Tax increases cannot solve the long-run fiscal imbalance, especially when tax rate increases would leave the U.S. economy weaker and federal revenues lower.

TABLE 1

Obama Tax Plan Will Increase Small Business Taxes by About $4,000

FIGURES ARE AVERAGES FOR BUSINESSES IN 2014	Number of Filers	Taxes Under Current Policy	Taxes Under Obama (Top Rate Expires)	Tax Increase Under Obama
INCOME LEVEL				
Losses more than $5,000	5,662,995	$20,614	$25,607	$4,993
Losses $0–$5,000	4,814,603	$16,502	$18,504	$2,002
Gains $1–$5,000	8,598,099	$14,465	$16,303	$1,839
Gains $5,000–$50,000	7,868,116	$15,092	$17,530	$2,438
Gains $50,000–$250,000	5,210,413	$44,013	$46,143	$2,130
Gains $250,000–$500,000	1,352,213	$124,790	$130,478	$5,688
Gains $500,000–$1 million	317,693	$313,732	$339,325	$25,593
Gains $1 million+	280,038	$1,054,059	$1,194,001	$139,943
All non-farm businesses	34,104,096	$36,131	$40,207	$4,076
TYPE OF BUSINESS				
Businesses with 50 percent or more of income from business sources*	11,445,793	$56,795	$61,380	$4,585
Businesses with employees**	1,839,888	$28,688	$30,264	$1,576

Note: Figures in this table are for non-farm businesses, which include those filing Schedule C, Partnership, or S-Corporation tax forms.
* Refers to businesses filing units with greater than 50 percent of all income coming from business sources (Schedule C, Partnership, or S-Corporation income).
** Businesses with employees are only those non-farm businesses with positive net income that have reported wage income paid in their deductions.

Source: Heritage Foundation calculations using data from the Center for Data Analysis Individual Income Tax Model.

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gains income rise for high-income earners.

This study uses the Center for Data Analysis's microsimulation model of the federal individual income tax, which is based on Internal Revenue Service (IRS) data and the IHS Global Insight (GII) short-term U.S. macroeconomic model, to evaluate the economic and budgetary effects of the tax scenarios.[3] We compare the forecast scenario to a baseline forecast scenario representing the indefinite continuation of the current tax policy.

Relative to the economy's performance under the current policy, we find that total output and income would decline by approximately $105 billion in 2012 and by an average of $196 billion per year over 2013–2022. The decline in economic output is consistent with prevalent recessionary concerns. The slowdown in real output occurs because:

- Higher tax rates on investment raise the cost of capital investment, and higher tax rates on labor income reduce the incentive to work and supply labor in the U.S. economy. Over the long run, the decline in private-sector investment would reduce the capital stock, leading to slower output and labor supply in the U.S. economy.

THE NATION FACES A SEVERE LONG-TERM FISCAL IMBALANCE, WITH ELEVATED SPENDING TODAY TRANSITIONING TO EVEN HIGHER ENTITLEMENT-DRIVEN SPENDING TOMORROW.

- Gross private-sector investment would decline by an average of $126 billion (4.1 percent) per year, reducing real capital stock in the U.S. economy by an average of $229 billion (1.2 percent) per year. The reduction in private-sector investment and capital services over the long run would reduce the labor supply at different economic margins: Private-sector employment in the U.S. economy would fall by an average 1.1 million jobs (1 percent) per year, and Americans would work 2 billion fewer hours relative to baseline levels.

- The President believes his tax proposal will increase federal revenue by an average of $160 billion per year. The results of the dynamic simulation indicate that the President's proposal would achieve only about $68 billion per year—less than one-half of the President's projection. The dynamic result is due to a smaller tax base commensurate with the smaller economy. For example,

Components of Taxmageddon

Taxmageddon and the fiscal cliff are not accidents. Over the past two years, President Obama and congressional leaders intentionally pushed the resolution of expiring tax provisions and excessive and unsustainable spending past the November election. In doing so, they added uncertainty to business and financial markets and created this artificial crisis.

Taxmageddon, the tax side of the fiscal cliff, involves the expiration of key tax provisions and the beginning of new tax policy. These changes would translate into about a $500 billion tax increase in 2013.[6]

The tax policies expiring on January 2, 2013, include:
- Tax cuts from the 2009 stimulus;
- A 2 percent payroll tax cut (the "payroll tax holiday");
- 100 percent expensing for business investment;
- The estate ("death") tax spousal exemption set at $5 million and the death tax rate set at 35 percent;
- A reduction in alternative minimum tax (AMT) liability; and
- The full slate of 2001 and 2003 Bush-era tax cuts.

