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Analysis of the Dole Economic Program

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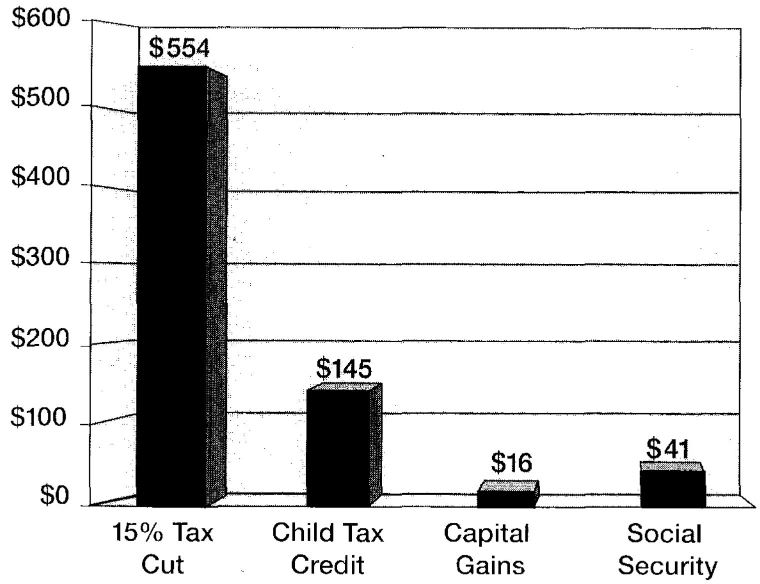
Republican Presidential candidate Bob Dole unveiled the heart of his economic program on August 5. The centerpiece of the plan is a set of tax cuts that, if enacted, are projected to reduce federal receipts by $12 billion in 1997, $123 billion in 2000 when fully phased in, and $548 billion over six years. In addition to tax relief, Senator Dole called for overhauling the federal income tax system, passage of the Balanced Budget Amendment and enactment of a balanced budget by the year 2002, expansion of the federal role in job training, growth-oriented regulatory reform, and lawsuit reform.

Figure 1
Average Tax Reduction Per Major Element of Dole Tax Plan, 1999



Source: Tax Foundation.

The Dole plan resolves the apparent conflict between tax reduction and eliminating the deficit by restraining federal spending and through increased revenues from accelerated economic growth. There are many controversial elements of the plan's fiscal components. This Report presents some key facts and observations surrounding some of these controversies.

The Dole Tax Cuts

The main elements of the Dole tax cut package are:

1) A reduction of personal income tax rates by 15% over 3 years.
2) A reduction of the top capital gains tax rate to 14% from 28%. The capital gains rate for taxpayers in the 15% income tax bracket would be set at 7.5%.
3) A $500 credit for every child 18 years of age and younger for low- and middle-income families.
4) A $500 per child Education Investment Account. Accumulated earnings in these accounts would be tax free if the funds are left in the accounts for at least five years. Funds withdrawn from the accounts to pay for college education-related expenses would be tax-free.
5) An expansion of Individual Retirement Accounts.
6) Tax incentives for job training.
7) To allow low- and middle-income parents and students to deduct interest paid on student loans for post-secondary education.
8) To repeal the 1993 tax hike on Social Security benefits.

Other minor tax provisions in the Dole program include:

- capital gains indexing,
- estate tax relief,

• a tax credit for charitable contributions,
• a $1,000 deduction for custodial care of certain elderly dependents,
• foreign sales corporation treatment for software,
• reform of the independent contractor rules,
• tax relief associated with State-sponsored college savings plans,
• making permanent the exclusion for employer-provided educational assistance,
• penalty-free withdrawals from IRAs and pension plans for education and training,
• increasing deductibility of health insurance premiums to 100 percent for self employed,
• clarifying the definition of principal place of business, and
• reducing the depreciation life of semiconductor manufacturing equipment from five to three years.

Charting the Numbers

The Dole presidential campaign released the figures in *Table 1* (below) to describe the budgetary consequences of the total program.

