NCPA

National Center for Policy Analysis

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FEDERAL BUDGET ISSUE:
The Perot Economic Plan

In contrast to George Bush and Bill Clinton, Ross Perot has proposed a serious plan to reduce the federal deficit.[1] If all of Perot's recommendations were implemented, the plan would reduce deficit spending by $711.5 billion over the next six years. Even ignoring Perot's recommended cuts in Medicare and Medicaid on the grounds of political realism, the plan would reduce deficit spending by $570.2 billion. This contrasts markedly with the programs of the other two candidates. As Figure I shows:

- If the Perot plan were followed precisely, the federal deficit would be only $25.5 billion in 1998.
- On the other hand, the Bush deficit that year would be $297.7 billion and the Clinton deficit would be $306.9 billion.[2]

"If the Perot plan focused more on stimulating investment, it would produce the same deficit reduction with far less pain."

Unfortunately, the Perot plan puts too much weight on deficit reduction at the expense of economic growth. It ignores the fact that *the economy affects the deficit much more than the deficit affects the economy.* If the Perot plan focused more on stimulating investment, it would produce the same deficit reduction with far less pain.

The Perot plan primarily attempts to close the deficit by increasing taxes, rather than reducing expenditures. Because of these increases, the plan would have a moderately depressing effect on the U.S. economy — increasing joblessness and slightly lowering the rate of economic growth. Specifically:

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- By 1998, the plan would lead to a *loss of about 335,000 jobs.*

- Over the same period, it would reduce the nation's *output of goods and services by about $84 billion — an amount equal to more than $840 per family.*

The NCPA forecast is similar to an earlier forecast that Data Resources Inc. (DRI), prepared for the Perot campaign. [See Table VII.]

Specifics of the Perot Plan: Spending Cuts

Perot claims his plan would reduce spending by $308 billion. However, $96.6 billion of that amount consists of tax increases that are mislabeled as "spending cuts." An additional $141.3 billion in spending cuts consists of reductions in Medicare and Medicaid spending that are unlikely to be realized.

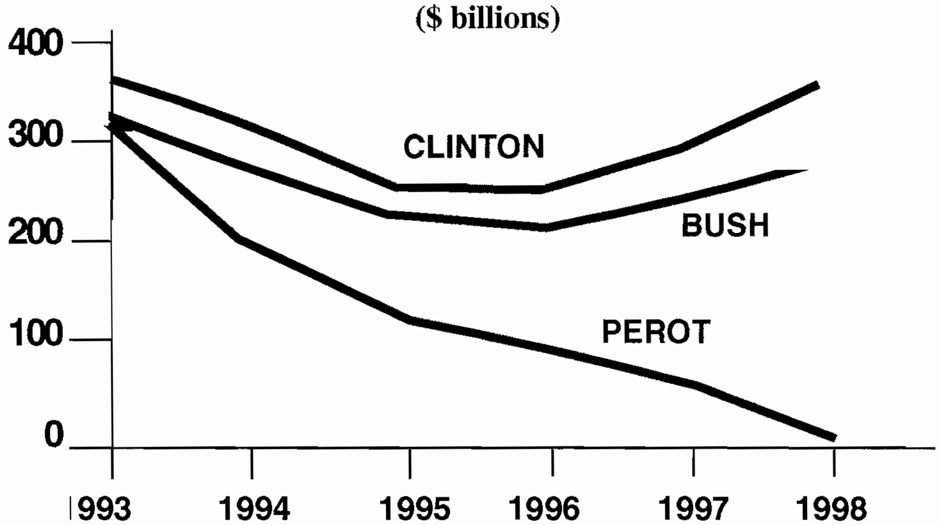
Without the Medicare and Medicaid cuts, the Perot plan would reduce net government spending by only $68.7 billion over five years. [See Table I.] By contrast, the plan would increase taxes by $388.5 billion over the same period. [See Table II.] Overall:

"96.6 billion mislabeled as spending cuts are actually tax increases."

FIGURE I

Annual Federal Deficit

($ billions)



- The Perot plan would raise taxes by \$5.65 for every \$1 reduction in spending.

- Even if the Medicare and Medicaid cuts are realized, the plan calls for almost \$2 in tax increases for every \$1 reduction in spending.

Medicare and Medicaid. As Table I shows, by far the largest spending cuts under the Perot plan would be in Medicare (\$82.5 billion) and Medicaid (\$58.8 billion). Perot proposes to make these cuts not by reducing benefits but by holding the growth of these programs to the growth in the number of beneficiaries and to increases in inflation. He does not say how he would do so.

"Realistically, Medicare and Medicaid spending cannot be reduced unless benefits are cut or health care is rationed."

Realistically, spending under these programs cannot be reduced unless benefits are cut or health care is rationed. The Perot plan endorses neither alternative. Significant waste might be removed through substantial privatization of the programs, but the Perot plan does not call for such radical restructuring. As a result, we estimate that none of the Perot savings in these two programs would be realized.

Misclassified Tax Increases. The Perot plan makes an increasingly common error. It attributes \$96.6 billion of increased taxes to entitlement spending reductions. The savings from these misclassified "spending cuts" are second only to the proposed Medicare/Medicaid cuts. Specifically, Perot would:

- Tax 85 percent of Social Security benefits. Currently, 50 percent of benefits for singles with adjusted gross income (AGI) over \$25,000 and couples over \$32,000 are subject to federal income tax.

- Subject all wages and salaries to the 2.9 percent payroll tax for Medicare Part A. Currently, the tax is paid on wages up to \$130,200. Although Perot claims this change would raise \$28.9 billion over five years, only \$18.6 billion is consistent with the estimate of the Medicare Trustees.[3]

- Make Medicare Part B participants pay a premium equal to 35 percent of Part B costs. Currently, participants pay premiums equal to 25 percent of costs.