The tax provisions mainly affecting high-income earners include:
- Raising the 33 percent marginal tax rate to 36 percent and the 35 percent rate to 39.6 percent;
- A 3.8 percent Medicare tax on wages and salaries over $250,000;
- The return of the personal exemption phaseout (PEP) and the itemizers' "haircut" (Pease provision);
- Returning to the 1997 estate tax parameters of the $1 million exemption threshold with 55 percent rate; and
- Raising the top dividend tax rate from 15 percent to a combined 44.4 percent (39.6 percent income tax rate plus the 3.8 percent Medicare surcharge) and raising the top capital gains tax rate from 15 percent to a combined 23.8 percent (20 percent income tax plus 3.8 percent Medicare surcharge).

Hours Worked in the U.S. Economy

The higher average effective and marginal income tax rates under the Obama tax plan would reduce the incentive to work in the U.S. economy whether the tax rates are raised on all income earners or only on high-income earners. Many high-income individuals earn their income from capital income rather than labor income. There is, after all, good reason that the nation boasts a thriving tax-planning industry. Those who earn primarily labor income have tremendous flexibility to adjust the forms of their compensation as well as their hours.

However, at the aggregate level, tax rates can affect the decisions of many individuals who are near the threshold of moving into a high-income earning bracket.[11] The higher tax rates affect the intensive and extensive margin for labor supply in the economy. Total and private employment levels would decline relative to baseline levels.

The reduction in aggregate hours worked in the economy would likely capture the behavior effect of many high-income earners. Relative to baseline levels, total hours worked would decrease by 2 billion. In the context of an average 40-hour work week for the average private-sector (nonfarm) worker, this is roughly 0.9 average fewer hours worked per week per worker than in the baseline scenario.

fewer hours worked and lower real wages result in less federal income and payroll tax receipts.

As we have argued previously, it is crucial that congressional leaders avoid all potential tax increases in the fiscal cliff.[4] The nation faces a severe long-term fiscal imbalance, with elevated spending today transitioning to even higher entitlement-driven spending tomorrow.

We cannot solve the long-run fiscal imbalance with tax increases, especially when tax rate increases would leave the U.S. economy weaker and federal revenues lower than assumed under static forecasts. The best path forward is to achieve fiscal balance by implementing pro-growth, revenue-neutral, fundamental reform of the U.S. tax code and by setting federal discretionary and mandatory spending on a significantly slower trajectory as detailed in The Heritage Foundation's *Saving the American Dream* plan.[5]
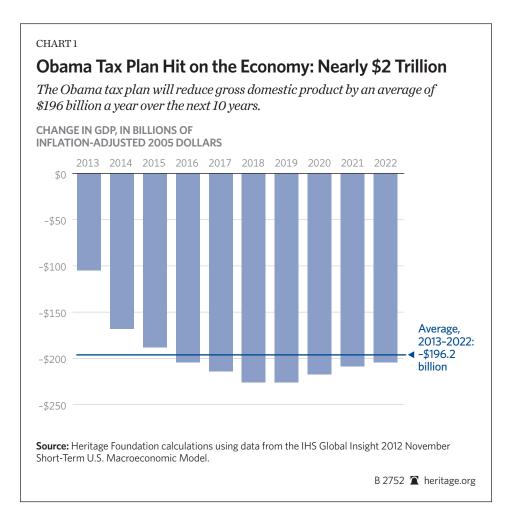
Punishing the Job Creators

The tax treatment of "the rich"—the high-income earners facing the top marginal tax rate—has received

CHART 1

Obama Tax Plan Hit on the Economy: Nearly $2 Trillion

The Obama tax plan will reduce gross domestic product by an average of $196 billion a year over the next 10 years.

CHANGE IN GDP, IN BILLIONS OF
INFLATION-ADJUSTED 2005 DOLLARS

Average,
2013–2022:
–$196.2
billion

Source: Heritage Foundation calculations using data from the IHS Global Insight 2012 November Short-Term U.S. Macroeconomic Model.

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a great deal of attention. However, the discussion generally ignores the fact that many of "the rich" are small-business tax filers who report their income through the individual income tax system rather than the corporate tax code.

A significant portion of the tax increases on small businesses will be due to the increase in the top marginal rate and the other tax cuts aimed at high-income earners. (See Table 1.) Small businesses tend to be owned by high-income individuals, even if the business losses and expenses mean that total annual business income is not high. This ownership means that these small businesses bear the highest marginal tax rate on decisions that their owners make on expansion and business growth.

