

# The Gingrich 1998 Tax Plan: An ITEP Policy Briefing

House Speaker Newt Gingrich has called for using two-thirds of the projected 1.5 trillion dollar federal budget surplus over the next decade to pay for tax cuts. This policy briefing examines the impact of Mr. Gingrich's proposal as it affects the federal budget and the Social Security system. It also examines the distributional effects of the particular kinds of tax cuts the Speaker has suggested.

In summary, the analysis finds that the Speaker's tax cut plan would endanger the long-term future of Social Security and that most of his suggested tax cuts would benefit people making more than \$200,000 a year.

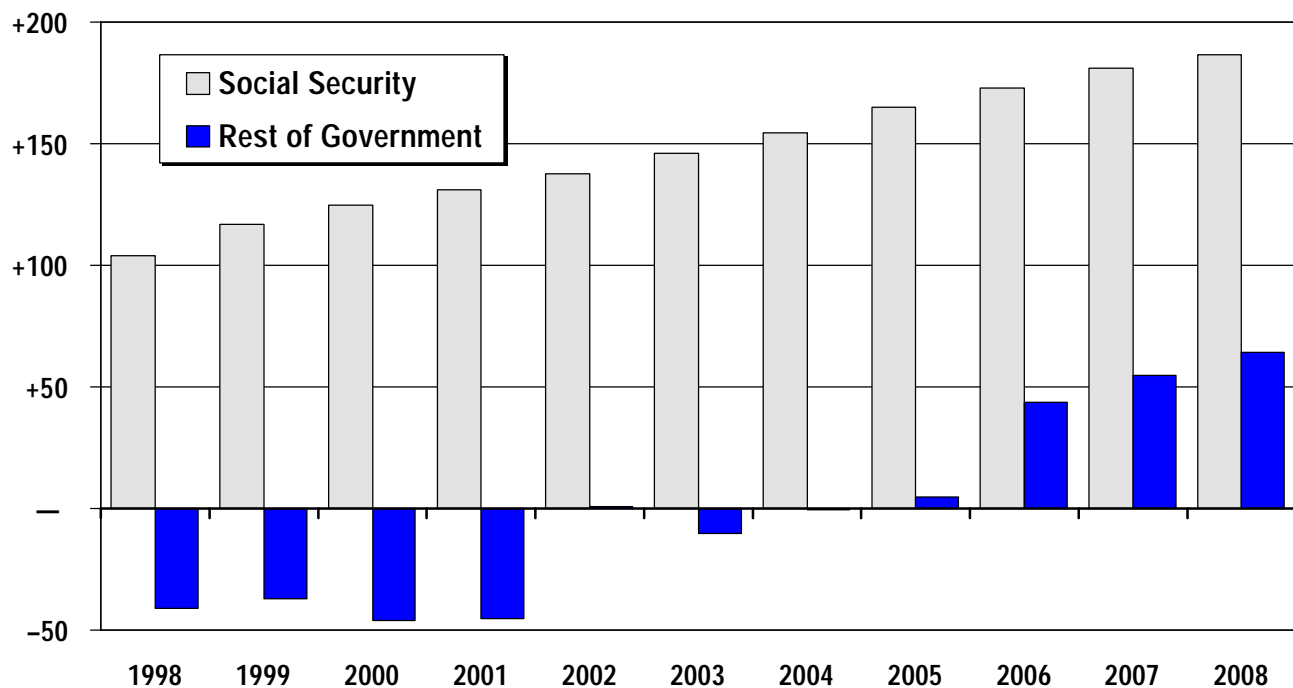
## Current budget projections

Recent long-term budget projections from the Congressional Budget Office show a \$1.547 trillion federal budget surplus over the next decade. This surplus, however, can be almost completely attributed to the building of the Social Security trust fund to pay future Social Security benefits. CBO shows the Social Security trust fund reserves growing by \$1.516 trillion over the same fiscal 1999-2008 period. The rest of the federal budget over these ten years is projected to have a cumulative surplus of only \$31 billion, or about \$3 billion a year. Thus, the Social Security trust fund accounts for virtually the entire projected federal budget surplus.

