IRET *Congressional Advisory*

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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DEMINT JOBS PLAN

Senator Jim DeMint (R-SC) is offering a substitute tax package for the stimulus bill. The DeMint plan would generate about 2.5 million new jobs on a permanent basis. The improvement in the economy would start quickly and grow over time. It would do more than return us to full employment in the short run. It would expand labor force participation, hours worked, and the stock of plant and equipment on a permanent basis, and leave the economy larger than otherwise. The added employment and income would not only benefit the country, they would eventually generate additional tax revenue, which, along with one modest revenue raiser in the package, would offset the revenue cost of the proposal to the federal budget. This is in sharp contrast to the massive outlays and tax rebates being proposed in the stimulus package, which would generate no permanent economic gains and would cost not only their immediate outlays, but would add to the government's debt and associated interest payments forever after.

We estimate that, compared to the tax rates in effect in 2009, the DeMint plan would boost business sector output by 2.2%, raise total GDP by about 1.8%, create nearly 400,000 full-time equivalent jobs, and raise wages by about 1.8%. (A full-time equivalent job assumes a 40 hour week. Some of these jobs would be divided among part time workers, so the employment count would be higher.) The effects would be far more dramatic compared to the post-2010 baseline, which assumes expiration of the 2001 and 2003 tax rate reductions, lowering investment, employment, and wages. Under DeMint, compared to the post-2010 baseline, business sector output would be 8.7% higher, total GDP about 7% higher, there would be 2.5 million more permanent full-time equivalent jobs, and wages would be about 6.3% higher. The economy under the DeMint plan would generate slightly more federal revenue than at present due to the added output and income. By contrast, under the depressed baseline economy, annual federal revenue would be reduced by more than $220 billion in spite of expiration of the pre-2001 tax reductions.[1]

In "Stimulus or Bust?", IRET Congressional Advisory No. 249, we criticized the stimulus package as passed by the House and introduced to the Senate for not pushing any of the "growth buttons" in the tax code. It would not lower marginal tax rates on individuals to encourage added work, hiring and investment by small businesses. It would not reduce the corporate tax rate or extend the Bush tax rates on dividends and capital gains to lower the cost of capital for corporate investment. It does have a modest but temporary restoration of the bonus expensing for equipment, but only for one year, which would not induce a permanent increase in productive capacity or employment. In short, it would give people little or no reason to offer more labor or capital to the production process, without which there can be no added output or income. The spending elements of the plan would have to be paid for either through taxing or borrowing, and would not add to GDP. They are largely a waste. The stimulus package, as currently structured, would saddle future budgets and taxpayers with $35 billion to $40 billion a year in additional interest, and the taxes raised to pay that interest would do considerable collateral economic damage, perhaps another $60 billion annually in lost GDP. Even if the package performed as advertised to shorten the downturn by three to six months (a real stretch of the imagination), its long term cost would make it a bad bargain by permanently depressing future output, employment, and income.

In sharp contrast, the DeMint plan would prevent several tax increases from occurring in 2011 when the 2001 and 2003 tax cuts are due to expire, and would go on to cut taxes on incremental labor and capital formation to expand capacity, output, and income. It would:

- Repeal the Alternative Minimum Tax.
- Make permanent the 15% tax rate on long term capital gains and dividends.
- Raise the estate tax exempt amount to $5 million and set the tax rate at 15%.
- Make the $1,000 child credit permanent.
- Make the marriage penalty relief permanent.
- Eliminate itemized deductions except for mortgage interest and charitable contributions, which would not phase out with income.
- Lower the top individual income tax rates to 25%.
- Retain the 10% and 15% tax rates.
- Lower the corporate tax rate to 25%.

Most of the elements of the plan reduce the tax on added work effort, or cut the required "hurdle" rate of return on investment. The hurdle rate is the amount an investment must earn to cover its initial cost, pay any taxes levied on the returns, and still leave a normal, minimally acceptable after-tax return to the investor (about 3% on an asset of average risk). This focus on reducing tax barriers to the supply of labor and capital is what makes the package so effective at promoting additional employment, investment, production, and income.

The marriage penalty relief is mainly a social issue, but it does move some couples into the next lower tax bracket, which reduces their marginal tax rates. The child credit is a social objective with little work incentive effect. It can harm incentives if it is phased out over a range of income (effectively increasing the tax rate in the range). We hope DeMint would end the phase-out.

We have only two concerns with the DeMint proposal. It does not completely eliminate the estate tax, and it eliminates the individual income tax's itemized deduction for state and local taxes. We estimate that the partial retention of the estate tax reduces GDP and actually depresses revenue slightly compared to full repeal when dynamic economic feedback is considered. We do not favor the elimination of the itemized deductions for state and local taxes for individuals. It is bad policy to tax a tax. Furthermore, most of what these state and local taxes pay for are things that should be deducted. Public education is an investment in human capital, which should be viewed as an expense for training that increases future taxable income. Police and fire protection prevent losses that would otherwise be deductible. Transfer payments should be taxable income to the recipient, not taxable income to the donor who had to give the income up. In the case of welfare transfers, the recipients would generally not owe tax due to their low levels of income.

The DeMint alternative would do more to restore economic growth and prosperity in both the short run and the long run than would the set of clumsy and ineffective tax rebates and government spending provisions in the House and Senate stimulus packages. The DeMint alternative would be far more budget friendly both short run and longer term. It is the superior approach to our current economic troubles.

Stephen J. Entin
President and Executive Director

Endnote

1. We used IRET's Cobb-Douglas production model for the economic estimates, and used a tax calculator furnished by Gary Robbins of Fiscal Associates and the Heritage Data Analysis Group for the income tax rates and estate tax rates generated by the proposals, which are inputs in the economic forecast, and for the associated revenues.
