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A Non-Profit, Tax-Exempt Educational Organization

The Growth Code:
"A Dynamic Plan to Restore and Advance the Economy of the United States."

A Project of:
The Free Congress Foundation Center for Fiscal Responsibility

Economic Data and Analysis and Technical Assistance with Design of The Growth Code Provided By

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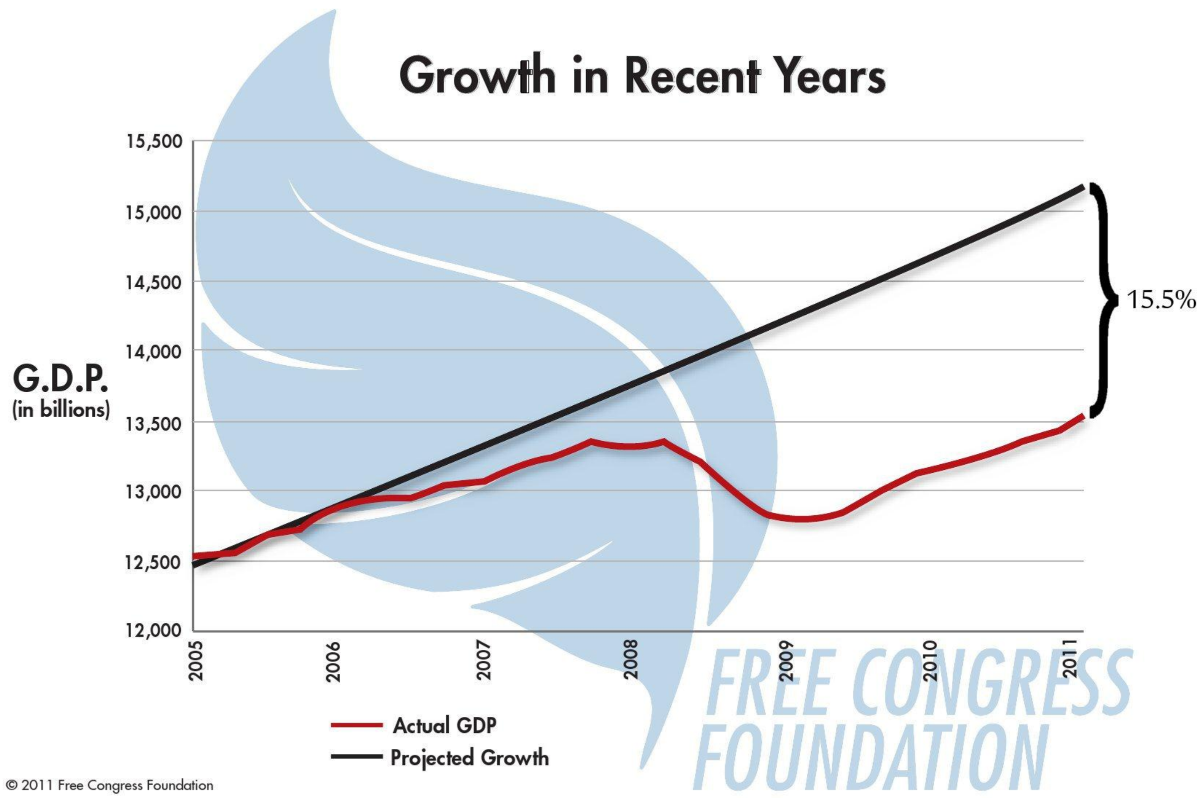
Acknowledgments

The following research has been commissioned by the Center for Fiscal Responsibility of the Free Congress Foundation (FCF), a §501(c)(3) non-profit organization. FCF is focused on the economic troubles facing the United States, following the "Great Recession" of 2008. Those economic challenges continue to this day.