The best outcome for tax policy this year would be to prevent all of the scheduled tax increases and address the spending drivers of the deficit now and over the early months of 2013. President Obama and Congress then need to implement comprehensive, revenue-neutral reform of the tax code featuring lower marginal tax rates and reduced tax preferences, which in their present form distort decision making and curry favor with the friends of politicians and lobbyists.

Economy-Wide Impact of the Fiscal Cliff

The U.S. faces a fiscal cliff whether the expiration of certain tax rates falls on all income earners or only on high-income earners.[7] This study

uses an economic forecast scenario in which taxes rise only on high-income earners under the President's tax plan (Obama tax plan).[8] The scenario forecast indicates a substantial decline in income levels (before and after tax); aggregate hours worked in the economy; and total output in the U.S. economy relative to baseline levels.[9]

In particular, the higher marginal tax rates on labor income (wages and salary) and higher marginal tax rates on investment income implied by the Obama tax plan significantly reduce the incentive and ability to save, invest, and supply labor in the U.S. economy. The resulting slower growth in the supply of labor and capital services reduces the productive capacity of the U.S. economy in 2013. This effect increases quickly and persists in the long run. Further, lower rates of private-sector investment reduce the amount of productive capital employed in the U.S. economy, further depressing the forces of economic growth. (See Text Box: "Hours Worked in the U.S. Economy.")
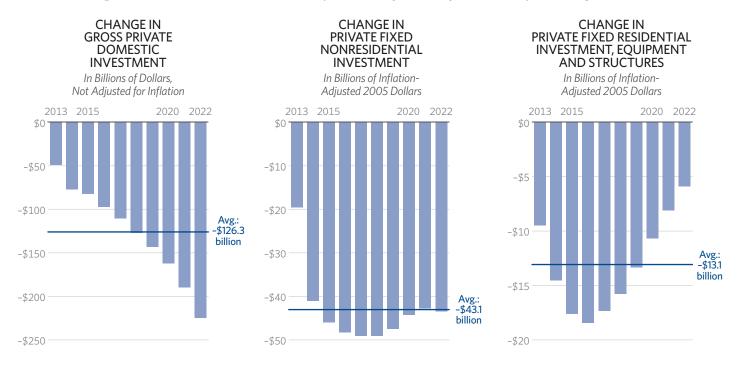
Specifically, economic growth would slow in 2013 under the Obama tax plan compared with current policy, shaving an average of $105 billion (0.8 percent) in 2013 and nearly twice that amount on average over 10 years.[10] The reduced output and productive capacity in the U.S. economy are reflected in a much weaker labor market in which an average of 1.1 million fewer workers would have jobs each year under the Obama tax plan.

Under the Obama tax plan, the higher tax rates on the returns to capital lead to an immediate decline in capital in the economy. This decline results from a combination of capital destruction[12]—taking productive capital offline—and cutting the rate of U.S. business investment. In addition, higher marginal tax rates

CHART 2

Substantial Slowdown in Business Investment Under Obama Tax Plan

The Obama tax plan would lower business investment by hundreds of billions of dollars each year through 2022.

CHANGE IN GROSS PRIVATE DOMESTIC INVESTMENT *In Billions of Dollars, Not Adjusted for Inflation*	CHANGE IN PRIVATE FIXED NONRESIDENTIAL INVESTMENT *In Billions of Inflation-Adjusted 2005 Dollars*	CHANGE IN PRIVATE FIXED RESIDENTIAL INVESTMENT, EQUIPMENT AND STRUCTURES *In Billions of Inflation-Adjusted 2005 Dollars*

Avg.: –$126.3 billion

Avg.: –$43.1 billion

Avg.: –$13.1 billion

Source: Heritage Foundation calculations using data from the IHS Global Insight 2012 November Short-Term U.S. Macroeconomic Model.

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on labor income reduce the saving rate while leaving households with less available income to save, thus slowing growth in private wealth and reducing the ability of U.S. citizens to fund and reap the benefits of domestic investment.

This is not simply a theoretical result. Whether taxes rise on all income earners or only on high-income earners, investment declines significantly and the capital stock shrinks, leading to lower real output in the economy and fewer jobs. Gross private investment would decline an average of $126 billion (4.12 percent) per year; private non-residential fixed investment would decrease an average of $43 billion (2.2 percent) per year; and private residential fixed investment would decline an average

of $13 billion (2.18 percent). The capital stock declines an average of $229 billion (1.2 percent) per year relative to the baseline over the long run.