TABLE 1

Spending Changes Proposed in Perot Plan[1]

(Amounts in $ billions)

	1994	1995	1996	1997	1998	Total
Defense	- 1.1	- 3.6	- 6.8	- 11.4	- 17.1	- 40.0
Domestic Discretionary Spending:						
Cuts:						
Program cuts (space station, REA, etc.)	- 3.0	- 5.5	- 7.5	- 9.0	- 10.0	- 35.0
Across-the-board cut of 10%	- 5.0	-10.0	-15.0	-20.0	-23.0	- 73.0
Increases:						
Increased R&D	0.0	4.0	9.5	15.0	17.0	45.5
Aid to cities	1.7	2.1	2.4	2.6	2.6	11.4
Education	3.0	2.6	2.4	2.2	2.2	12.4
Infrastructure	8.0	8.0	8.0	8.0	8.0	40.0
Total Discretionary	4.7	1.2	- .03	- 1.3	- 3.1	1.3
Entitlements:						
Claimed Entitlement Cuts	-16.4	-35.4	-50.6	-71.0	-94.5	-267.9
Illusory Health Care Cuts:						
Medicare	3.8	9.0	15.2	23.1	31.4	82.5
Medicaid	2.9	6.9	11.3	16.3	21.4	58.8
Total	6.7	15.9	26.5	39.4	52.8	141.3
Misclassified Tax Increases:						
Tax 85% of SS benefits	2.8	5.8	6.4	7.1	7.9	30.0
Repeal Medicare FICA cap[2]	2.7	5.8	6.2	6.7	7.5	28.9
Increase Medicare SMI premium	2.8	4.0	6.0	10.1	14.8	37.7
Total	8.3	15.6	18.6	23.9	30.2	96.6
Actual Entitlement Cuts:						
Limit fed. emp. COLA's for 5 yrs.	- 0.6	- 1.5	- 2.6	- 3.6	- 4.7	- 13.0
Agricultural supports	- 0.8	- 2.4	- 2.9	- 4.1	- 6.8	- 17.0
Total	- 1.4	- 3.9	- 5.5	- 7.7	-11.5	- 30.0
Actual Spending Changes	2.2	- 6.3	-12.6	-20.4	-31.7	- 68.7

[1] Spending reductions relative to the Bush budget. Columns may not add exactly due to rounding.

[2] To be consistent with the estimates of the Medicare Trustees, these numbers should be corrected to read as follows: 1994: $1.8; 1995: $3.8; 1996: $4.1; 1997: $4.3; 1998: $4.6; Total: $18.6.

TABLE II

Tax Proposals in the Perot Plan[1]

(Amounts in $ billions)

	1994	1995	1996	1997	1998	Total
Tax Cuts:						
Incremental ITC[2]	- 5.0	- 5.2	- 5.3	- 5.5	- 5.6	- 26.6
Capital gains tax cut[3]	3.8	- 3.5	- 5.9	- 5.8	- 5.4	- 16.8
Permanent R&D credit	- 0.8	- 1.4	- 1.6	- 1.9	- 2.2	- 7.9
Worker training credit	- 1.0	- 1.8	- 2.1	- 2.5	- 2.9	- 10.3
Tax Increases:						
Increase gas taxes[4]	12.5	22.3	32.0	41.0	50.0	157.8
Tax health insurance benefits	6.1	9.9	11.6	13.6	15.9	57.1
Increase 31% rate to 33% or 35%	3.7	6.9	7.4	7.5	7.6	33.1
Eliminate subsidies	1.9	3.7	4.7	5.4	6.2	21.9
Crack down on foreign corp. taxes	4.0	4.2	4.3	4.4	4.5	21.4
Increase tobacco excise tax	3.0	4.0	3.9	3.9	3.8	18.6
Limit business entertainment deduct.[6]	1.6	3.5	3.5	3.6	3.7	15.9
Restrict mortgage deductions	1.1	2.8	3.2	4.1	4.6	15.8
Impose more user fees	1.8	2.4	2.5	2.6	2.7	12.0
Improve IRS collections	1.8	2.0	2.0	2.2	2.2	10.2
Misclassified as "Spending Cuts"[7]	7.4	13.6	16.5	21.5	27.3	86.3
All Tax Changes	41.9	63.4	76.7	94.1	112.4	388.5

[1]Tax changes relative to current law. Columns may not add exactly, due to rounding.

[2]10 percent tax credit for "new" investment.

[3]Exclusion ranging from 10 percent to 50 percent, based on the length of time the asset is held.

[4]Increases 10 cents per gallon per year for five years.

[5]Imposes limits on the amount of employer-provided health insurance benefits that can be excluded from the personal income tax and the FICA (Social Security) tax.

[6]Deduction limited to 50 percent.

[7]Includes adjustment to make repeal of $130,200 Medicare FICA cap consistent with tax numbers from the Medicare Trustees.

None of these proposed changes belongs under the heading of "spending cuts" because they do nothing to curb the growth in Social Security or Medicare spending.

Other Spending Changes. The Perot plan calls for other spending reductions. These include:

- A 10 percent, across-the-board cut in domestic discretionary programs.
- A $40 billion cut in defense spending, over and above the reductions proposed by the Bush administration.
- A $35 billion cut in programs such as the Rural Electrification Administration and the space station.
- A $17 billion cut in agricultural programs.
- A $13 billion cut in federal employee retirement benefits, achieved by limiting cost-of-living adjustments to two-thirds of the increase in the consumer price index.

"If the Perot plan were implemented, taxes would consume as much as 25 percent of gross domestic product."

Overall, Perot would cut $108 billion from domestic discretionary spending programs. But as Table I shows, he would offset these spending cuts with a $109.3 billion spending increase on such items as research and development, education, aid to cities and infrastructure. As a result, net domestic discretionary spending would actually increase by $1.3 billion over five years. Despite the cuts in defense spending and reduced interest payments on the federal debt, the overall effect of the Perot plan would be to continue historic high levels of federal spending.

Specifics of the Perot Plan: Tax Increases

Perot proposes increasing taxes by $363.8 billion over the period 1994 to 1998. This is in addition to the $96.6 billion (actually $86.3 billion) in tax increases his plan misclassifies as spending reductions. [See Table II.] If the Perot plan were completely implemented, *taxes would be at an all-time high — consuming as much as 25 percent of gross domestic product.*

Gasoline Tax. Perot would increase the federal gasoline tax by 50 cents a gallon, phased in at 10 cents a year for five years, in an attempt to raise $157.8 billion. Although a gasoline tax would provide a fairly stable source of revenue, it tends to be regressive — imposing a greater relative burden on families with lower incomes. It also places an arbitrary burden on those whose use of gasoline is greater than average. Moreover, the gas tax — like other narrowly based excise taxes in the Perot plan — introduces inefficient distortions into the economy.

