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# ADMINISTRATION MID-SESSION ESTIMATES EXCLUDE LIKELY COSTS, INFLATE TEN-YEAR SURPLUS ESTIMATES BY $800 BILLION OR MORE

by Joel Friedman

The Administration's Mid-Session Review excludes a variety of costs that are virtually certain to be incurred over the next decade and thereby overstates the projected surplus outside the Social Security trust fund through 2011. In particular, the Administration's new figures ignore the cost of extending dozens of tax provisions that are scheduled to expire over the next ten years. Those provisions include several popular tax credits that expire in 2001 — and for which the Administration supports a one-year extension — as well as the temporary relief from the Alternative Minimum Tax that was provided in the recently enacted package of tax cuts (P.L. 107-16). Similarly, the Mid-Session Review's projections of federal spending — from the cost of a prescription drug benefit for seniors, to the Administration's plans for a missile-defense system, to appropriations for non-defense programs, such as education, veterans health, transportation, and law enforcement — are well below levels called for by Congress or implied by the Administration's own policies.

The Administration projects that the surplus outside the Social Security trust fund amounts to $575 billion between 2002 and 2011. Of this total, $537 billion represents the surplus in the Medicare Hospital Insurance trust fund, according to Administration estimates. On a ten-year basis, therefore, there is little remaining surplus outside the Social Security and Medicare trust funds. But the outlook would appear even more constrained if the Administration had included anticipated costs that are nearly certain to occur.

- A more accurate accounting of these costs (see Table 1) would result in a surplus that could be between $800 billion and $1.25 trillion smaller over the next ten years, overwhelming the $575 billion that the Administration estimates as the non-Social Security surplus in the Mid-Session Review.

- The non-Social Security surplus, as shown in the Administration's documents, would be concentrated in the latter part of the ten-year period, with 70 percent of it occurring in the last three years of the decade. However, the unaccounted-for costs follow a similar pattern, so when even the low-end estimates are combined with the Administration's figures the resulting projections would show that the Social Security surpluses would be used to fund other government expenditures in each year of the decade.

In its Mid-Session Review, the Administration had the opportunity to present a set of policies that accurately project the nation's fiscal position over the next decade, by updating its

**Table 1**

**Potential Costs That Have Not Been Accounted For in Mid-Session Review**
in millions of dollars

| | Ten-year total 2002-2011 |
|---|---|
| AMT relief* | 250-350 |
| Extend other expiring tax provisions** | 70 |
| Missile-defense system and other defense increases | 100-200 |
| Non-defense appropriations | 70-250 |
| Medicare prescription drug benefit | 110 |
| Agriculture | 70 |
| Interest on all of the above | 130-210 |
| Total, potential costs not accounted for | 800-1,250 |

Note: Totals exclude any funds to address the solvency of the Social Security and Medicare trust funds.

*Low estimate reflects the cost of reducing the number of taxpayers affected by the AMT to the levels projected before enactment of the Bush tax cut (i.e., to about 21 million taxpayers in 2011 rather than to over 35 million); the high estimate reflects a rough approximation of the additional funding needed to reduce the number AMT taxpayers to a more acceptable level than 21 million. See Joint Tax Committee analysis for Rep. Rangel, June 14, 2001.

**See Joint Tax Committee, JCX-66-01, August 3, 2001.

budget request and adjusting for the gimmicks that artificially reduce the cost of the recently enacted tax cuts.[1] Unfortunately, the estimates in the Mid-Session Review reflect the Administration's continued willingness to rely on unrealistic assumptions and gimmicks to understate anticipated costs in order to portray the centerpiece of its fiscal policy — a very large tax cut that disproportionately benefits high-income families — in a more favorable light. The following is a summary of some of the costs that the Administration has excluded from its projections.

***Alternative Minimum Tax*** — The Mid-Session Review proposes to extend permanently all of the recently enacted tax-cut provisions that artificially expire in *2010*. The projections, however, leave out the extension of those enacted provisions that expire *before* 2010 — including the substantial cost of extending the AMT relief that was part of the tax-cut package

[1] For a discussion of the gimmicks in the enacted tax-cut package, see Joel Friedman, Richard Kogan, and Robert Greenstein, "New Tax-Cut Law Ultimately Costs as Much as Bush Plan: Gimmicks Used to Camouflage $4.1 Trillion Cost in Second Decade," *Center on Budget and Policy Priorities*, revised June 27, 2001.

but ends after 2004. As a result, the Mid-Session Review revenue estimates are based on the unrealistic assumption that the number of taxpayers subject to the AMT will jump from about 1 million today to more than 35 million by the end of the decade. Such dramatic growth in the reach of the AMT would be unprecedented, and it would transform the AMT from a narrow tax aimed at preventing high-income taxpayers from avoiding income taxes through excessive use of tax shelters to a burdensome tax that affects a broad cross-section of taxpayers. Congress will surely act to prevent this outcome and the higher taxes that it would force upon millions of middle-class taxpayers. But rather than reflecting the cost of a proposal to solve this problem in its Mid-Session estimates, the Administration artificially relies on these extra AMT revenues to bolster its surplus projections over the next ten years.