The reduced growth of real output in the economy and the consequently lower levels of personal and corporate income translate into smaller tax bases for corporate and personal income taxes. As the incomes of households and businesses are smaller than assumed in the static revenue forecasts, federal tax revenues will likewise be lower than expected. Compared with the evolution of the economy under current policy, fewer jobs, individuals working fewer hours, less investment, and less investment income translate directly into a smaller tax base for the federal government.

The President assumes that his tax proposal would generate $1.6 trillion in additional federal revenue, but this projection assumes that tax increases would have no effect whatsoever on the economy. In reality, if the economic effects are considered, the Obama plan to raise taxes on high-income earners would generate only about 44 percent ($680 billion) of the projected $1.6 trillion.[13]

Conclusion

In 2012, the federal government ran a $1.1 trillion budget deficit—predominantly because of the ongoing weakness in the American economy, which depressed federal receipts—and substantially increased spending during the first years of the Obama Administration. As the President's

own budget figures show, as the economy recovers, federal receipts will increase toward 18 percent to 19 percent of GDP, which is the traditional post–World War II share of federal receipts.

America's fiscal imbalances are the result not of a systemic shortfall in revenues, but of dramatically increased federal spending under President Obama. Federal spending threatens to continue climbing as the costs of the major entitlement programs soar.

The January 1, 2013, expiration of a wide range of tax policies and resulting unprecedented increase in tax rates and tax burdens would cause substantial economic harm and job loss whether the increases apply to everyone or only to the subset of high-income earners whom the President favors targeting.

After five years of elevated unemployment, the President and congressional leaders should attend to policies that would strengthen the economy, not weaken it further. Rather than debate alternative ways to increase taxes, they should focus on addressing the real source of the nation's fiscal imbalance—entitlement spending—and on reforming the federal tax code to substantially reduce impediments to economic growth.

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Appendix A
Static Methodology

Analysts in the Center for Data Analysis (CDA) at The Heritage Foundation used forecasts from the CDA microsimulation model of the federal individual income tax to estimate both the impact of President Obama's proposed repeal of the 2001 and 2003 tax cuts affecting high-income taxpayers and the components of "Taxmageddon." The CDA tax model simulates the effects of changes in tax law on a representative sample of taxpayers based on IRS Statistics of Income taxpayer microdata, matched with demographic data from the U.S. Census Current Population Survey. Data for base-year taxpayers are extrapolated or "aged" to reflect detailed taxpayer characteristics in future years.

The static comparison of current policy with the current-law expected tax increases ("Taxmageddon") and the proposal put forth by President Obama ("the Obama plan") was obtained by running simulations of the current policy baseline and the tax plan and by comparing the differences in revenue, tax rates, and tax increases across income and demographic groups. For each simulation, tax increases were estimated both separately and together (e.g., Taxmageddon). The tax increases were based on the most recent budget proposal and information on the IRS website.[14]

Taxmageddon is the tax system as it will stand in 2013 if no intervening legislation is enacted. The tax increases include the new taxes in the Patient Protection and Affordable Care Act (Obamacare) health care bill, the repeal of the Bush tax cuts for the wealthy, the end of the payroll tax holiday, and the expansion of the alternative minimum tax, which will occur if the AMT "patch" is not extended. Taxmageddon was compared with current policy, which is the tax code as it stands including the complete Bush tax cuts, the payroll tax cut, and the AMT patch, as well as the Obama policy, which allows the tax cuts to expire for filers with incomes over $200,000 (filing singly) or $250,000 (filing jointly).

The static Individual Income Tax Model shows only the effect of the simulated tax policy on tax burden and overall revenue. However, these results can then be used as inputs into a dynamic economic model, which can estimate the effects on employment, wages, and other economic factors. In the CDA individual income tax model, the income and growth of the population are projected (based on the CBO forecast) without regard for the macroeconomic (dynamic) effect of tax changes on the growth of income. However, average effective and marginal tax rates produced by the model were then used to estimate dynamic economic effects using a separate dynamic economic model.

Dynamic Methodology

The analysis employs a version of the IHS Global Insight November 2012 short-term model of the U.S. economy (GII model) to estimate the overall net economic effects relating to the expiration of the tax policies under the Obama tax plan. The relationships in the model are calibrated with 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 it accounts for indirect and direct effects to provide a more realistic estimate of the overall economic impact.