Employer-provided Health Insurance. Perot would limit the amount of employer-provided health benefits that can be excluded from income and Social Security taxes. Currently, there are no limits. Under the Perot plan, individuals could exclude up to $1,620 a year in health benefits and couples could exclude up to $4,020. These amounts would be indexed for inflation. Perot also would provide the same tax treatment to those who purchase their own health insurance.

"It is likely that an increase in the tax rate would lose revenue."

Marginal Rates. Perot would increase the top marginal income tax rate from 31 percent to 33 percent. The higher rate would start at an income of $55,550 for singles and $89,250 for couples in 1993. If the increase failed to bring in sufficient revenue, Perot would raise the rate to 35 percent. It is likely, however, that the rate increase would lose revenue. During the 1980s, the top marginal rate was reduced from 70 percent to 28 percent, and the share of federal income taxes paid by those with the highest incomes increased. Preliminary evidence suggests that despite the rate increase imposed by the 1990 budget deal (from 28 percent to 31 percent), taxpayers with highest incomes are paying a lower share of federal income taxes.[4]

Tax Subsidies. The Perot plan would reduce or eliminate a number of tax subsidies, among them subsidies for hydroelectric power, historic buildings, extractive industries and private-activity, tax-exempt bonds.

Foreign Corporations. Perot would tighten the tax rules on foreign corporations.[5] He charges that some foreign-owned corporations engage in transfer pricing in order to avoid paying U.S. taxes. Although this proposal is supposed to raise $21.4 billion, the Treasury Department estimates that it would raise only $1 billion over five years.

Other Tax Increases. The Perot plan contains a number of other tax increases. For example, it would double the federal excise tax on cigarettes from 24 cents to 48 cents a pack, impose user fees, restrict the home mortgage deduction, limit business entertainment deductions to 50 percent of actual cost[6] and improve IRS collections.

Specifics of the Perot Plan: Investment Incentives

As an economic stimulus, the Perot plan calls for $61.6 billion in tax cuts from 1994 through 1998. These proposals primarily are aimed at stimulating investment. (See Table II.)

Capital Gains. Perot would reduce the capital gains tax rate, basing the amount of the reduction on the length of time an asset is held. Specifically, he would exclude 10 percent of the capital gain from taxation for assets held between one and two years, whereas assets held more than five years would receive a 50 percent exclusion. The proposal is similar but slightly less generous than the one made by President Bush.[7]

The idea of having different tax rates, depending on the holding period, is common to many capital gains reform proposals. Its proponents argue that it encourages people to invest in long-lived assets. But this argument confuses the life of the asset with the length of time an owner holds the asset. It is true that the tax law discriminates against long-lived assets and that we should remove this discrimination. However, once people invest in such assets, we have no economic reason to care how long a particular owner holds them.

"Perot would reduce the capital gains tax rate, based on the length of time an asset is held."

Investment Tax Credit. The plan proposes a 10 percent investment tax credit (ITC) which is intended to apply only to investments that would otherwise not be made.[8] Unfortunately, the ITC will not have the effect the authors hope. Industries that are contracting or restructuring during an economic downturn and are most in need of help will not be eligible to receive the credit.

The design of the ITC is contradictory. The limit implies that the authors think that the credit is simply a giveaway, not an incentive. If the ITC is not an effective incentive, it should not be included. If it is an incentive, it should not be limited.

Other Tax Cuts. The Perot plan includes a tax credit for worker training that amounts to $10.3 billion over five years. It also would make permanent the current 20 percent tax credit for research and experimentation at a cost of $7.9 billion over five years. Yet, experience with labor-based tax credits has been disappointing. The lack of tangible evidence of success suggests that the training tax credit will lead to widespread abuse and little economic good.

"The deficit reduction part of the plan would destroy 665,000 jobs."

"Investment incentives would cut the job loss in half."

TABLE III

Decomposing the Perot Plan:

The Effects of Deficit Reduction Without Investment Incentives

Year	Change in Jobs (thous.)[1]	Cumulative Change in GDP ($ bil.)	Cumulative Change in the Deficit ($ bil.)[2]
1994	- 128	- $ 14.8	- $ 50.9
1995	- 265	- 56.1	- 151.7
1996	- 401	- 129.7	- 293.6
1997	- 525	- 239.0	- 484.9
1998	- 665	- 389.0	- 732.8

The Effects of Investment Incentives

Year	Change in Jobs (thous.)[1]	Cumulative Change in GDP ($ bil.)	Cumulative Change in the Deficit ($ bil.)[2]
1994	+ 7	+ $ 2.2	+ $ 4.8
1995	+ 27	+ 28.2	+ 13.8
1996	+ 115	+ 87.2	+ 21.9
1997	+ 221	+ 179.0	+ 26.6
1998	+ 330	+ 305.0	+ 21.2

[1]Net increase or decrease as of the year indicated.

[2]Assumes Medicaid and Medicare cuts are realized.

What's Wrong With Reducing The Deficit by Increasing Taxes?

Ross Perot's prime objective is to reduce the federal deficit, and he acknowledges that his plan's austere measures will lower the nation's output of goods and services temporarily. This loss in output is the price he is willing to pay for deficit reduction. Just as a borrower needs to know how much it will cost to reduce a personal debt, the nation needs to know how much the Perot deficit reduction plan will cost.