The Baseline Revenues are taken directly from the Congressional Budget Office. The tax reduction estimates are presented as consistent with Joint Tax Committee scoring. JTC scores the package as reducing federal revenues by $551.3 over the six year period relative to the baseline. The income growth effect represents the increase in revenues assumed to follow from the enactment of the overall program, not just the tax relief elements. The congressional budget resolution for fiscal year 1997 establishes spending targets that would result in the federal government spending $393 billion less than baseline over the next six years. The budget resolution outlays for 1997 through 2002 assume the Congress will achieve at least this amount of spending restraint in 1996. In addition, Senator Dole proposes additional spending restraint to balance the budget by 2002.

Key Questions

Unavoidably, the Dole program description raises more questions than it answers. Questions that appear key to its credibility from a fiscal policy perspective are (a) whether the assumptions regarding accelerated economic growth are reasonable, and (b) whether the spending cuts would be sufficient to prevent the deficit from increasing, let alone to eliminate the deficit.

Sources of Economic Growth

There are four main sources of additional near-term economic growth contained in the Dole plan: the individual income tax rate cuts, the capital gains tax rate cut, the cut in federal spending, and the reduction in the budget deficit. The reduction in individual income tax rates will reduce the tax system's disincentives

Table 1
Six-Year Budgetary Consequences of Dole Tax Proposal, 1997-2002
(Billions$)

	1997	1998	1999	2000	2001	2002	Total
Baseline Revenues (CBO Adjusted)	$1,498	$1,564	$1,635	$1,710	$1,790	$1,875	$1,0072
Tax Reductions	-12	-58	-99	-123	-127	-129	-548
Income Growth Effect	2	12	25	34	36	38	147
Projected Revenues	1,488	1,518	1,561	1,621	1,699	1,784	9,671
Budget Resolution Outlays	1,622	1,769	1,718	1,765	1,797	1,842	10,423
Proposed Spending Restraint	13	27	35	38	45	59	217
Deficit	121	134	122	106	53	-1	

Source: Dole in '96 campaign.

to work, save, and invest, while the reduction in the capital gains tax rate will spur capital formation and saving by reducing the cost of capital. There is, however, no consensus among economists about the magnitude of these effects. Proponents of supply side theory argue that the additional growth from these types of marginal rate reductions can be significant, but no mainstream supply-sider would argue that the revenue from the additional growth from an income tax rate cut would be sufficient to pay for the tax cut entirely.

The Dole plan calls for slowing the growth in federal spending. If achieved, this restraint would reduce the amount of labor and capital services that would otherwise be claimed by the federal government, leaving these resources to more productive uses in the private sector. By increasing the resources available to the private sector, the reduction in federal spending would allow for faster economic growth

Eliminating the budget deficit as projected would reduce the borrowing requirements of the federal government. One certain consequence of this decline in governmental dissaving is that annual federal interest expense would be lower in all future years. At the current federal borrowing interest rate of about 6.8 percent, every $10 billion decline in borrowing in one year produces a $680 million decline in annual interest expense in future years.

Many economists and observers would also argue that a reduction in federal borrowing would reduce the real rate of interest throughout the economy, stimulating economic activity by reducing the cost of capital. A reduction in the real rate of interest would also further feed into future spending restraint by reducing the cost of future federal borrowing when rolling over previous federal debt issues.

Certain other elements of the Dole plan would have longer-term economic growth benefits, such as the expansion of the Individual Retirement Accounts, the creation of a new Education Investment Account, and tax, regulatory, and tort reforms. Some elements of the plan, however, would have little or no growth consequences, such as the $500 child tax credit and the repeal of the 1993 income tax hike on Social Security benefits.

Economic Growth Assumptions

Senator Dole has made accelerating economic growth the central goal of his program. According to the 1996 Economic Report of the President, the Clinton Administration projects economic growth to remain at 2.3% per year for the next few years. Senator Dole has set a 3.5% annual growth rate as his goal. Economic growth in the post World War II period has been much closer to the Dole goal of 3.5%, but recent experience is more consistent with the Administration projections.

The extent to which adjusting federal policies can encourage the economy to grow more rapidly is unsettled. There is no serious debate that the current tax system slows economic growth by discouraging work effort, saving, and investment. Whatever its other merits, much of government spending slows the economy to the extent it claims resources that would otherwise be more productively employed in the private sector, while government regulations can restrict economic growth through similar resource misallocations and high compliance costs.

The Dole program assumes a slightly faster rate of growth than would otherwise occur. The description of the Dole program does not specify the precise amount of assumed additional annual growth in the economy, but this can be inferred from the data. According to the revenue estimates associated with the income growth effect, the Dole plan appears to assume the pattern of economic growth as seen in *Table 2* (below).