We used inputs from the static estimates described in the previous section. The CDA individual income tax model estimates the changes in average marginal tax rates and average effective tax rates, which are then used as parameter values in the GII model. The GII model has a variable measuring the average federal marginal income tax rate, and we used the percent changes from the baseline instead of the actual estimate to minimize the biases in the estimate due to the different baseline values in the micro and dynamic models. The GII model has a variable (stochastic) that measures the average effective federal personal income tax rate. We applied the changes to this series as add-factor adjustments by the percent change estimated in the micro model.[15]

The estate tax is part of the unified budget revenues in the GII model, but it is not counted in the National Income and Product Accounts for government receipts. Thus, an adjustment variable in the GII model reconciles the two government revenue variables, and the static revenue level was applied to this variable.[16] The capital cost adjustment was made by increasing the GII variable that tracks the yield on AAA-related corporate bonds.[17]

APPENDIX TABLE 1

The Economic and Budgetary Effects of the Obama Tax Plan (Page 1 of 3)

ECONOMIC INDICATORS										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022

Gross Domestic Product (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	13,726.0	14,054.0	14,509.4	14,915.5	15,302.6	15,671.0	16,062.8	16,484.7	16,908.5	17,350.6	154,985.1
Baseline	13,831.0	14,222.2	14,697.4	15,119.7	15,516.7	15,897.1	16,288.8	16,702.1	17,117.3	17,554.7	156,947.0
Difference	–105.0	–168.3	–188.0	–204.3	–214.1	–226.1	–226.0	–217.3	–208.8	–204.1	-1,961.9

Real GDP Growth Rate (Percent Change from Previous Year) — Average, 2013–2022

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Average, 2013–2022
Forecast	1.31	3.10	3.07	2.72	2.49	2.41	2.53	2.63	2.54	2.68	2.55
Baseline	2.29	3.30	3.15	2.78	2.53	2.44	2.46	2.54	2.46	2.64	2.66
Difference	–0.97	–0.20	–0.08	–0.06	–0.03	–0.03	0.07	0.09	0.08	0.04	–0.11

Total Employment (Thousands of Jobs)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	134,701	136,405	138,826	141,311	143,206	144,509	145,580	146,840	147,889	149,109	142,837
Baseline	135,207	137,542	140,265	142,815	144,685	145,956	146,953	148,072	148,963	150,050	144,051
Difference	–506	–1,137	–1,440	–1,505	–1,479	–1,447	–1,372	–1,232	–1,074	–941	–1,213

Private Employment (Thousands of Jobs)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	112,755	114,523	116,889	119,166	120,805	121,840	122,671	123,560	124,523	125,514	120,225
Baseline	113,229	115,526	118,138	120,502	122,160	123,206	123,993	124,778	125,623	126,514	121,367
Difference	–474	–1,003	–1,249	–1,337	–1,355	–1,366	–1,322	–1,218	–1,100	–1,000	–1,142

Manhours in Private Non-farm Establishment (Billions of Hours, Annual Rate)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	190.8	194.1	198.5	202.0	204.3	205.9	207.3	208.8	210.5	212.1	203.4
Baseline	191.7	196.1	200.8	204.3	206.7	208.3	209.6	210.9	212.3	213.8	205.4
Difference	–0.9	–1.9	–2.2	–2.4	–2.4	–2.4	–2.3	–2.1	–1.9	–1.7	–2.0

Unemployment Rate (Percent of Civilian Labor Force)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	8.01	7.88	7.27	6.79	6.54	6.44	6.34	6.15	5.95	5.76	6.71
Baseline	7.76	7.37	6.69	6.21	5.99	5.91	5.84	5.71	5.57	5.43	6.25
Difference	0.25	0.51	0.58	0.57	0.55	0.54	0.50	0.44	0.38	0.33	0.46

Disposable Personal Income (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	10,359.1	10,665.6	10,970.2	11,258.7	11,490.7	11,716.7	12,011.4	12,328.7	12,649.8	12,993.7	11,644.5
Baseline	10,505.8	10,840.5	11,163.5	11,484.8	11,753.9	12,015.0	12,313.8	12,622.4	12,931.7	13,266.9	11,889.8
Difference	–146.7	–174.9	–193.3	–226.1	–263.2	–298.4	–302.4	–293.7	–281.8	–273.2	–245.4