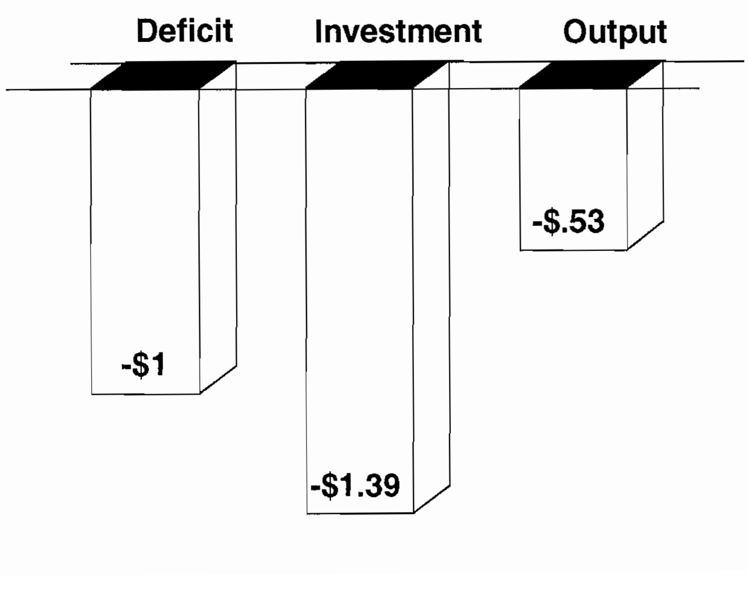
Decomposing the Perot Plan. One way of assessing the cost of deficit reduction under the Perot plan is to separate the plan into two parts: the part dedicated to reducing the deficit and the part dedicated to stimulating investment. This is done in Table III. As the table shows:

- Ignoring Perot's investment incentives, the deficit reduction measures alone would cost 665,000 jobs and $389 billion in lost output.
- The effect of Perot's investment incentives is to cut these job losses in half and gain back three-fourths of the potential loss of output.
- Thus the investment incentives part of the Perot package goes a long way toward covering up the cost of the deficit reduction program.

"For every $1 of taxes raised to reduce the deficit the economy would lose 53 cents in output and $1.39 in investment."

FIGURE II

Relative Costs of Deficit Reduction Under The Perot Plan



The Cost of Deficit Reduction. Perot's commitment to reducing the deficit is commendable. But his method of doing so is costly to the private sector. Using Perot's forecast of his own plan (prepared by DRI), we conclude that for every $1 additional taxes needed to reduce the deficit the economy would lose an additional 85 cents in lost output and lost private investment. The decomposition in Table III allows us to make a more precise estimate.

- Ignoring Perot's investment incentives, for every $1 of deficit reduction output would decline by 53 cents under the Perot plan.
- For every $1 higher taxes used to reduce the deficit, investment would decline by $1.39.

This is a very heavy price to pay for deficit reduction. And, as we shall see below, it is unnecessary.

What's Wrong With Taxing Social Security Benefits?[9]

"Taxing 85 percent of Social Security benefits would make the deficit larger in the long run."

A major component of the Perot plan is its attempt to raise $30 billion over five years by taxing 85 percent of Social Security benefits. Like the proposal to extend the Medicare payroll tax to more income, the Perot plan treats this tax increase as a spending reduction. In fact, extending the Social Security benefit tax would have a major negative impact on work and savings by the elderly, and in the long run it would make the deficit larger.[10]

TABLE IV

Marginal Tax Rates for the Elderly On Income from Savings

Income Tax Bracket	Social Security Benefit Tax	Total Tax
15%	7.5%	23%
28%	14.0%	42%

Current Law. The elderly pay income taxes on up to one-half of their Social Security benefits if their total income exceeds $25,000 (individuals) or $32,000 (couples). They pay taxes on 50 cents of benefits for each $1 income above these income thresholds.

Proposed Change. Under the Perot plan, the tax would apply to 85 percent rather then 50 percent of Social Security benefits. Similar proposals have long been favored by the Brookings Institution and are routinely listed as a budget option by the Congressional Budget Office (CBO).

How the Social Security Benefit Tax Works. Suppose an elderly couple receives $12,000 in Social Security benefits and $20,000 in other taxable income.[11] Since the couple's *total* income (including benefits) is $32,000, the income tax applies *only* to the $20,000 of ordinary taxable income. If they earn $1 more, however, the income tax applies to that $1 *plus* 50 cents of Social Security benefits. If they earn $12,000 of additional income, $6,000 (one-half of their Social Security benefits) is taxed.

Why the Tax is Really a Tax on Income. The Social Security benefit tax usually is described as a tax on *benefits*. In fact, it is a tax on other *income*. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 50 cents of benefits is taxed for each additional $1 of income, when elderly taxpayers earn $1 they pay taxes on $1.50. The effective tax rate on income is 50 percent higher than it otherwise would be.

"The Social Security tax is a tax on other income, not on benefits."

Tax Rates on Elderly Income from Savings: 23 and 42 percent. About 60 percent of the income of elderly taxpayers comes from investments (including pensions).[12] For younger people, the tax rates on investment income are 15 percent and 28 percent. Yet, because of the Social Security benefit tax, the rates for the elderly on income from savings can be 50 percent higher. As Table IV shows:[13]

- Elderly taxpayers in the 15 percent income tax bracket can pay an effective rate of 22.5 percent (15% x 1.5).

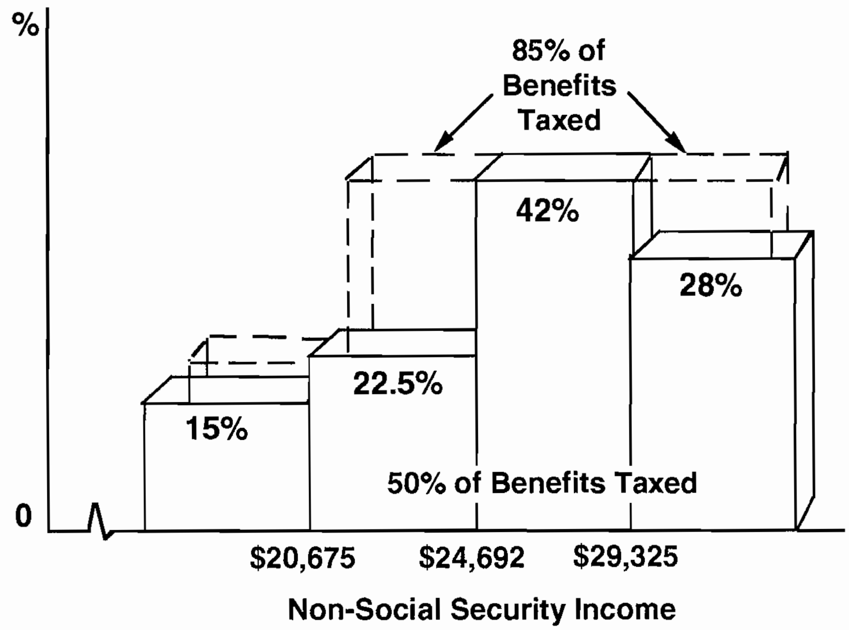
- Elderly taxpayers in the 28 percent tax bracket can pay an effective rate of 42 percent (28% x 1.5).