History

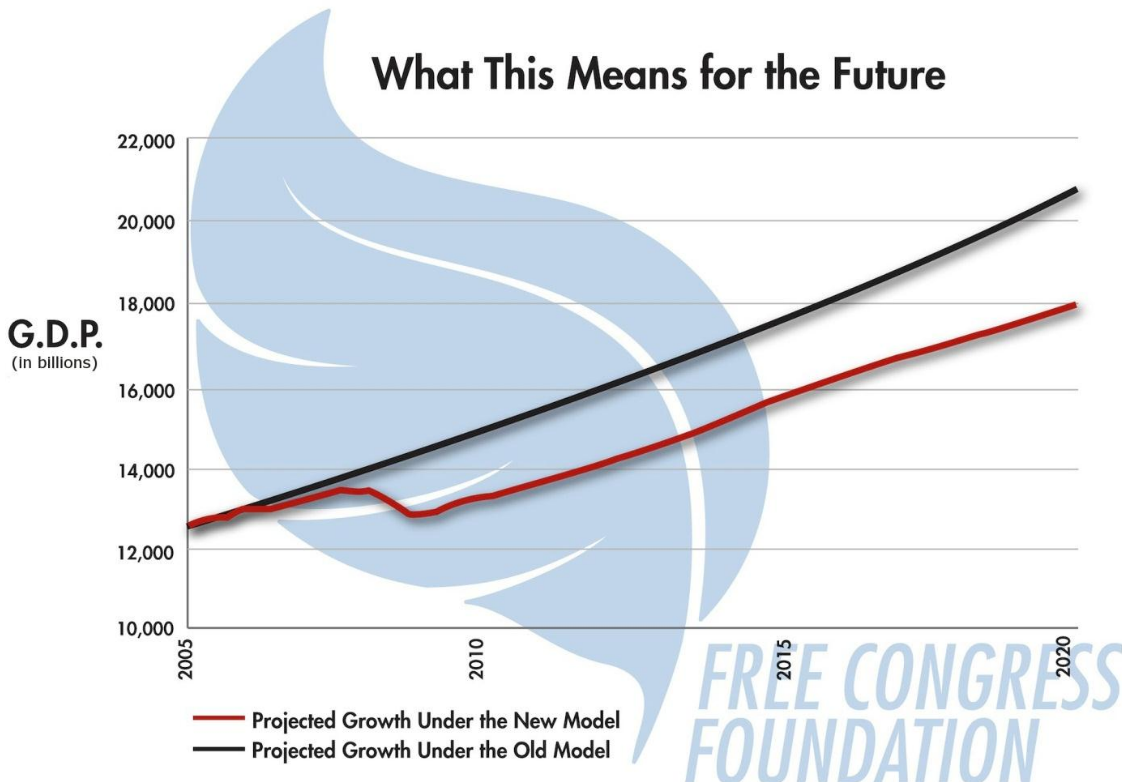
In the paper "Denying the New Normal," FCF President and CEO, former Governor Jim Gilmore, wrote that the decline in American economic growth since 2006 can be defined in terms of lost growth that will not be recovered in accelerated growth in the near future.

Chart I



FCF believes that these data make it clear that America's potential growth cannot be accelerated and its economic health restored to pre-2006 rates without changes to the current policies of the nation. The magnitude of this lost growth since 2005 and projected through 2020 is shown below in terms of America's Gross Domestic Product. The lost GDP as of 2011 is 15.5% (Chart I) and will widen in the years ahead.