By law, Social Security trust fund reserves are invested in government bonds. This, in essence, creates a debt owed by the non-Social Security part of the federal budget to the Social Security trust

### Projected Deficits (-) & Surpluses (+) in Fiscal 1998-2008

(Current Law, \$-billions)



fund. The government obligates its non-Social Security budget to, in the future, pay off the bonds to pay Social Security benefits.

By borrowing from the Social Security trust fund through these bonds, the government as a whole reduces the amount it borrows from the public. During the budget-deficit era, the national debt owed the public rose because the non-Social Security budget deficit was greater than the Social Security surplus. With the non-Social Security budget now virtually balanced, under current law the trust fund will be used to reduce the amount of debt owed to the public. Hence, the net national debt is expected to decline by \$1.4 trillion between fiscal 1998 and fiscal 2008.<sup>1</sup>

Lower public debt increases net national savings which, in theory, leads to increased investment and higher future incomes. In addition, lower interest payments on the national debt will free up public resources now devoted to debt service. Indeed, under current projections, net interest payments are expected to fall from \$244 billion in fiscal 1998 to \$140 billion in fiscal 2008.

These dividends from the building of the Social Security trust fund, coupled with a balanced non-Social Security budget, will make it easier for taxpayers to afford to maintain Social Security benefits for future retirees. This is the policy that was anticipated under the 1983 Social Security amendments, but it has turned out to be impossible until now.

## The Speaker's tax proposal

Speaker Gingrich has proposed a different use for the growing surplus in the Social Security trust funds than current law provides. He would spend a trillion dollars of the projected surplus to finance \$750 billion in tax cuts. According to the Speaker, the remaining \$250 billion would be devoted to interest payments on the additional national debt his plan entails over current law.

Specifically, the Speaker's key proposed tax cuts include:

- # A capital gains tax cut. In 1997, the top capital gains tax rate was cut from 28% to 20%. The Speaker proposes a further reduction to 15%—a tax cut worth \$16 billion a year. Three quarters of that would go to those with incomes above \$200,000.
- # "Marriage penalty" relief. The leading House proposal on this issue, sponsored by Rep. Jerry Weller (R-Ill.) and David McIntosh (R-Ind.), would make the married tax brackets and standard deduction double the current single amounts. This plan would cost \$34 billion a year, with most of the tax cuts going to those making more than \$100,000.
- # Elimination of the estate tax. Under current law, this tax raises \$25 billion a year, and applies only to the largest 2% of estates.

### Speaker Gingrich explains how his tax plan adds \$1 trillion to national debt

"We should take the \$1 trillion in surplus and spend it on a tax cut," Gingrich told reporters after a House GOP leadership meeting. But Gingrich also said that the \$1 trillion tax cut plan he favors might net only \$750 billion in tax relief for technical reasons.

Gingrich said he favors "taking \$1 trillion in surplus and spending it on tax cuts which, for reflow reasons, probably gets about to be \$750 billion" in total tax relief.

A House Budget Committee aide later explained that if you have a \$1.5 trillion surplus, "a lot of that is due to interest savings" and that "you would lose some of those interest savings if you were to have a tax cut" and spend the surplus. "A large portion of the projected surplus is due to paying down debt and therefore lower interest costs," the aide said. "If you use it for something else, you don't get the same level of interest savings."

—BNA *Daily Tax Report*, July 22, 1998, p. GG-2

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<sup>1</sup>For technical reasons, the annual (and cumulative) change in the national debt differs slightly from the amount of surplus or deficit the government runs in a given year.

## Analysis of the Speaker's tax plan and the budget

Although Speaker Gingrich likes to combine the Social Security surplus with the rest of the budget, the official figures show that virtually all of the projected federal budget surpluses over the next decade reflect an anticipated build-up in Social Security reserves to pay future benefits. Thus, it is fair to say that Speaker Gingrich's tax plan would divert a trillion dollars from the Social Security trust funds to fund tax cuts.