Tax Rates on Elderly Wages: 62 and 80 Percent. When the Social Security FICA tax (7.65 percent) is added to the income tax rates of 15 and 28 percent, marginal tax rates for younger workers are 23 and 36 percent. For the elderly who earn more than $10,200 in wages, however, there is an additional

"The proposal would impose higher marginal tax rates on moderate-income elderly families."

FIGURE III

Marginal Tax Rates on Income From Savings for an Elderly Individual[1]



[1] Assumes $8,650 of Social Security benefits. The Social Security benefit tax applies when Social Security benefits plus all other income reach $25,000.

penalty.[14] They lose $1 of Social Security benefits for each additional $3 of earnings. The Social Security earnings penalty is a 33 percent tax. As Table V shows, when this penalty is combined with the Social Security benefit tax, the total tax rate on earnings can reach 80 percent.

How the Proposal Would Affect Tax Rates for the Middle-Income Elderly. The proposal to tax 85 percent of benefits would increase the range of income subject to the very high marginal tax rates for the moderate-income elderly. [See Figure III.] Currently, about 38 percent of elderly families do not pay any income tax.[15] Among those who do, only one in five has enough income to be subject to the Social Security benefit tax.[16] However, because the income thresholds are not indexed, the effects of inflation alone will increase the percentage of people paying the tax over time, and eventually the tax will apply to all retirees.

Economic Effects of the Proposal: Short-Term Revenue Gains, Long-Term Revenue Losses. The Social Security benefits tax currently adds about $6 billion to federal revenue. Over the long run, however, the tax

"Marginal tax rates for some elderly workers exceed 80 percent."

TABLE V

Marginal Tax Rates on the Wages of Elderly Workers[1]

Tax	15% Bracket	28% Bracket
Income Tax	**15.00%**	**28.00%**
FICA Tax	**7.65%**	**7.65%**
Social Security Earnings Penalty	**33.33%**	**33.33%**
Social Security Benefit Tax[2]	**6.25%**	**11.67%**
Total	**62.23%**	**80.65%**

[1] Workers are assumed to be below the caps on the FICA tax, the Social Security benefit tax and the Social Security earnings penalty (which becomes zero once all benefits are lost).

[2] The Social Security benefit tax rate is lower in this case because of the loss of benefits due to the earnings penalty.

actually reduces federal revenue. Because the tax applies to the tax-deferred savings of young people, it reduces their aftertax return on investment and makes them less willing to save. Because it discourages savings and investment, it reduces economic growth. Slower growth means less output in the future and, therefore, less revenue for government. Previously, we have estimated that:[17]

- By the year 2000, the Social Security benefit tax will cause our gross national product (GNP) to be $84.4 billion lower than otherwise.

- At that time, total annual federal revenue will be $10 billion lower because of the tax.

The proposal to subject 85 percent of benefits to taxation would have an even greater impact. By the year 2000, total federal receipts would drop by $14 billion per year.[18]

Is There a Better Way? Yes. The argument for taxing Social Security benefits is that the beneficiaries paid for only a small portion of their benefits through payroll taxes.[19] If this argument is accepted, it is reasonable to include a portion of the elderly's Social Security benefits in their ordinary income, taxable at rates of 15 and 28 percent. They would face the same marginal tax rates as younger taxpayers. Exemptions could be raised to prevent undue hardship for the low-income elderly without increasing marginal tax *rates*.

Perot vs. the Other Two Candidates

Our complete forecast of the Perot plan is shown in Table VI. How does this compare to our previous forecasts of the Bush and Clinton plans? Let's take a look.

"The Perot plan would cost 335,000 jobs and $84 billion in lost output."

Perot vs. Bush. Perot's plan for investment incentives is similar to the House Republican ("fast track") version of the Bush proposal and would have moderately positive effects on the economy. Unlike Bush, Perot has proposed a specific plan to reduce the deficit. But Perot's heavy reliance on tax increases has a negative effect on the economy. On balance, the Perot plan would lose jobs while the Bush plan would create them. Overall:

- Whereas the Perot plan would reduce deficit spending by at least $570 billion and as much as $711 billion if the Medicare and Medicaid cuts are realized, the Bush plan would *increase* the deficit by $60 billion over the same period of time.

- On the other hand, the Bush plan would create 602,000 jobs by 1998, whereas the Perot plan would cost 335,000 jobs. [See Figure IV.]

Perot vs. Clinton. Both Clinton and Perot propose to increase government spending on education and infrastructure and to partly fund this increase with reduced spending on other programs. Both also propose a capital gains tax cut, an investment tax credit and a permanent research and development tax credit. The differences are: (1) Clinton's increased "infrastructure" spending is twice the size of Perot's; (2) Clinton's investment incentives are weaker than Perot's; and (3) although Clinton's proposed tax increases are smaller than Perot's, they fall heavily on investors (in an attempt to tax the "rich") and thus would do more harm to the economy than Perot's excise taxes would. Overall:

"The Clinton Plan would cost almost three times as many jobs and achieve no deficit reduction."

