

## America in Balance: Family Income and a Balanced Budget

### I. Introduction

This report presents the economic benefits of the Majority balanced budget plan for a typical young American family, the Coopers. These economic benefits arise from additional economic and income growth and from a reduction in interest rates that trims the financing costs of mortgage, auto, and student loans. According to an economic analysis by DRI/McGraw-Hill, implementation of the Majority budget plan would boost economic growth and reduce long-term interest rates by about 2.7 percentage points by 2002. This analysis is based on a somewhat less significant reduction in interest rates and more conservative economic assumptions consistent with the DRI/McGraw-Hill analysis for the year 2000.

The Coopers are a typical young family: a married couple having one child and falling in the 15 percent income tax bracket. This family in the year 2000 has a new home mortgage with a loan amount of \$100,000 and an interest rate of 8.14 percent before the effects of the balanced budget plan are taken into account. They also have a new \$15,000 car loan and are five years into a ten-year, \$11,000 student loan.

Benefits of balancing the budget.		
	Monthly Benefits	Yearly Benefits
Home Mortgage (after-tax)	\$ 121	\$ 1,456
Student Loan	\$ 4	\$ 50
Car Loan	\$ 9	\$ 108
Child Tax Credit	\$ 42	\$ 500
Economic Growth	\$ 16	\$ 194
<b>Total Savings</b>	<b>\$ 192</b>	<b>\$ 2,308</b>

**Note:** Numbers may not total due to rounding.

**Source:** JEC staff calculations.

This report finds that when all the economic effects of the Majority budget plan are taken into account, the Coopers would receive benefits of \$192 a month, or \$2,308 on an annual basis. Over five years this accrual of benefits to the Coopers would amount to over \$12,000. Clearly this would be a substantial increase in the economic well-being of the Cooper family. If the Coopers have a second child, the monthly benefits under the Majority plan would increase to \$234, or \$2,808 annually. Over a five-year period, the benefits for a two-child family would total over \$14,500.

## **II. Benefits of Lower Interest Rates**

Two organizations, the non-partisan Congressional Budget Office (CBO) and the independent consulting firm DRI/McGraw-Hill, have produced econometric analyses showing the impact of a balanced budget on interest rates. The estimated reduction in interest rates differ by year and by type of interest rate but range up to 2.7 percentage points in 2002 for long-term rates.

Since so many activities in the economy are sensitive to interest rates, this reduction will yield benefits for all American families. Even families at the lowest income levels are aware that interest rates determine the cost of buying a car or even household appliances. This hypothetical scenario estimates the impact of lower interest rates on a home mortgage, a student loan, and a car loan.

### ***Home Mortgage***

The Coopers take out a \$100,000 mortgage on a new home in 2000. At an 8.14 percent 30-year fixed rate (the projected rate for 2000), the monthly mortgage payment is \$744. Under the Majority balanced budget plan, the fixed mortgage rate in 2000 will fall 2.22 percentage points to 5.92 percent. At the lower rate, the monthly mortgage payment is reduced \$149 to \$594. In the first year of the mortgage, the average after-tax savings from lower interest rates amount to \$121 per month.[\[1\]](#)

### ***Student Loan***

The Coopers are also in the middle of paying off an \$11,000 student loan. In 2000, the Coopers will have already paid off five of the ten years on the loan. Assuming the Coopers are able to take advantage of lower rates, these lower interest rates will save the Coopers \$250 in interest payments over the remaining five years.[\[2\]](#) For their monthly loan payments, lower interest rates due to the balanced budget will save the Coopers \$4 each month.

### ***Car Loan***

The year 2000 also turns out to be the year the Coopers purchase a car, for which they obtain a \$15,000 loan repayable over five years. Based on current economic forecasts, the expected monthly car payment is \$294. Lower interest rates from balancing the budget will reduce the monthly car payment to \$285, a savings of \$9 per month.[\[3\]](#)

These examples provide just some idea of the wide-spread effect of lower interest rates. There are also other, more indirect advantages from the lower interest rates produced by a balanced budget. For example, businesses that want to expand their workforce often require a loan to do so. With lower interest rates, that loan becomes more affordable, meaning that more people can be hired, prices for consumers are lower, or both.