Note that the average additional growth expected is one half of one percentage point per year. Another way to look at this is that the economy is expected to be 3 percent bigger in 2002 than it would be without the pro-

Table 2
Six-Year Economic Growth Projection for Dole Tax Proposal, 1997-2002

	1997	1998	1999	2000	2001	2002	Total
Current Law	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	13.8%
New Growth	0.1	0.6	0.8	0.7	0.4	0.3	3.0
Total Projected Growth	2.4	2.9	3.1	3.0	2.7	2.6	16.9

Note: Totals may not correspond due to rounding.
Source: Dole in '96 campaign.

Table 3
State-by-State Breakdown of Major Dole Tax Cuts, 1997-2002

State	Rate Reduction	Family Tax Credit	Repeal of '93 Social Security Tax Increase	Individual Capital Gains Reforms	Total Federal Individual Income Tax Burden ($Millions)	Total Burden w/ Dole Proprosal (Millions)	Per-Filer Federal Tax Burden	Per-Filer Burden with Dole Tax Provisions	Per-Filer Tax Cut
Alabama	$4,805.6	$1,066.0	$32.9	$102.0	$55,447	$49,441	$31,218	$27,836	$3,382
Alaska	1,060.7	161.8	83.5	10.8	12,833	11,516	35,048	31,452	3,596
Arizona	4,624.1	1,034.4	379.8	180.6	57,460	51,241	34,547	30,808	3,739
Arkansas	2,298.8	602.7	233.0	66.5	28,286	25,085	27,766	24,624	3,142
California	51,595.3	8,910.9	3,243.2	2,406.8	556,052	489,896	39,038	34,393	4,645
Colorado	4,939.8	1,024.3	372.4	157.0	68,086	61,592	41,652	37,680	3,973
Connecticut	9,589.5	1,193.7	417.6	316.0	93,655	82,138	50,986	44,716	6,270
Delaware	1,255.1	221.3	78.7	34.2	13,633	12,044	39,430	34,833	4,597
Dist. of Col.	1,322.1	233.7	80.9	67.2	13,969	12,265	39,347	34,547	4,799
Florida	21,147.9	3,885.8	1,440.6	963.6	265,326	237,888	42,103	37,749	4,354
Georgia	9,493.4	1,853.0	683.8	289.0	108,430	96,111	36,147	32,040	4,107
Hawaii	1,742.7	360.5	129.8	90.4	22,330	20,007	39,187	35,110	4,077
Idaho	957.3	265.1	97.8	32.8	15,053	13,699	35,173	32,011	3,162
Illinois	22,131.6	3,583.9	1,295.6	606.5	238,476	210,859	41,919	37,065	4,855
Indiana	8,184.1	1,679.4	608.1	148.8	91,063	80,443	34,049	30,078	3,971
Iowa	3,455.0	829.5	306.3	75.4	40,651	35,985	30,324	26,843	3,481
Kansas	3,599.2	746.1	268.6	106.0	41,602	36,882	35,287	31,284	4,003
Kentucky	4,173.5	958.4	364.8	101.0	48,595	42,997	30,395	26,894	3,501
Louisiana	4,632.5	1,025.4	405.4	71.4	54,346	48,212	30,600	27,146	3,454
Maine	1,613.4	391.9	139.9	64.5	17,066	14,856	27,864	24,256	3,608
Maryland	9,983.5	1,617.7	567.0	302.2	101,783	89,313	40,742	35,751	4,992
Massachusetts	13,095.9	2,132.9	737.2	440.3	130,209	113,803	40,183	35,120	5,063
Michigan	16,087.9	2,761.4	1,012.3	271.4	161,725	141,592	36,294	31,776	4,518
Minnesota	6,883.0	1,364.6	487.5	205.6	81,555	72,615	38,103	33,926	4,177
Mississippi	2,224.5	592.6	242.2	44.9	26,742	23,638	25,234	22,305	2,929
Missouri	7,457.7	1,507.3	554.7	168.2	83,252	73,564	34,213	30,232	3,981
Montana	783.2	217.5	85.4	26.5	11,479	10,366	30,758	27,777	2,981
Nebraska	2,053.6	478.2	176.8	50.1	24,856	22,097	32,130	28,564	3,566
Nevada	2,164.1	393.3	134.3	100.8	31,355	28,562	46,082	41,978	4,104
New Hampshire	2,260.1	400.4	137.4	87.1	22,594	19,709	37,421	32,643	4,778
New Jersey	20,158.6	2,838.1	999.8	644.6	198,331	173,690	45,128	39,521	5,607
New Mexico	1,546.3	393.3	155.3	45.4	20,094	17,954	29,533	26,387	3,146
New York	37,251.2	5,654.6	2,010.8	1,548.7	384,701	338,235	43,554	38,294	5,261
North Carolina	8,958.0	1,976.6	731.2	298.7	102,210	90,245	31,886	28,153	3,732
North Dakota	686.0	184.3	69.8	13.4	8,532	7,578	27,967	24,841	3,126
Ohio	16,490.3	3,420.4	1,224.8	348.1	178,312	156,829	33,174	29,177	3,997
Oklahoma	3,559.0	842.2	314.8	72.5	41,923	37,134	30,381	26,911	3,470
Oregon	3,689.9	845.4	311.1	126.1	48,084	43,111	35,308	31,657	3,651
Pennsylvania	19,570.2	3,754.9	1,351.0	468.0	211,194	186,050	35,627	31,385	4,242
Rhode Island	1,746.8	334.8	118.0	65.4	17,109	14,844	33,028	28,655	4,372
South Carolina	4,012.3	975.2	365.1	107.1	45,899	40,440	28,689	25,276	3,412
South Dakota	713.3	192.9	74.6	18.6	10,465	9,465	32,069	29,006	3,062
Tennessee	6,602.5	1,393.1	523.2	173.0	78,379	69,687	34,181	30,390	3,790
Texas	24,549.8	4,535.0	1,746.9	582.5	295,235	263,821	38,541	34,440	4,101
Utah	1,733.2	437.0	158.1	41.9	23,202	20,832	33,447	30,030	3,417
Vermont	815.7	182.6	65.6	38.9	8,869	7,766	30,897	27,055	3,842
Virginia	10,959.2	1,947.6	691.8	334.6	120,476	106,542	39,638	35,054	4,584
Washington	7,674.6	1,509.5	530.9	199.4	105,088	95,173	45,083	40,830	4,253
West Virginia	1,894.7	456.9	169.4	33.9	20,921	18,366	28,181	24,740	3,441
Wisconsin	7,143.8	1,496.7	541.0	236.2	83,286	73,868	35,085	31,118	3,967
Wyoming	629.6	135.2	49.6	15.6	8,284	7,454	38,108	34,290	3,818
United States	406,000.0	75,000.0	27,000.0	13,000.0	4,528,500	4,007,500	37,670	33,336	4,334