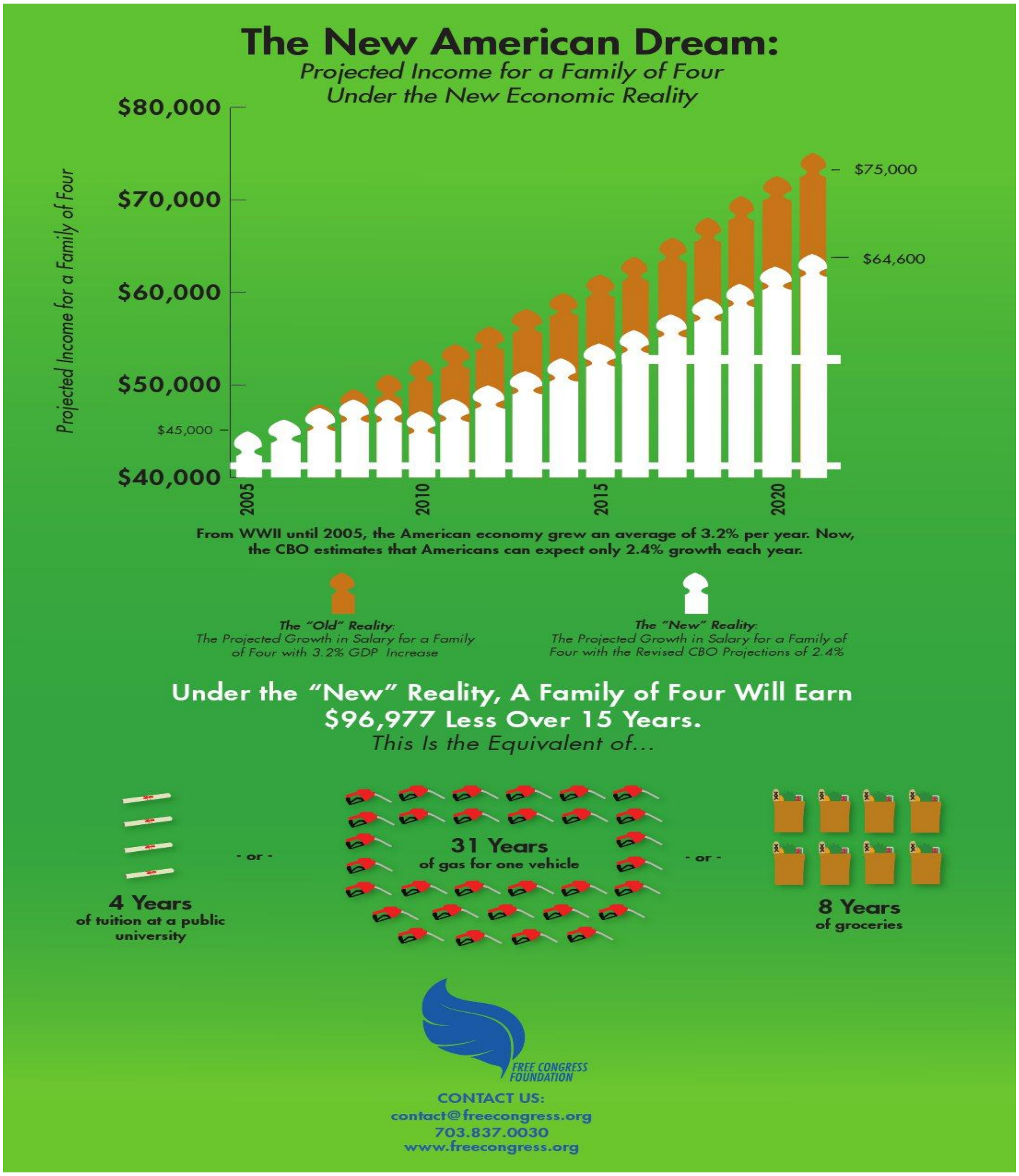
Chart II



FCF's research indicates that this loss of growth does not have to be permanent and that the lost economic growth in the years between 2006 and 2012 can be mitigated by a re-accelerated economy. The American people – in terms of their quality of life, employment rates and family purchasing power – will be direct beneficiaries of this re-acceleration of economic growth.

The consequences to the American family are significant for the future. Chart II demonstrates the loss of income for the average family of four in the years ahead, earning $96,977 less over the next 15 years. Chart III shows in practical terms what a family loses in purchasing power from the permanent loss of economic growth in terms of its earnings.

Chart III



During the past three years, the United States has experienced a steady unemployment rate of over 9%, sometimes reaching as high as 10%. In its October 7, 2011 report, the Bureau of Labor and Statistics said that the long-term unemployed numbered some 6.2 million Americans and that another 9.3 million were employed only part time because they cannot find full time jobs.

These numbers do not factor in the number of Americans who have simply given up their search for a full time job which elevates the unemployment figure to closer to 15%. America is suffering the highest rate of long-term unemployment since the Great Depression.