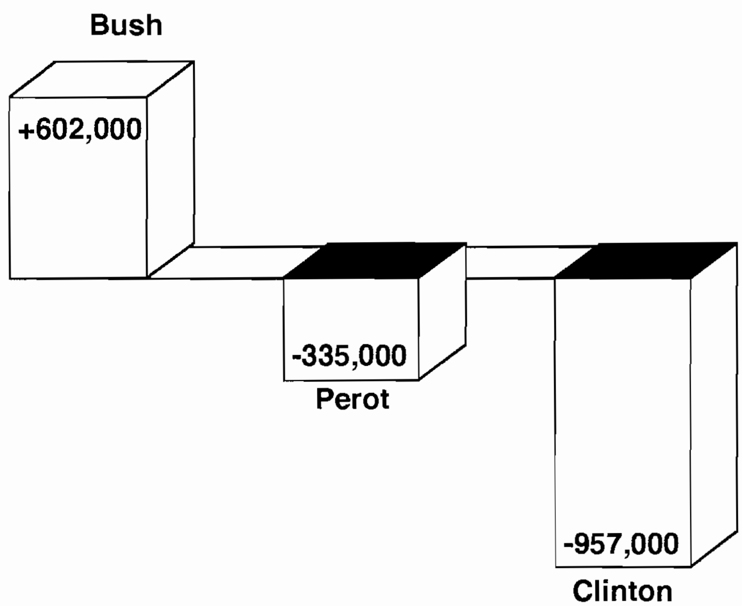
"Only the Bush plan would increase both jobs and gross domestic product."

FIGURE IV

Economic Programs of The Three Candidates:

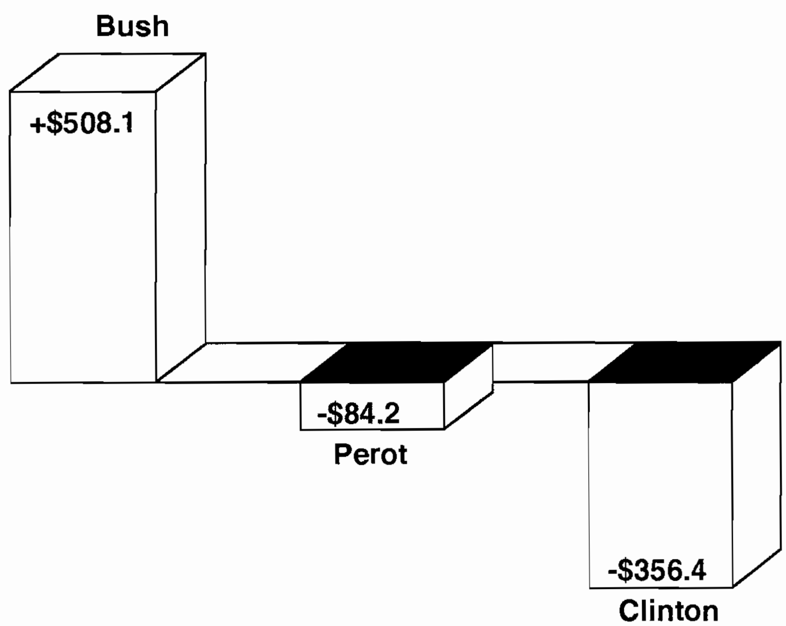
(1993-1998)

Effects on Jobs



Effects on Gross Domestic Product

(six-year totals; in $ billions)



"Perot might consider some more radical approaches adopted in other pro-growth proposals."

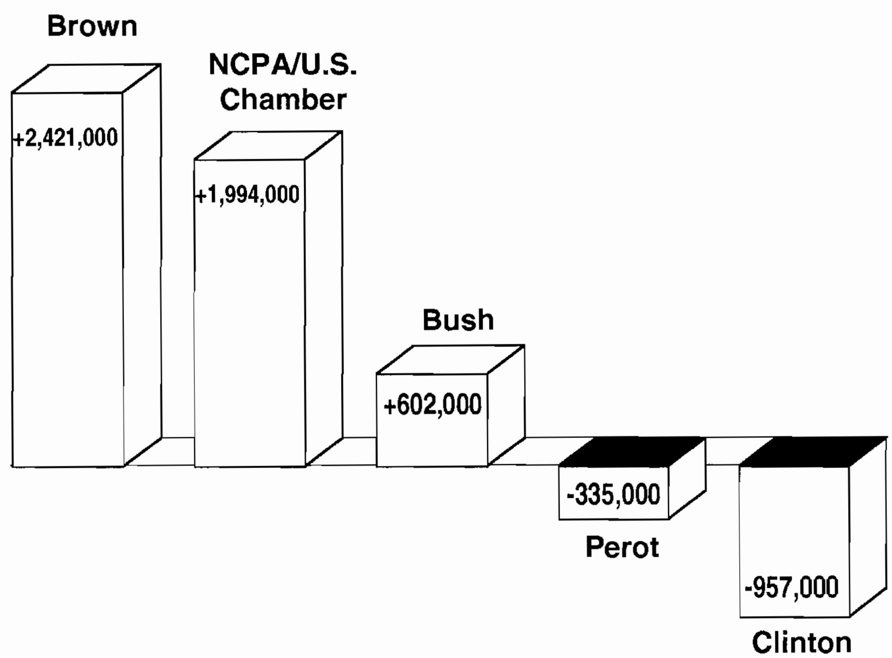
"If Perot's spending cuts were combined with Jerry Brown's tax plan, the deficit could be eliminated more quickly, tax rates could be even lower and even more jobs would be created."

FIGURE V

Economic Programs:

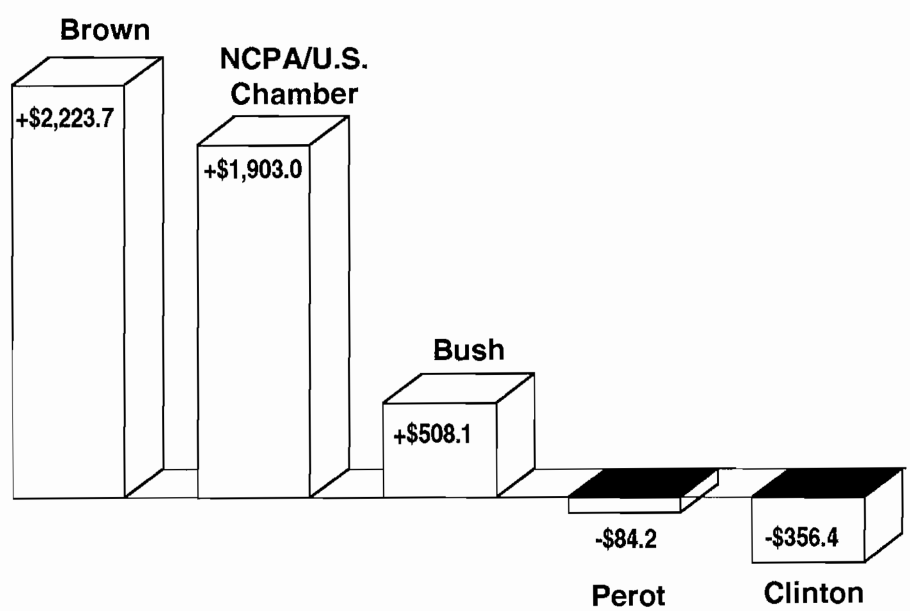
(1993-1998)

