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HOUSE BUDGET PLAN WOULD SWELL DEFICITS BY EXTENDING THE 2001 AND 2003 TAX CUTS AND MAKING THEM PERMANENT

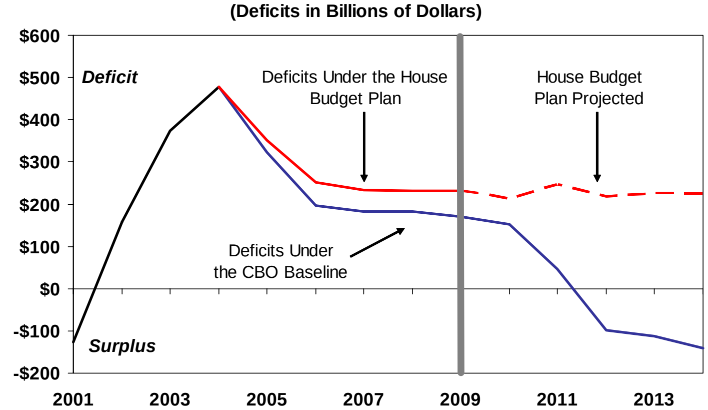
Plan Would Make Deficits $240 Billion Higher Over Five Years — and $1.5 Trillion Higher Over 10 Years — Than They Otherwise Would Be

by Richard Kogan and Robert Greenstein

The budget plan that House Budget Committee Chairman Jim Nussle unveiled on March 11 and the Budget Committee approved on March 17 would substantially increase budget deficits. Because the plan's tax cuts and defense spending increases cost significantly more than the plan's domestic program cuts would save, the plan makes deficits substantially higher than they otherwise would be.

The plan does show deficits declining between 2004 and 2009, but that is in spite of the plan, not because of it. The deficit decline is largely caused by economic recovery, not by the Committee's budget. As the adjacent graph and Table 1 show, deficits would be considerably larger under the plan than the deficits the Congressional Budget Office projects under current law.

House Budget Plan Would Result in Higher Deficits in Every Year
(Deficits in Billions of Dollars)



Note: The CBO baseline has been adjusted to remove the mechanical repetition of the 2004 Iraq supplemental after 2004. For purposes of comparability , the 2005 Iraq funding in the House budget plan has also been removed.

- The Committee's plan would increase deficits above the levels the Congressional Budget Office projects under current law (i.e., above the CBO baseline levels) by a total of $242 billion for the five-year period. [1]

- Over the next *ten* years, the plan increases deficits by $1.5 trillion, compared with the deficits in the CBO baseline, as a result of the plan's large tax cuts and defense spending increases.[2]

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[1] The CBO baseline has been adjusted to treat the $87 billion fiscal year 2004 Iraq supplemental as a one-time event, removing the mechanical repetition in the baseline of this $87 billion every year after 2004. In order to be comparable with the CBO baseline, the spending and deficit numbers in the Committee's plan have been adjusted to remove the $50 billion fiscal year 2005 supplemental for operations in Iraq that is part of the plan.

[2] The ten-year figures reflect CBO's baseline assumptions and CBO's estimates of the cost in 2010-2014 of extending the tax cuts in the House plan. These figures also reflect the assumption that there would be no net changes in entitlement programs after 2009; the entitlement changes under the Committee's plan round to zero in

Table 1:
House Budget Plan versus CBO Baseline
(in billions of dollars)

	2005	2006	2007	2008	2009	5-year total	10-year total
Deficits in CBO Baseline[(1)]…………..	323	197	182	183	170	1,055	905
Deficits under House Plan[(2)]….............	352	251	232	231	231	1,297	2,429
Increases in the deficit due to the plan	**28**	**54**	**50**	**48**	**61**	**242**	**1,524**

Rows and columns may not add due to rounding.
(1) CBO revised baseline (March 2004), adjusted to treat the $87 billion fiscal year Iraq supplemental as a one-time event, removing the mechanical repetition in the baseline of this $87 billion every year after 2004.
(2) To be comparable with the CBO baseline, excludes the $50 billion fiscal year 2005 supplemental appropriation for operations in Iraq that is part of the House Budget Committee plan.

The plan's centerpiece is a "reconciliation directive" to the House Ways and Means Committee to approve $138 billion in tax cuts over five years.[3] This is the exact cost through 2009 of making nearly all of the 2001 and 2003 tax cuts permanent, including the major tax-cut provisions scheduled to expire at the end of 2004.[4]

The five-year $138 billion cost of extending these tax cuts and making them permanent greatly understates the full dimensions of these tax-cut proposals, however, because the cost of the proposals grows dramatically in the second five years. The costs of making permanent the tax cuts that expire in 2010 do not show up until 2011.