## **III. Middle Class Tax Relief**

The Majority balanced budget plan contains a wide variety of tax relief for middle class families. The tax provisions of the Majority budget reduce taxes on capital gains, Social Security

benefits, and savings accounts. The budget plan also provides relief for the marriage tax penalty, home care of the elderly, adoption expenses, and estate taxes.

A central component of the Majority balanced budget plan is a \$500 child tax credit. Under this proposal, a qualifying family is entitled to a \$500 tax credit for each dependent child they have. With their child, the Cooper family is eligible for this credit. Over the course of one year, this tax credit averages out to nearly \$42 per month. Although the Majority plan's tax cuts will benefit families in numerous ways, this analysis only considers the benefits of the \$500 child tax credit.

#### **IV. Benefits of Economic Growth**

Majority budget policy will also boost the Coopers' monthly income by increasing economic growth. This economic growth results from shifting resources from the government to the private sector through spending restraint and from reducing punitive treatment of saving and investment. This improvement in economic growth will translate to an improvement in the Coopers' monthly income.

A central element of the Majority budget plan is its commitment to eliminate deficit spending by reducing spending growth. The heavy burden of financing excessive government spending is a drag on the ability of workers, businesses, and others to expand the production of goods and services. Reducing spending growth, not raising taxes, is the key to eliminating the deficit. Tax increases have failed to reduce the deficit in the past because raising taxes stimulates additional spending while further inhibiting economic and revenue growth.

Instead, the Majority budget would foster economic growth by improving tax incentives for saving and investment. The Majority balanced budget plan includes a capital gains tax rate reduction, estate tax relief, and expanded opportunities for IRAs. Current capital gains and estate taxes punish investors, small businesses, and families that have prudently saved for the future, unfairly taxing illusory income arising from inflation. Capital gains and estate taxation also levy a multiple tax on income arising from saving and investment, depressing capital formation and economic growth.

Several economists have estimated the effect of lower taxes on capital, as proposed by the Republican budget, on economic growth.<sup>[4]</sup> The various estimates of the impact of lower taxes on capital on economic growth range from a low of 0.25 percent higher growth to 1.8 percent higher growth. The Coopers can expect this added economic growth to increase their take-home pay.

Based on a conservative estimate of the economic growth resulting from the Majority balanced budget plan, the additional economic growth would translate into yearly gains of about \$194 in the Coopers' family budget. Other more optimistic estimates of economic growth suggest that lower taxes on capital could generate as much as \$2,000 additional income for the Coopers each year.

#### **V. Conclusion**

As this analysis shows, the balanced budget is no mere "game" of numbers. Balancing the budget is vital to improve the lives of America's working families. Homes will be more affordable, more families can send their children to college, and every purchase on credit will be easier for the typical family to handle. More importantly, balancing the budget with spending and tax cuts will improve the American economy and provide benefits for every future American generation.

**This analysis was prepared by Dan Miller, economist,  
and Reed Garfield, senior economist.**

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### **Endnotes:**

1. Estimate compares monthly payment on 30-year fixed-rate \$100,000 mortgage under two interest rates. Since the comparison is based on two different new mortgages, there are no refinancing charges to consider. The analysis further assumes a marginal tax rate of 15% and takes into account higher taxes due to a reduced tax deduction (since there is less home mortgage interest to deduct from taxable income). Baseline and balanced budget interest rates are from DRI/McGraw-Hill, "The Economic Impact of Balancing the Federal Budget," October, 1995.
2. Estimate assumes a 10-year loan based on the 10-year Treasury note rate. The baseline and balanced budget forecasts of interest rates were prepared by the Congressional Budget Office.
3. Estimate assumes an interest rate 200 basis points above the 5-year Treasury note rate. The baseline forecast of interest rates was prepared by the Congressional Budget Office. The balanced budget forecast of interest rates was based on analysis by the Congressional Budget Office and JEC calculations.
4. Estimates of the effects of the Majority budget come from DRI/McGraw-Hill, "Economic Impact of Balancing the Federal Budget," October, 1995; DRI/McGraw-Hill, "Growth and Budget Repercussions of the Republican *Contract with America*," February, 1995; Laurence D. Meyer, "Macroeconomic Aspects of the Republican *Contract with America*," March, 1995; and Gary and Aldona Robbins, "Putting the Economy Back on the Growth Track: Six Steps to 'Upsize' the Economy," Institute for Policy Analysis, Report No. 128, September, 1994.