Effects on Jobs



Effects on Gross Domestic Product

(six-year totals; in $ billions)



"The Perot plan would reduce deficit spending by at least $570 billion, but would cost 335,000 jobs."

TABLE VI

NCPA Forecast of the Perot Plan

Year	Change in Jobs (thous.)[1]	Cumulative Change in GDP ($ bil.)	Cumulative Change in the Deficit ($ bil.)
1994	- 121	- $ 12.5	- $ 39.4
1995	- 238	- 27.9	- 115.3
1996	- 286	- 42.5	- 222.6
1997	- 314	- 60.1	- 369.8
1998	- 335	- 84.2	- 570.2[2]

[1]Net decrease as of the year indicated.

[2]The amount would be $711.5 billion if the Medicare and Medicaid cuts are fully realized.

"An earlier forecast prepared for the Perot campaign showed similar changes."

TABLE VII

DRI Forecast of the Perot Plan

Year	Change in Jobs (thous.)[1]	Cumulative Change in GDP ($ bil.)	Cumulative Change in the Deficit ($ bil.)
1994	- 204	- $24.1	- $47.7
1995	- 445	- 64.4	- 144.3
1996	- 407	- 98.0	- 285.5
1997	- 369	- 127.5	- 482.0
1998	- 471	- 163.1	- 744.0

[1]Net decrease as of the year indicated.

- Whereas the Perot plan would *reduce* the deficit by at least $570 billion by 1998, the Clinton plan would *increase* the deficit by $179 billion.

- Whereas the Perot plan would cost the economy 335,000 jobs, the Clinton plan would cost 957,000 over the same number of years.

Thus the Clinton plan would cost almost three times as many jobs and achieve nothing in the way of deficit reduction.

Making the Perot Plan Better

"Minor changes in the Perot plan would result in major improvements."

The Perot plan is bold but not original. Many of the deficit reduction ideas come from the Congressional Budget Office, which does not believe that tax changes have any effect on the behavior of investors. Much of the investment incentives package has been taken from the economic plans of the Democratic leaders in Congress — who habitually misunderstand how investment incentives work.

The Perot plan was motivated in part by the belief that investment incentives matter. Those who adhere to that belief will discover there is a much richer and more interesting menu of policy options.

Specific Recommendations. Within the general framework of the Perot plan, minor changes would result in major improvements. For example:[20]

- Perot would more than double the stimulative effect of his capital gains tax cut if he excluded from taxation 50 percent of *all* capital gains — not just gains on assets held for five years. As noted above, there is no economic reason to care how long people hold an asset, and basing taxes on holding periods introduces distortions into capital markets.

- Perot could more than double the stimulative effect of his investment tax credit by applying the tax credit to all investment instead of limiting it to "incremental" investment.

- Neutral cost recovery would have ten times the impact of Perot's investment tax credit. This idea, developed by the authors and proposed by Jack Kemp in the 1980s, would index depreciation for inflation and the time value of money. Not only would it have considerably more impact than Perot's investment tax credit but it also would cause less initial revenue loss.

- Perot could include more pro-growth tax cuts or more net spending reductions if he dropped his plan to spend $109 billion on infrastructure. Although some argue that public sector investment operates much like private sector investment, creating jobs and increasing wages,[21] the most recent research shows that public capital spending increases have no effect on private sector output, productivity or capital formation.[22]

In addition to these modest changes, Perot might also consider some more radical approaches adopted in other pro-growth proposals.

Jerry Brown's Plan.[23] An intriguing plan proposed by presidential candidate Jerry Brown would neither cut taxes nor reduce spending. It would merely rearrange the way taxes are collected. As Figure V shows, the plan would have a substantial stimulative effect on the economy — generating enough additional output, and therefore taxes, to eliminate the federal deficit in the year 2000. If Perot's spending cuts were combined with Brown's tax plan, the deficit could be eliminated more quickly, tax rates could be even lower and even more jobs would be created.

The NCPA/U.S. Chamber of Commerce Plan.[24] Another pro-growth plan has been proposed by the National Center for Policy Analysis and the U.S. Chamber of Commerce. This plan is even more stimulative (in the long run) than the Brown plan — primarily because the extra government revenues generated by faster growth are used to fund even more pro-growth tax cuts, rather than to reduce the deficit.

Conclusion

Ross Perot's economic plan emphasizes reducing the federal deficit at the expense of the U.S. economy. His deficit reduction plan would have the private sector sacrifice 53 cents of goods and services and $1.39 of investment in return for each $1 reduction in federal debt. Even with the addition of his stimulus package, the economy would lose jobs, output and capital formation. By emphasizing deficit reduction over growth, Mr. Perot is likely to fail at both.

"By emphasizing deficit reduction over growth, Mr. Perot is likely to fail at both."

Perot's commitment to reduce the deficit is laudable. However, this goal could be reached with far less pain if Perot were equally committed to increasing the nation's rate of economic growth.

Aldona Robbins and Gary Robbins

Footnotes

[1] Ross Perot, *United We Stand: How We Can Take Back Our Country* (New York: Hyperion, 1992). Specific details of the Perot plan used for this report were obtained from a document produced for the Perot campaign by Data Resources, Inc. This document was delivered to *U.S. News and World Report* by the Perot campaign and has generally been treated as the "official" Perot plan.