Over ten years, the tax-cut policies in the Committee's plan would cost *$1.2 trillion*.[5] A substantial majority of this ten-year cost reflects the cost of extending and making permanent various upper-income tax-cut measures, including repeal of the estate tax, capital gains and dividend tax cuts, and reductions in tax rates for higher-income households.

Furthermore, the plan's deficits are likely understated. For instance, the plan's deficit figures are based on the unrealistic assumption that Alternative Minimum Tax relief will end after 2005, and that the number of families subject to the AMT will consequently soar from three million today to about 30 million by 2009. This assumption artificially reduces the cost of extending the tax cuts and making them permanent, because the swollen AMT is assumed to

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2009. Finally, the 10-year figures in these tables reflect the assumption that discretionary spending under the plan would grow with inflation after 2009.

[3] As shown in Table 2, the House plan calls for tax cuts that cost $146 billion over five years, reflecting $128 billion in revenue losses and $18 billion in outlays for refundable tax credits. Of this five-year total, $138 billion — the cost of extending and making permanent most of the 2001 and 2003 tax cuts — is reconciled to the Ways and Means Committee.

[4] A clear sign that the resolution is proposing to make permanent the tax cuts that expire in 2010 is that the $138 billion includes costs associated with making permanent the repeal of the estate tax. The Joint Committee on Taxation estimates that if estate tax repeal is made permanent, high-income families will change their behavior in a way that reduces income and gift tax receipts by $7.2 billion between 2005 and 2009. This cost is included in the $138 billion reconciliation instruction to the Ways and Means Committee.

[5] The $1.2 trillion cost of the tax cuts reflects $1.1 trillion of revenue losses and $64 billion of refundable tax credits.

Table 2
How the House Budget Committee's Plan Increases Deficits
(in billions of dollars)

	2005	2006	2007	2008	2009	5-year total	10-year total
Deficits in CBO Baseline[1]…………..	**323**	**197**	**182**	**183**	**170**	**1,055**	**905**
House Budget Plan:							
- Tax cuts…………………………..	20	30	29	23	26	128	1,103
- Refundable tax credits……………	*	5	4	4	4	18	64
- Entitlement changes……….……..	2	7	-1	-2	*	6	6
- Cuts in domestic discretionary programs (outside homeland).........	-7	-12	-18	-24	-31	-90	-257
- Defense, international, and homeland security increases[2]……	13	23	31	39	50	155	400
TOTAL policy changes…………….	28	52	45	41	51	216	1,316
interest on policy changes...........	*	2	5	8	10	26	208
TOTAL increase in the deficit…...	**28**	**54**	**50**	**48**	**61**	**242**	**1,524**
Resulting Deficits…………………….	**352**	**251**	**232**	**231**	**231**	**1,297**	**2,429**
Note: $50 billion for 2005 Iraq supplemental, with associated interest costs (not included above)…………	25	20	7	4	3	59	76

Rows and columns may not add due to rounding.
"*" means less than $500 million.

(1) CBO revised baseline (March 2004), adjusted to treat the $87 billion 2004 Iraq supplemental appropriations bill as a one-time event.
(2) For comparability, excludes the $50 billion in the House Budget Committee plan for a 2005 Iraq supplemental appropriation.

cancel out part of the tax cut for millions of taxpayers. If the more realistic assumption is made that AMT relief will continue, deficits in the plan would be $672 billion higher over ten years, including the added interest payments on the debt. (See box on page 5.)

Similarly, the Budget Committee's plan includes no funding for operations in Iraq after 2005. Although the plan includes $50 billion in 2005 for operations in Iraq — which adds $59 billion to deficits over five years and $76 billion over ten years, when the associated interest costs are included — this amount likely understates how much operations in Iraq will add to future deficits, because it reflects no costs for operations in Iraq after 2005.

Increases in Defense Spending, Reductions in Domestic Spending

The increases in deficits generated by the Committee's plan also stem in part from the plan's sizable increases in spending for the category of defense, homeland security, and international affairs. Compared with the CBO baseline, the plan reflects $155 billion over five years in increased spending for these areas. (The $155 billion increase does not include the $50 billion that the House plan allocates for a 2005 Iraq supplemental appropriation, which is excluded here for purposes of comparing the Budget Committee plan with the CBO baseline.)

Key Middle-Class Tax Provision *Not* Extended

The House plan does not extend *all* of the 2001 and 2003 tax cuts. It would let a major tax-cut provision for families with incomes under $50,000 expire, even as it makes permanent every tax-cut provision geared to the nation's highest-income individuals.