Source: Tax Foundation.

gram, which is roughly equivalent to an additional year of economic growth for every six years.

Also, after a minor initial surge, the economy is projected to settle down to about a 2.6 percent annual growth rate, or about 3 tenths of a percentage point higher than would otherwise be the case. Such a projected increase for such a modest tax reduction proposal might be questioned, but based on an overall program including tax reform, a balanced budget, and regulatory and tort reform, the accelerated growth assumed in this plan appears entirely reasonable.

Finally, the surge in growth projected to occur in 1999 coincides with the completion of the 15% rate reduction. Projecting a temporary surge is reasonable because part of the benefit of the lower marginal tax rates arises as the lower rate induces individuals to move out of activities and investments made artificially favorable by the former, higher tax rates. While this is a permanent benefit of the lower rates, there is a finite number of pre-existing arrangements that would no longer be desirable and which caused some of the nation's resources to be applied sub-optimally. As taxpayers dissolve some of these pre-existing arrangements, there would be a one-time surge in economic activity as these resources are released to more productive activities.

Additional Spending Restraint

The Dole program lists $217 billion in proposed spending restraint over six years relative to current law. The program proposes the following areas for spending restraint:

Proposed Reduction	**6-Year Savings**
10% Cut in Non-Defense Administrative Costs	$90 billion
FCC Spectrum Auction	$34 billion
Non-Defense Program Reductions:	
Energy Department	$32 billion
Commerce Department	$15 billion
1% Reduction in Other Spending Programs	$46 billion
Total Savings	$217 billion

Of this amount, the $34 billion from auctioning radio spectrum is actually not a reduction in spending but is similar to an asset sale, so the spending restraint would only reduce outlays by $183 billion. To put this figure into perspective, it represents 1.8% of the total $10.4 trillion the federal government would otherwise expect to spend over the next six years if current law is maintained. Expressed another way, federal spending would rise from 1997 through 2002 by $167 billion instead of by $220 billion.