Personal Consumption Expenditures (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	9,732.9	9,945.8	10,179.5	10,425.7	10,649.6	10,849.8	11,074.1	11,320.1	11,586.2	11,874.7	10,763.8
Baseline	9,822.0	10,093.1	10,345.1	10,607.4	10,844.9	11,059.1	11,282.2	11,513.9	11,761.3	12,032.0	10,936.1
Difference	–89.1	–147.3	–165.6	–181.7	–195.3	–209.3	–208.2	–193.8	–175.1	–157.4	–172.3

Gross Private Domestic Investment (Billions of Dollars, Not Adjusted for Inflation)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Forecast	2,151.6	2,372.2	2,660.9	2,817.4	2,948.9	3,054.5	3,161.3	3,286.3	3,402.4	3,524.8	2,938.0
Baseline	2,200.8	2,449.5	2,743.1	2,914.6	3,059.3	3,181.5	3,304.3	3,448.4	3,592.1	3,749.7	3,064.3
Difference	–49.2	–77.3	–82.2	–97.2	–110.4	–127.0	–143.1	–162.1	–189.7	–224.9	–126.3

Source: Heritage Foundation calculations using data from the IHS Global Insight
2012 November Short-Term U.S. Macroeconomic Model.

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The Economic and Budgetary Effects of the Obama Tax Plan (Page 2 of 3)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Average, 2013–2022
ECONOMIC INDICATORS											
Private Fixed Nonresidential Investment (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)											
Forecast	1,522.1	1,623.1	1,741.7	1,827.0	1,911.4	1,976.3	2,037.7	2,113.2	2,187.1	2,264.5	1,920.4
Baseline	1,541.7	1,664.2	1,787.7	1,875.3	1,960.4	2,025.4	2,085.1	2,157.5	2,229.9	2,308.0	1,963.5
Difference	–19.6	–41.1	–46.0	–48.3	–49.1	–49.1	–47.5	–44.3	–42.8	–43.5	–43.1
Private Fixed Residential Investment, Equipment and Structures (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)											
Forecast	414.1	491.4	581.0	617.7	621.0	624.3	629.3	634.9	637.5	640.3	589.2
Baseline	423.6	506.0	598.6	636.1	638.3	640.1	642.6	645.6	645.6	646.2	602.3
Difference	–9.5	–14.5	–17.6	–18.5	–17.4	–15.8	–13.4	–10.7	–8.1	–5.9	–13.1
Full Employment Capital Stock (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)											
Forecast	15,608.2	16,086.2	16,634.1	17,186.0	17,743.8	18,313.3	18,893.8	19,497.5	20,125.5	20,773.7	18,086.2
Baseline	15,636.0	16,175.6	16,785.8	17,386.1	17,983.9	18,586.3	19,194.6	19,819.3	20,463.7	21,127.5	18,315.9
Difference	–27.9	–89.4	–151.7	–200.1	–240.1	–273.0	–300.8	–321.8	–338.2	–353.8	–229.7
Stock of Non-farm Inventories (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)											
Forecast	1,705.1	1,738.9	1,787.4	1,822.2	1,859.0	1,895.8	1,936.3	1,981.5	2,027.9	2,078.2	1,883.2
Baseline	1,719.3	1,762.3	1,811.5	1,848.6	1,886.7	1,924.8	1,964.6	2,008.0	2,053.0	2,102.4	1,908.1
Difference	–14.2	–23.4	–24.1	–26.3	–27.8	–29.0	–28.4	–26.5	–25.0	–24.2	–24.9
Net Exports of Goods and Services (Billions of Dollars, Inflation-Adjusted, Indexed to the 2005 Price Level)											
Forecast	–419.6	–432.9	–400.6	–338.3	–262.3	–164.1	–66.6	22.9	111.7	188.7	–176.1
Baseline	–446.8	–482.1	–451.1	–392.3	–317.0	–217.4	–111.9	–7.9	97.1	190.4	–213.9
Difference	27.1	49.1	50.5	54.1	54.7	53.3	45.3	30.8	14.7	–1.7	37.8
Consumer Price Index (Percent Change from Previous Year)											
Forecast	2.33	2.36	2.40	2.44	2.48	2.51	2.55	2.58	2.61	2.64	2.49
Baseline	2.33	2.37	2.41	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.53
Difference	0.00	0.00	–0.01	–0.01	–0.02	–0.04	–0.05	–0.07	–0.09	–0.11	–0.04
Treasury Bill, 3–Month (Annualized Percent)											
Forecast	0.07	0.07	0.70	2.63	3.68	3.68	3.67	3.66	3.64	3.63	2.54
Baseline	0.10	0.10	0.72	2.64	3.71	3.73	3.73	3.73	3.73	3.72	2.59
Difference	–0.03	–0.02	–0.01	–0.02	–0.03	–0.04	–0.06	–0.07	–0.08	–0.10	–0.05
Treasury Bond, 10–Year (Annualized Percent)											
Forecast	2.41	3.10	3.85	4.68	5.16	5.09	5.03	4.98	4.94	4.91	4.42
Baseline	2.09	2.75	3.46	4.31	4.85	4.85	4.85	4.85	4.84	4.84	4.17
Difference	0.32	0.36	0.39	0.37	0.32	0.24	0.18	0.13	0.09	0.06	0.25