A recent Gallup poll found that only 54% of Americans believe that today's youth will have a better life than their parents - the lowest number holding that belief since 1983. This poll illustrates that one of the collateral effects of long-term lack of economic growth is the resulting disbelief that prosperity can be restored. FCF believes that this negative outlook is reflected in the public's lack of confidence in government. One of the benchmarks of the American economy has been each generation's ability to pass along the opportunity for greater success than it enjoyed. Without restoring economic growth and accelerating our economy so that it can gradually recoup the lost growth between 2006 and 2012, America's middle class of today may not be able to give their children the opportunity they enjoyed.

Today, Americans find themselves with more impediments to reaching that benchmark because of their government's actions. In Thomas Jefferson's words, "the government that governs least, governs best." In economic terms, FCF believes Jefferson's credo should lead us to remove government obstacles to growth in ways that are relatively simple, rapidly achievable, and will have the maximum effect in the minimum amount of time.

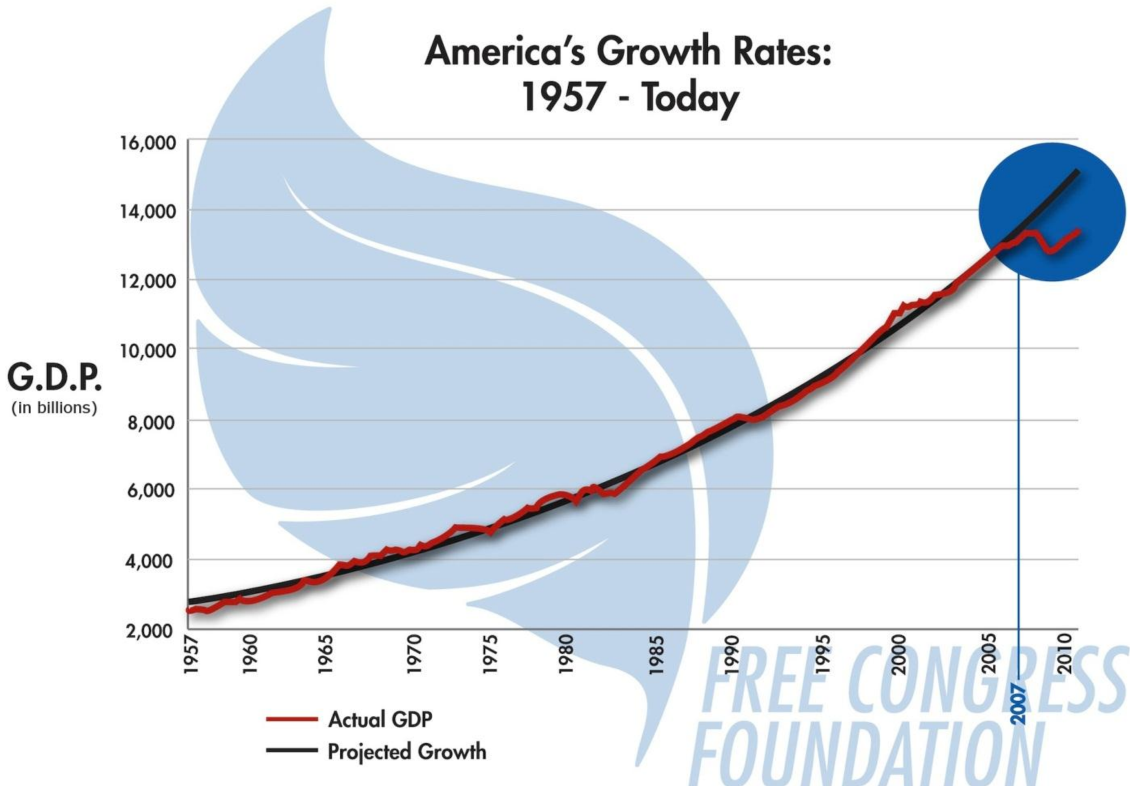
The problems with our system are not new, and both political parties should accept generous portions of the blame. But this is not a time for hand-wringing or finger-pointing. It is a time when the best ideas should be put forward and adopted quickly so that American economic growth is restored to its historic rates to enable us to pass on to our children the opportunity for the prosperity we enjoyed.