Judged in this light, the spending restraint is plausible, even minor, if the Congress and the President could agree on where to restrain. However, the Dole plan states specifically that Medicare, Social Security, and Defense programs are "off-the-table." These programs represent 51% of total federal spending, while interest on the debt represents another 15%. Therefore, the spending restraint must affect 34% of the total budget, which means spending in these areas would need to be 5.4% less than if current law were maintained.

Interestingly, the Dole program does not appear to take credit for the reduction in federal interest expense that would follow if the proposed spending cuts are sufficient to reduce the deficit below the baseline projections. Assuming a constant rate of interest of 6.8 percent over the period, these interest savings would total about $20 billion over the six years. These savings result because a lower deficit reduces federal borrowing requirements, thereby reducing future years' interest expense. Moreover, these savings do not include the savings that is often predicted would arise if inflation-adjusted interest rates were to fall as the deficit is decreased.

The Distribution of the Tax Cuts

A common analysis of tax programs is the presentation of the distribution of the tax changes over various income groups. *Table 4* (on page 6) presents this analysis for the Dole plan and for each of its major tax reduction components.

As the table indicates, on average, taxpayers with incomes below $25,000 would see their income tax burden eliminated. It is important to realize, however, that some of this tax relief derives from the $500 child credit. Therefore, families with children in this income range are almost certain to pay no income tax, while tax filers without eligible dependents may still owe some income tax. Filers in the next highest income group ($25,000 to $50,000) would experience a 38% drop in their income tax liability, on average, while the corresponding figures for the other income ranges from lower to higher ranges are 30%, 27%, 22%, and 25%, respectively.

Table 4
Average Individual Income Tax Estimates, Current Law v. Major Elements of the Dole Plan (1999 Estimates)

AGI	Current Law	Fully Phased-In Dole Plan	Value of Cuts in Isolation* 15 Percent Rate Cut	Child Tax Credit	Capital Gains	Social Security
$1 under $25,000	$99	$33	$50	$35	$1	$1
$25,000 under $50,000	3,376	2,722	351	261	2	45
$50,000 under $75,000	6,817	5,717	701	321	6	81
$75,000 under $100,000	12,168	10,480	1,245	311	22	125
$100,000 under $200,000	22,847	20,491	2,147	0	62	163
$200,000 or more	155,648	141,113	19,673	0	10,802	298
All Taxpayers	$5,596	$4,856	$812	$182	$218	$41
Total Revenue ($Mils.)	$730,848	$634,094	$72,293	$18,902	$2,102	$5,382

* The individual tax cuts are, in many cases, mutually interactive.
Approximately $5 billion of cuts are unaccounted for in this table.
Source: Tax Foundation.

A State-by-State Analysis

Income levels vary dramatically on a state-by-state basis. The federal income tax is progressive, meaning individuals with higher incomes pay higher rates of tax than individuals with lower income levels. For this, and for other demographic reasons such as the percent of retirees in a state's population, federal income tax burdens can vary significantly from one state to another and so the distribution of the tax relief will also vary. *Table 3* (on page 4) presents Tax Foundation estimates of the distribution of the tax relief under the Dole plan.

Conclusion

The fiscal elements of the Dole economic program call for significant reductions in taxes and federal spending and demonstrate an intent to eliminate the federal deficit by the year 2002. Increased federal receipts from accelerated economic growth is one source of the deficit reduction. Contrary to many initial reports, the additional economic growth implied by the revenue estimates is quite modest and therefore plausible. The balance of the deficit reduction is projected to come from restraining the growth of spending. This spending restraint, like the amount of assumed additional economic growth, appears modest, and so it is not unreasonable to expect that a Congress and President working together could achieve these goals. This is not to predict that the spending restraint would be enacted, only to state that it is not an unreasonable expectation. The remaining question that only President Clinton and Senator Dole can argue, and that only the electorate can decide, is whether the reductions in spending would be wise and whether the promised tax relief is a fair trade for this amount of spending restraint.

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