Specifically, the plan fails to extend the Savers' Credit, scheduled to expire after 2006. This credit, one of the soundest provisions of the 2001 tax cut legislation, provides a tax credit to encourage retirement saving among working families with incomes under $50,000. IRS data show that 3.7 million modest-income families use this credit. The House plan would apparently let this credit die while making permanent the repeal of the estate tax, reductions in capital gains and dividend tax rates, and reductions in marginal tax rates, including the top tax rates.

At the same time, the plan contains sizable reductions in domestic discretionary (or non-entitlement) programs outside homeland security. This is the part of the budget that covers everything from environmental protection and national parks to education, veterans' health care, health research, transportation, housing, and an array of other programs. Funding for domestic discretionary programs (outside homeland security) would be cut by $113 billion over five years. (Actual expenditures, or outlays, for these programs will be reduced $90 billion over the 2005-09 period.)

The plan calls for funding for 13 of the 15 categories of domestic discretionary programs to be cut over the five-year period. All domestic discretionary program categories except education and training and Social Security administrative costs would be reduced. For example, housing programs and environmental and natural resources programs are targeted for large cuts in all years. In addition, formerly favored areas such as veterans' medical care, law enforcement, and biomedical, agricultural, and scientific research would be cut deeply by 2009.

Entitlement Changes

Four House committees — the Agriculture Committee, the Education and Workforce Committee, the Energy and Commerce Committee, and the Government Reform Committee — would be directed to approve and report legislation reducing entitlement expenditures by $5 billion over five years. In addition, the Ways and Means Committee would be directed to report legislation reducing deficits by $8 billion over five years.

The Ways and Means Committee could achieve these savings either by cutting entitlements or by raising revenues. The "Section 302 allocation" included in the House Budget Committee report that accompanies the budget plan shows that $3 billion of the $8 billion in savings that the Ways and Means Committee is directed to produce is supposed to come from reductions in mandatory programs. These reductions are assumed to come in the part of the budget that consists primarily of programs that assist low-income families and individuals.

The Energy and Commerce Committee and the Government Reform Committee each would be required to report measures reducing expenditures by about $2 billion. Budget Committee documents indicate that the Energy and Commerce Committee would be expected to secure these savings primarily by reducing Medicaid. The Government Reform Committee could be expected to cut federal employee retiree or health benefits; those are the only major entitlement programs under that committee's jurisdiction. (Similar judgments are hard to make for the Agriculture and Education and Workforce Committees, because the cuts assigned to those

House Budget Committee Plan, By Excluding AMT Relief, Likely Understates Deficits

The level of deficits in the House plan are likely understated, primarily because it does not assume extension of relief from the Alternative Minimum Tax beyond 2005. No knowledgeable observer believes, however, that the President and Congress will allow such relief to expire after 2005, and senior Administration officers have said they expect a proposal to continue AMT relief to be included in next year's budget. The omission from the Committee's plan of the cost of the continuation of AMT relief after 2005 is essentially a gimmick that makes deficits artificially look lower.

Table 3 shows CBO's estimate of the cost of continuing AMT relief after 2005. If these costs were reflected in the Nussle plan, deficits would be $149 billion higher over five years than the plan shows and $672 billion higher over ten years. Deficits under the plan, assuming continuation of AMT relief, would total nearly $3.1 trillion over ten years.

Table 3
Suppose the House Plan Also Reflected Relief from the Alternative Minimum Tax
(in billions of dollars)

	2005	2006	2007	2008	2009	5-year total	10-year total
Deficits under Committee's plan(1)........	352	251	232	231	231	1,297	2,429
Cost of AMT relief that was omitted from the plan, including interest(2)…….		13	35	45	57	149	672
Deficits under the plan, with AMT relief continued................................	352	264	267	276	288	1,447	3,101

Totals may not add due to rounding.
(1)Excludes expenditures for the $50 billion held in reserve in 2005 for operations in Iraq.
(2) CBO estimates of the cost of indexing the AMT and extending the treatment of non-refundable personal credits after 2005.

committees are not large enough to make obvious which program the cuts are likely to come from.)

The plan also includes some small increases in entitlement programs. Those increases are not included in the reconciliation directive, which means that the relevant committees would *not* be required to report legislation that contains these increases. Taken together, the net effect of the entitlement reductions and the entitlement increases in the plan is about a wash — a net increase of $6 billion over five years.

Emerging Budget Process Changes

The House budget resolution does not itself include major changes in budget rules, but the Budget Committee approved legislation on March 17 that would do so. That legislation would exempt tax cuts from budget discipline in full, thereby weakening the budget process. It also includes discretionary spending caps for each of the next five years that would lock in the discretionary spending levels that the House and Senate Budget Committees agree to in the forthcoming conference on the budget resolution.