[2] For estimates of the Bush and Clinton deficits, see Aldona Robbins and Gary Robbins, "Bill Clinton's Economic Plan," National Center for Policy Analysis, NCPA Policy Backgrounder No. 120, August 17, 1992. The Clinton plan used in this forecast is the one contained in "Putting People First: A National Economic Strategy," June 20, 1992. The forecast does not take account of Clinton's proposal for employer-mandated health insurance or his proposal for manadatory worker training. The Bush plan used in the forecast is the House Republican "fast track" version of the Bush proposal. For the evolution of the Bush plan and an analysis of how it compares to Democratic alternatives, see Aldona Robbins, Gary Robbins and John C. Goodman, "Reviving the Economy: Bush vs. the House Democrats," National Center for Policy Analysis, NCPA Policy Backgrounder No. 113, February 28, 1992; and Aldona Robbins, Gary Robbins and John C. Goodman, "Bush vs. the Congressional Democrats: Whose Tax Plan is Better?" National Center for Policy Analysis, NCPA Backgrounder No. 116, April 7, 1992.

[3] See the *1992 Annual Report of the Board of Trustees of the Federal Hospital Insurance Fund,* Washington, DC, April 1992.

[4] *Mid-Session Review: The President's Budget and Economic Growth Agenda,* Office of Management and Budget, July 24, 1992, p. 7.

[5] This is similar to a proposal made by Bill Clinton. See Robbins and Robbins, "Bill Clinton's Economic Plan."

[6] The business entertainment limit is basically a tax on that industry and will have an effect similar to that of the luxury tax on boats, cars and jewelry. It will lead to fewer jobs in those industries that provide entertainment services to business.

[7] See Gary Robbins and Aldona Robbins, "The Bush Savings Plan," National Center for Policy Analysis, NCPA Policy Report No. 152, June 1990.

[8] The credit would be triggered when investment exceeded an industry threshold level equal to the ratio of capital expenditures to gross receipts.

[9] This section is partly based on John C. Goodman, "Should 85 Percent of Social Security Benefits be Taxed?" National Center for Policy Analysis, NCPA Policy Backgrounder No. 101, July 1992.

[10] Raising the wage base has a disproportionate effect on marginal tax rates on labor. See Aldona Robbins and Gary Robbins, "Reducing Social Security Taxes: Sound Policy for Today and Tomorrow?" The Institute for Policy Innovation, IPI Policy Report No. 110, March 1991. Increasing the tax on Social Security benefits will lead to less saving for retirement. See Aldona Robbins and Gary Robbins, "Taxing the Savings of Elderly Americans," National Center for Policy Analysis, NCPA Policy Report No. 141, September 1989.

[11] After adjusting for personal exemptions and deductions.

[12] See Aldona Robbins and Gary Robbins, "Elderly Taxpayers and the Capital Gains Debate," National Center for Policy Analysis, NCPA Policy Report No. 153, July 1990.

[13] Assumes taxpayer is below the maximum Social Security benefit tax.

[14] This earnings penalty applies to elderly retirees from age 65 to age 70. For those age 62 to 64 the earnings limit is $7,440. Above that amount, retirees face a 50 percent tax rate — losing $1 of benefits for every $2 of earnings.

[15] See U.S. Department of the Treasury, *Financing Health and Long-Term Care: Report to the President and Congress,* Washington, DC, March 1990, Table 4.1.

[16] See Aldona Robbins, *The ABC's of Social Security* (Washington, DC: Institute for Research on the Economics of Taxation, 1988), p. 6.

[17] Robbins and Robbins, "Taxing the Savings of Elderly Americans." Amounts are in current dollars.

[18] Ibid. Amounts are in current dollars.

[19] Note, however, that today's young people will pay more in Social Security taxes than they will ever receive in benefits. No one has suggested that the proposal would be a temporary measure aimed only at the current generation of retirees. The proposal, once adopted, would surely become a permanent feature of the tax code.

[20] For a development of some of these ideas, see Gary Robbins and Aldona Robbins, "A Strategy for Growth," National Center for Policy Analysis, NCPA Policy Report No. 170, January 1992.

[21] See Peter Passell, "More Concrete, More Growth?" *New York Times,* July 30, 1992.

[22] For a review of the literature and empirical estimates, see John A. Tatom, "Public Capital and Private Sector Performance," *Federal Reserve Bank of St. Louis Review,* May/June 1991, pp. 3-15.

[23] See Gary Robbins and Aldona Robbins, "Jerry Brown's Tax Plan," National Center for Policy Analysis, NCPA PolicyBackgrounder No. 117, April 16, 1992.

[24] Robbins and Robbins, "A Strategy for Growth."

The National Center for Policy Analysis

The National Center for Policy Analysis is a nonprofit, nonpartisan research institute, funded exclusively by private contributions. The NCPA originated the concept of the Medical IRA (which has bipartisan support in Congress) and merit pay for school districts (adopted in South Carolina and Texas). Many credit NCPA studies of the Medicare surtax as the main factor leading to the 1989 repeal of the Medicare Catastrophic Coverage Act.

NCPA forecasts show that repeal of the Social Security earnings test would cause no loss of federal revenue, that a capital gains tax cut would increase federal revenue and that the federal government gets virtually all the money back from the current child care tax credit. These forecasts are an alternative to the forecasts of the Congressional Budget Office and the Joint Committee on Taxation and are frequently used by Republicans and Democrats in Congress. The NCPA also has produced a first-of-its-kind, pro-free-enterprise health care task force report, written by 40 representatives of think tanks and research institutes, and a first-of-its-kind, pro-free enterprise environmental task force report, written by 76 representatives of think tanks and research institutes.

The NCPA is the source of numerous discoveries that have been reported in the national news. According to NCPA reports:

- Blacks and other minorities are severely disadvantaged under Social Security, Medicare and other age-based entitlement programs;
- Special taxes on the elderly have destroyed the value of tax-deferred savings (IRAs, employee pensions, etc.) for a large portion of young workers; and
- Man-made food additives, pesticides and airborne pollutants are much less of a health risk than carcinogens that exist naturally in our environment.

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