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APPENDIX TABLE 1

The Economic and Budgetary Effects of the Obama Tax Plan (Page 3 of 3)

FEDERAL BUDGET INDICATORS										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total, 2013–2022
Unified Federal Tax Revenue (Billions of Dollars, Not Adjusted for Inflation)											
Forecast	2,836.6	3,049.9	3,286.7	3,515.3	3,721.8	3,924.1	4,096.8	4,285.1	4,473.3	4,682.6	37,872.3
Baseline	2,734.4	2,987.4	3,231.1	3,441.8	3,623.8	3,810.7	4,003.2	4,219.7	4,442.7	4,694.8	37,189.6
Difference	102.2	62.5	55.6	73.5	98.0	113.4	93.6	65.3	30.6	–12.2	682.7
Unified Federal Spending (Billions of Dollars, Not Adjusted for Inflation)											
Forecast	3,609.4	3,716.6	3,857.7	4,055.1	4,244.7	4,430.3	4,610.8	4,806.2	5,008.7	5,255.5	43,595.1
Baseline	3,603.7	3,707.9	3,849.3	4,055.4	4,262.7	4,476.1	4,689.5	4,919.0	5,159.6	5,456.5	44,179.7
Difference	5.8	8.7	8.3	–0.2	–18.0	–45.8	–78.7	–112.8	–150.8	–201.0	–584.6
Federal Government Net Interest Payments (Billions of Dollars, Not Adjusted for Inflation)											
Forecast	309.4	328.2	359.1	422.5	495.0	553.8	589.3	619.0	673.3	763.2	5,112.8
Baseline	303.7	320.0	348.2	410.6	485.3	550.1	590.4	619.4	671.1	764.4	5,063.1
Difference	5.7	8.1	10.9	11.9	9.7	3.7	–1.1	–0.4	2.2	–1.2	49.7
Unified Federal Surplus/Deficit (Billions of Dollars, Not Adjusted for Inflation)											
Forecast	–855.6	–681.3	–591.1	–534.5	–530.7	–511.6	–510.5	–519.6	–527.7	–563.2	–5,825.8
Baseline	–929.1	–741.7	–637.3	–600.1	–634.7	–662.9	–681.2	–696.5	–708.3	–749.8	–7,041.7
Difference	73.5	60.4	46.2	65.6	104.0	151.3	170.7	176.9	180.7	186.6	1,215.9
											Average, 2013–2022
Publicly Held Federal Debt (Billions of Dollars, Not Adjusted for Inflation, End of Period)											
Forecast	12,487.9	13,266.1	13,946.5	14,587.9	15,210.0	15,809.1	16,408.0	17,009.9	17,624.3	18,276.9	15,462.6
Baseline	12,574.7	13,407.0	14,134.8	14,849.5	15,587.0	16,345.3	17,117.0	17,897.7	18,694.6	19,537.1	16,014.5
Difference	–86.8	–141.0	–188.2	–261.6	–377.1	–536.2	–709.0	–887.8	–1,070.2	–1,260.2	–551.8

Source: Heritage Foundation calculations using data from the IHS Global Insight
2012 November Short-Term U.S. Macroeconomic Model.

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Endnotes

1. Congressional Budget Office, "What Accounts for the Slow Growth of the Economy After the Recession?" November 2012, http://www.cbo.gov/publication/43707 (accessed November 19, 2012).

2. Congressional Budget Office, "Economic Effects of Policies Contributing to Fiscal Tightening in 2013," November 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/11-08-12-FiscalTightening.pdf (accessed November 26, 2012), and Robert Carroll and Gerald Prante, "Long-Run Macroeconomic Impact of Increasing Tax Rates on High-Income Taxpayers in 2013," Ernst & Young, July 2012, http://www.nfib.com/LinkClick.aspx?fileticket=OMV7uZczVaM%3d&tabid=1083 (accessed November 26, 2012).