To address these challenges, The Free Congress Foundation, together with Fiscal Associates, Inc., has developed "The Growth Code." This paper explains briefly what that Code is, how it will work, and, in practical terms, how it can be accomplished quickly with only five legislative changes to the US tax code. It then engages in a more in-depth explanation of the principles established within The Growth Code and why this is the plan that can get America's economy moving again to recapture America's future.

Current Policies

Chart IV shows that American economic growth was relatively constant from 1957 until 2006. Since 2006 there has been a sudden 15.5% drop in economic growth.

Chart IV



This sudden drop in the rate of growth accounts for the loss of more than $2 trillion in wealth that would have been created in those years and which, in turn, caused related reductions in family earnings, employment rates and Americans' quality of life. The proximate causes of the drop in the economic growth rate are lack of private investment coupled with increased demands for more government revenue.

It follows, inevitably, that unless there are changes in the policies which are preventing the recovery of our economy, we will continue to lose value and will never recapture that lost 15.5% rate of growth. Moreover, if the American economy cannot be restored to its pre-2006 growth rate, even if some of the lost growth is regained, the years of 2006-2012 may be the American equivalent of Japan's "lost decade." What concerns FCF most is that there does not seem to be a productive conversation on how to reverse the lack of investment in our economy.

Government policies are the root cause of the problem. These policies, to borrow Hayek's term, have "put America on a new road to serfdom." There are three basic areas that need to be discussed.

First, the permanent loss of traditional growth has cost families money. Second, the certain repeal of the "Bush" tax cuts promises less income. Third, Government regulation costs dramatically deter investment because of their loss from expendable income at all levels, both personal and industrial. In other words, in the many instances where government funds or government borrowing are necessary to enable a project, large sums of this money are not for the project itself, but rather for government's regulation of said project.

The result is that the amount of income families can earn and keep for their discretionary spending is being encumbered. We fear that if these policies continue, social unrest could potentially follow. We have already seen the rise of the "Tea Party" movement to express frustration with both political parties. More recently, "Occupy Wall Street" demonstrations are sending an anti-business message intended to persuade ordinary citizens that the political system is not fair.

Our Goal

In our study we analyzed two issues: (i) the nature of the economic crisis we now face, and (ii) how to inform policy makers of the best direction for economic improvement. Our research reveals these two key issues will focus future discussions and create positive changes in the economy.

Defining the problem is the first step in this process. There is much debate and confusion about what exactly the problem is with the economy. Our study shows that at the current time the government is pursuing policies which are intended to treat the symptoms of our ailing economy, but which will not, in the short or long term, restore the rate of growth so critical to American economic success. Key data points help to focus the discussion. If we compare the share of major components in Gross Domestic Product over the 10 years before the recession to the share during the recession (Dec 2007-June 2009) and the recovery (3rd quarter 2009 through the 2nd quarter of 2011) we can see which components were falling and which were rising. A comparison of economic indicators during the recession and in the so-called "recovery" periods demonstrates the real problem:

Selected Items Relative to GDP

	Recession	Recovery
Consumption	1.9%	2.2%
Investment	-23.2%	-25.7%
Net Investment	-80.5%	-66.9%
Net Exports	8.4%	13.1%
Government	12.1%	12.1%
Capacity Utilization	-7.2%	-5.0%

- Despite the commonly-made assertion, loss of consumption is not the current problem with the economy. In fact, the share of consumption in GDP increased by 1.9% over its prior 10 year average during the recession, and has risen to 2.2% during the recovery.
- The share of net exports in GDP has increased by 8.4% during the recession and expanded to 13.2% during the recovery.
- The share of government spending in terms of GDP has increased by 12.1% in both periods.
- The share of investment in GDP has fallen by almost one quarter in both periods.
- **Net investment, as a percentage of GDP, has fallen by 80.5% during the recession and by 66.9% during the "recovery". Net investment is the measure of the accumulation of business capital. Net investment was negative during 2009, meaning that the stock of physical business capital was actually shrinking.**

The Growth Code

It is our conclusion that the economy of the United States is failing to recover because Americans are not investing money to expand business. As a result, productivity is not being enhanced, and jobs are not being created to utilize new investment. Less capital now and in the future will have two effects: National output will be lower than it otherwise would be. The demand for labor will be lower because labor productivity will be less since workers will have less capital to work with. In other words, business is not hiring new workers because expansion is less profitable.