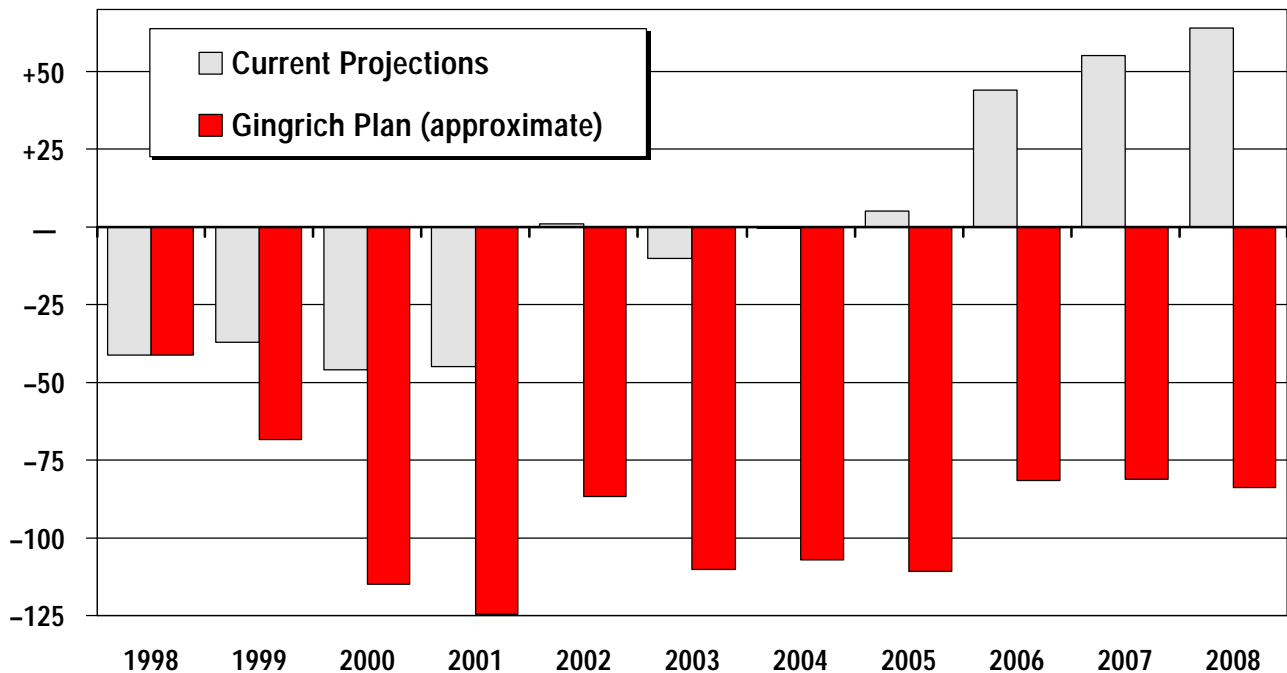
Put another way, adoption of the Speaker's tax plan would mean large, ongoing deficits in the regular, non-Social-Security government budget over the next decade, rather than the balance currently projected. Such deficit spending would eat up national savings and increase federal interest costs. It would thereby make it even more difficult to address Social Security's long-term problems when baby boomers begin to retire in large numbers.

"There is a surplus, but all the surplus belongs to the Social Security Trust Funds. . . . I'm telling you there is no surplus."

Senate Budget Committee Chairman Pete Domenici (R-NM), *BNA Daily Tax Report*, July, 22, 1998, GG-3

### Projected Deficits (-) & Surpluses (+) Excluding Social Security

Fiscal 1998 to Fiscal 2008 (\$-billions)



## Distributional effects of the Speaker's tax cuts

The fact that Speaker Gingrich's suggested tax cuts are so heavily tilted toward the very top of the income scale makes his plan even more troubling. Our analysis of the three key tax changes the Speaker has mentioned finds that:

- # 60 percent of the tax cuts would go to the two percent of taxpayers making more than \$200,000 a year.
- # The average tax cut in the over \$200,000 group would exceed \$17,600 per year.
- # In contrast, less than 5 percent of the Speaker's tax cuts would go to the 70 percent of taxpayers making less than \$50,000 a year. The average tax cut for these taxpayers would be only \$39 a year, or 75 cents a week.

The tax plan described here would cut taxes by 75 cents a week for the typical taxpayer. Over ten years, that means a total tax cut of \$390. In exchange, the national debt would be a trillion dollars more in 2008 than currently projected.