3. The IHS Global Insight 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 methodologies, assumptions, conclusions, and opinions in this report are entirely the work of CDA economists and have not been endorsed by and do not necessarily reflect the view of the owners of the IHS Global Insight model.

4. Patrick Louis Knudsen, "Fiscal Cliff: What Congress Should Do," Heritage Foundation *Issue Brief* No. 3775, http://www.heritage.org/research/reports/2012/11/fiscal-cliff-what-congress-should-do.

5. William W. Beach, Stuart M. Butler, and Alison Acosta Fraser, "Saving the American Dream: The Fiscal Cliff and Beyond," Heritage Foundation *Backgrounder* No. 2750, December 11, 2012, http://www.heritage.org/research/reports/2012/12/saving-the-american-dream-the-fiscal-cliff-and-beyond.

6. For a comprehensive overview of the tax policies set to expire and tax policies set to commence on January 1, 2013, see Curtis S. Dubay, "Taxmageddon: Massive Tax Increase Coming in 2013," Heritage Foundation *Issue Brief* No. 3558, April 4, 2012, http://www.heritage.org/research/reports/2012/04/taxmageddon-massive-tax-increase-coming-in-2013.

7. Congressional Budget Office, "Economic Effects of Policies Contributing to Fiscal Tightening in 2013."

8. "Obama Tax Plan" is the scenario in which changes in tax policy on January 1, 2013, affect only those earning $250,000 or more in annual income as specified in the President's proposal.

9. These policies have no material effect on the trajectory of aggregate prices. Thus, all values that would be subject to a change in the price level, such as consumption in a given year, are understood to reflect the price level for that year in the baseline scenario.

10. Using a general equilibrium model of the U.S. economy, Carroll and Prante estimate $200 billion less in total real output with the expiration of tax rates on "high income earners." Carroll and Prante, "Long-Run Macroeconomic Impact."

11. William W. Beach, Rea S. Hederman, Jr., John L. Ligon, Guinevere Nell, and Karen Campbell, "Obama Tax Hikes: The Economic and Fiscal Effects," Heritage Foundation *Center for Data Analysis Report* No. 10–07, September 20, 2010, http://www.heritage.org/research/reports/2010/09/obama-tax-hikes-the-economic-and-fiscal-effects.

12. Chetty and Saez find that the change in federal tax treatment of dividend income in 2003 induced firms with varying characteristics to initiate regular dividend payment policy. The reduction in the dividend income tax for 2003 likely improved the capital allocation efficiency in the U.S. economy. The change was the largest among publicly traded U.S. corporations in the past 30 years. The response to the change in dividend taxation varied across firm structure of the corporations but was concentrated toward low-growth and moderate-growth firms. Moreover, the tax response was strongest in firms with strong principals and/or agents whose tax incentives changed. Raj Chetty and Emmanuel Saez, "Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut," National Bureau of Economic Research *Working Paper* No. 10841, October 2004, http://www.nber.org/papers/w10841 (accessed November 28, 2012).

13. The changes in the economy (e.g., hours worked, rates and levels of investment, and capital stock) affect the corporate and personal income tax base, which determines the taxable income in the economy. For example, a weaker economy, lower wages, and higher unemployment lead to fewer payroll taxes, even assuming the payroll tax rates begin to rise in 2013.

14. U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013* (Washington: U.S. Government Printing Office, 2012), http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf (accessed December 7, 2012).

15. Foertsch and Rector discuss this general methodology using the Heritage individual income tax model and the IHS Global Insight dynamic model. Tracy L. Foertsch and Ralph A. Rector, "A Dynamic Analysis of the 2001 and 2003 Bush Tax Cuts: Applying an Alternative Technique for Calibrating Macroeconomic and Microsimulation Models," Heritage Foundation *Center for Data Analysis Report* No. CDA06–10, November 22, 2006, pp. 10–14, http://www.heritage.org/research/reports/2006/11/a-dynamic-analysis-of-the-2001-and-2003-bush-tax-cuts-applying-an-alternative-technique-for-calibrating-macroeconomic-and-microsimulation-models.

16. U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013*, p. 208.

17. James M. Poterba, "Estate Tax and After-Tax Investment Returns," in Joel M. Slemrod, ed., *Does Atlas Shrug?* (Cambridge, MA: Harvard University Press, 2000), and Foertsch and Rector, "A Dynamic Analysis of the 2001 and 2003 Bush Tax Cuts," pp. 11–14.