Having defined the problem, the second step is providing the solution. The Free Congress Foundation in consultation with Fiscal Associates, Inc. has developed a plan for growth that will restore jobs, grow GDP, and relieve the pressure on the Federal Budget. We call this plan "**The Growth Code,**" and we assert that national policy must be re-oriented to deploy active measures to grow the economy. Moreover, the government must avoid any additional laws and policies that would render US economic growth subordinate to political whim.

Five Objectives of The Growth Code

In constructing The Growth Code, we tailored our approach to pursue five major objectives:

1. To identify the legal constraints on growth, and to adjust the law - especially the Internal Revenue Code - to encourage growth of our economy.
2. To create a system that, while profound in its results, can be implemented by simple legislation. This is an essential feature of The Growth Code because it avoids the complex and time-consuming problems that inevitably accompany Constitutional Amendments to accomplish the essential.
3. To design an approach that is fair to small businesses. We recognize that small business is the engine of entrepreneurship, commerce and comprises the principal force of the job creation in this country.
4. To design a plan that will end the bias against private investment in our country. We must make it just as good a choice to invest as it is to consume.

5. To design a plan that meets the policy objective of raising sufficient revenues to fund the proper activities of the government, rather than forcing economic and personal choices by way of tax penalties that reward conduct unrelated to government finance. More commonly stated: "Get the government out of people's lives."

How Does The Growth Code Work?

The first element of The Growth Code is to unify all business taxation in the United States. All business income will be declared on one tax form that treats all businesses the same. **Taxes will be imposed at the rate of 15% for business-created income.** We believe that policies which create different levels of "citizens" in this country are restrictive of growth. It is an economic contradiction that some businesses are treated differently than others for arbitrary reasons. For the purposes of taxation, all businesses should be treated the same. Small businesses will be taxed and treated the same as large corporate enterprises, and partnerships will share the same tax benefits as large corporations.

The second proposal of The Growth Code is to allow for immediate first year expensing of business investments. An option should exist to allow expensing any credit against future years' income if it can be shown that the income from the investment occurred after the end of the year in which it was made. Under current law, gradual depreciation schedules prolong recovery of the investment under tax law, and prevents full recovery of the amount invested in the business for equipment or other assets.

Third, individuals who continue to file their income taxes on the standard Form 1040 will be subject to a simplified progressive tax of 10, 15, or 25%. Deductions will be taxed in accordance with the "No Double Taxation" rule. If a company deducts pension benefits, then those benefits will be included in the income of the recipient. Likewise if a lender pays tax on the interest they receive from a borrower, then the borrower may deduct the interest from his income tax.

Fourth, The Growth Code ends double taxation which is an existing tax bias against business investment. In the current system, profits, interest or other earned income from investment is taxed as ordinary income in addition to the business tax rate. Spending on consumption is now treated more advantageously than saving for investment. It is our contention that we should level the playing field so that consumption spending and saving for investment are treated the same. In addition, profits earned abroad will be repatriated to the U.S. tax free because those profits will already have been taxed once by the foreign country.

Under this principle, dividends and capital gains will not be taxable to the person receiving the money, because it has already been taxed once at the corporate level. Implicit with this rule, deductions for mortgage payments will continue to be deductible for an individual. Also, The Growth Code does not propose to disturb the payroll tax which goes directly to fund entitlement programs. Charitable contributions will continue as deductions based on the recognition of the long-standing American belief that private citizens who desire to fund charity and provide services should be able to do so to relieve what would otherwise be the government's burden.

Fifth, under The Growth Code, every citizen will pay some form of tax, usually at the lowest 10% level under the simplified tax brackets. However, we recognize the need and desire to shield the very poor and families. With this in mind we propose to establish a Family Refundable Tax Credit (FRTC) of $4,300. Families earning less than the poverty level would receive this credit in the form of a check to supplement their income, reduced in the amount of their tax liability. For example, if a family has a total income of $20,000 per year, they will be in the 10% tax bracket, but because this family falls below the poverty line, they will receive an FRTC check for $2,300 ($4,300-2,000). This approach encourages civic virtue for everyone according to their ability, and gives every single American a stake in the political system that determines how public money is spent and for what purpose it is used.