Thus, in exchange for a total of \$390 in tax cuts over ten years, the typical taxpayer's pro rata share of the national debt will be \$7,200 higher.

## Effects of Speaker Gingrich's Three Key Tax Cut Proposals

(1999 Levels)

Income Group	% of All Returns	Tax Cuts for Couples		Capital Gains Tax Cut		TOTAL Tax Cuts With Estate Tax Repeal	
		Average Cut For Married Couples	% of Tax Cut for Couples	Average Cut, All	% of Total Capital Gains Tax Cut	Average For All Taxpayers	% of TOTAL Tax Cut
<\$10,000	12.2%	\$ —	—	\$ —0	0.0%	\$ -1	0.0%
\$10-20,000	20.0%	-28	0.4%	-1	0.1%	-9	0.3%
\$20-30,000	16.7%	-94	1.9%	-3	0.4%	-35	1.0%
\$30-40,000	11.5%	-157	3.0%	-6	0.5%	-82	1.6%
\$40-50,000	9.2%	-158	3.0%	-13	1.0%	-110	1.7%
\$50-75,000	14.6%	-383	15.1%	-30	3.5%	-313	7.7%
\$75-100,000	7.1%	-993	22.5%	-69	4.0%	-920	11.0%
\$100-200,000	6.1%	-1,123	22.4%	-288	14.2%	-1,607	16.4%
\$200,000+	2.0%	-4,879	31.6%	-4,663	76.4%	-17,686	60.3%
<b>ALL</b>	<b>100.0%</b>	<b>\$ -603</b>	<b>100.0%</b>	<b>\$ -123</b>	<b>100.0%</b>	<b>\$ -592</b>	<b>100.0%</b>
<b>Annual Tax Cut</b>		<b>-\$34.2 billion</b>		<b>-\$15.5 billion</b>		<b>-\$74.6 billion</b>	

The three tax cuts modelled include: the Weller-McIntosh "marriage penalty" bill; a reduction in the top capital gains tax rate to 15% (7.5% for 15% bracket taxpayers); and elimination of the estate tax. All three proposals are shown fully effective.

Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, July 1998, preliminary.

**ADDENDUM:**

**Speaker Newt Gingrich's Plan for the National Debt**

\$-billions

Fiscal years	CBO Projections under Current Law (Surpluses applied to reduce national debt)					Gingrich Plan (Approximate) (Most of Social Security surplus used for tax cuts)			
	Deficit (-) or Surplus (+)			Interest on the Natl. Debt	National Debt	Gingrich Tax Cut	National Debt	Interest on the Natl. Debt	Deficit (-) or Surplus (+) without Social Sec.
	Entire Govt.	Social Security	All But Social Security						
1998	\$ +63	\$ +104	\$ -41	\$ 244	\$ 3,717				
1999	+80	+117	-37	238	3,655	\$ -30	\$ 3,687	\$ 240	\$ -69
2000	+79	+125	-46	232	3,589	-63	3,689	238	-115
2001	+86	+131	-45	221	3,518	-69	3,698	232	-125
2002	+139	+138	+1	209	3,395	-72	3,663	224	-87
2003	+136	+146	-10	198	3,275	-76	3,643	222	-110
2004	+154	+154	-0	189	3,136	-80	3,611	216	-107
2005	+170	+165	+5	178	2,961	-84	3,552	210	-111
2006	+217	+173	+44	166	2,779	-88	3,495	204	-81
2007	+236	+181	+55	153	2,557	-92	3,409	197	-81
2008	+251	+187	+64	140	2,320	-97	3,320	191	-84
1999-08	\$ +1,547	\$ +1,516	\$ +31	\$ 1,924		\$ -750		\$ 2,174	\$ -969
Cumulative changes under Gingrich plan compared to current law:							\$ +1,000	\$ +250	\$ -1,000

The Institute on Taxation & Economic Policy has engaged in research on tax issues since 1980, with a focus on the distributional consequences of both current law and proposed changes. ITEP's research has often been used by CTJ in its studies and analyses, and ITEP is frequently consulted by government estimators in performing their official analyses.

**Institute on Taxation and Economic Policy**  
**July 1998**