Economic Forecast of The Growth Code

Will The Growth Code mean an immediate net loss of revenue to the U.S. budget? Some will be likely to charge that this proposal will deplete the budget of the United States Government. An analysis by Fiscal Associates in the table below demonstrates that The Growth Code will be revenue neutral.

The static analysis is based on the assumption that the past spending practices, which have created out-of-control deficits, must be sustained. But there is no good reason why a reform plan must be based on "revenue neutrality." Analysis by Fiscal Associates shows that in future years, The Growth Code will actually increase revenues received by the Treasury.

Result of Full Replacement of Corporate and Personal Income and Estate Taxes

(Amounts in $billions)

	Baseline	Static Results			Dynamic Results		
	2008	**Level**	**Dif**	**%Dif**	**Level**	**Dif**	**%Dif**
Gross domestic product	**14,369**	**14,369**	**0**	**0.0%**	**16,455**	**2,086**	**14.5%**
Private Business Capital Stocks	**27,451**	**27,451**	**0**	**0.0%**	**37,148**	**9,698**	**35.3%**
Total hours worked	**259**	**259**	**0**	**0.0%**	**271**	**11**	**4.4%**
Total Federal receipts	**2,531**	**2,531**	**0**	**0.0%**	**2,906**	**375**	**14.8%**
Estate and Gift Taxes	***28***	***0***	***-28***	***-100.0%***	***0***	***-28***	***-100.0%***
Current receipts	2,502	2,531	28	1.1%	2,906	403	16.1%
Current tax receipts	1,448	2,448	1,001	69.1%	1,694	246	17.0%
Simple Tax	***0***	***1,331***	***1,331***	***0.0%***	***1,531***	***1,531***	***0.0%***
Personal current taxes	***1,103***	***0***	***-1,103***	***-100.0%***	***0***	***-1,103***	***-100.0%***
Taxes on production and imports	96	96	0	0.0%	109	13	14.0%
Excise taxes	67	67	0	0.0%	76	9	14.0%
Customs duties	29	29	0	0.0%	33	4	14.0%
Taxes on corporate income	232	32	-200	-86.4%	36	-196	-84.4%
Federal Reserve banks	32	32	0	0.0%	36	5	14.5%
Other (Corporate income tax)	***200***	***0***	***-200***	***-100.0%***	***0***	***-200***	***-100.0%***
Taxes from the rest of the world	17	17	0	0.0%	17	0	0.0%
Contributions for social insurance	***972***	***972***	***0***	***0.0%***	***1,124***	***152***	***15.6%***
Income receipts on assets	31	31	0	0.0%	31	0	0.0%
Interest receipts	21	21	0	0.0%	21	0	0.0%
Rents and royalties	10	10	0	0.0%	10	0	0.0%
Current transfer receipts	55	55	0	0.0%	63	8	14.0%
From business	35	35	0	0.0%	40	5	14.0%
From persons	20	20	0	0.0%	23	3	14.0%
Current surplus of government enterprises	-4	-4	0	0.0%	-6	-2	50.2%

Fiscal Associates October 2011

The goal of The Growth Code is to create a dynamic change. The Fiscal Associates' analysis above shows that, due to increased investment and increased economic activity, Gross Domestic

Product would increase by 14.5%. Invested Capital stock would increase 35.3% and total hours worked would increase 4.4% (due to more people being employed). The result would be a reduction in unemployment to a rate of approximately 4.7%. Total Federal receipts would actually increase 14.8% thus allowing for debt and deficit reduction, and relief of budgetary pressure.

Conclusion

The time has arrived for a bold strategy designed to reinvigorate the American economy. We at the Free Congress Foundation believe that given the opportunity, Americans' potential for achievement is limitless. Once the government's limitations on the American economy are removed, it will again become a juggernaut of productivity, jobs, and economic growth. We are pleased to offer The Growth Code, knowing that it is the plan that can most quickly and effectively restore the strength of our economy and enable us to pass on to our children what we inherited: the land of opportunity.