The Joint Committee on Taxation estimates it would cost about $124 billion over the decade just to extend the levels of the AMT exemption set in the tax-cut legislation. It would cost a further $123 billion — for a total of $247 billion — to hold the number of taxpayers affected by the AMT to 20.5 million in 2011, essentially the level projected before enactment of the Bush tax-cut package.[2] Even having 20.5 million taxpayers subject to the AMT would likely be unacceptable; Congress will face significant pressure to reduce the growth in the number of AMT taxpayers to more moderate levels, at a potential cost of another $100 billion or so.

***Other expiring tax provisions* —** The Joint Committee on Taxation has identified more than three dozen tax provisions that will expire at some point over the next decade. In the Mid-Session Review, the Administration proposes to extend only a few of the popular tax credits that have regularly been renewed in previous years, such as the research and experimentation tax credit, which expires in 2004. A host of other provisions are simply assumed to expire, including those that are scheduled to expire in 2001. In its April budget submission, the Administration had proposed a one-year extension of the credits that expire in 2001. In the Mid-Session Review, however, the Administration excluded even these one-year extensions from its revenue proposals, while stating that it still supports these extensions. (See box on page 4.) As past experience demonstrates, most of these tax provisions are certain to be extended on a bipartisan basis. Assuming the extension of all expiring credits throughout the ten-year period would cost an additional $70 billion over the next ten years.

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[2] The recently enacted package of tax cuts increased the AMT exemption by $2,000 for singles and $4,000 for couples, but this increase expires at the end of 2004. Similarly, current authority that allows non-refundable tax credits, such as the HOPE and Lifetime Learning credits, to reduce AMT liability expires at the end of 2001. The Joint Tax Committee estimated that gradually raising the exemption amounts, reaching a total increase of $4,500 for singles and $9,000 for couples by 2009, as well as allowing non-refundable credits to offset AMT liability, would reduce the number of taxpayers subject to the AMT to a little less than 21 million by the end of the decade, compared to the more than 35 million that would be hit by the AMT without these changes. In an analysis for House Ways and Means Committee Ranking Member, Rep. Rangel, the Joint Tax Committee estimates that these changes would cost $247 billion between 2002 and 2011.

**Funding Dropped from Budget for Must-pass Tax Item
Administration Says It Still Supports**

The budget figures in the Administration's Mid-Session Review provide a rosy and unrealistic picture of the budget — and of projected budget surpluses — over the next ten years, primarily because the Administration has omitted an array of virtually inevitable costs. One omission stands out — the removal of the funds included in the Bush budget presented to Congress earlier this year to extend an array of the tax credits scheduled to expire at the end of 2001.

It is a foregone conclusion that these tax credits will be extended. They enjoy strong bipartisan support, are always extended for a few years at a time and always are renewed when their current term expires.

The original Bush budget included funds to extend these credits for one year. The treatment of these tax credits in the original Bush budget was problematic itself, as the budget pretended these credits will be extended for only one year (in order to avoid showing the cost of extending them throughout the decade). But the Mid-Session Review goes one step farther. It omits even the cost of extending for one year the credits that will expire this year.

The omission does not mean that these credits will not be extended — they surely will be — or that the Administration does not support their expansion. The Mid-Session Review states: "The Administration supports the extension of these provisions in a fiscally responsible manner and looks forward to working with Congress to achieve that goal."

The reason for their omission from the mid-session budget numbers may be that extension of these provisions would cost $1.4 billion in fiscal year 2002. The Mid-Session Review shows a surplus of only $1 billion in 2002 outside the Social Security trust fund. Inclusion of this cost apparently would cross the line and require use of a small amount of Social Security trust fund revenue.

***Defense* —** The Mid-Session Review estimates for defense spending include the additional $18 billion in 2002 that the Administration requested beyond the levels in its initial budget and an equivalent amount each year, adjusted for inflation, throughout the rest of the decade, for a total of $209 billion over ten years. But the budget acknowledges that this is only a *portion* of the defense spending increases the Administration will seek. The Mid-Session Review states: "This is the first installment, totaling $209 billion, of investment in restoring our national defense capabilities..." The Administration plans to request additional amounts for its defense program, including the funds for an accelerated missile-defense system and its force modernization program. While we do not know the ultimate size of the additional defense increases the Administration will advocate, it could reach $100 billion to $200 billion over ten years beyond the figures in the Mid-Session Review.

***Non-defense Appropriations* —** The Mid-Session Review mirrors the Administration's original budget request for non-defense programs funded through the appropriations process (i.e., for "non-defense discretionary" programs). Expenditures for these non-defense programs would be cut below the levels necessary to keep pace with inflation by about $70 billion over ten years.[3] History suggests such cuts are not likely to occur, especially if both education and health research are increased, as the President and a solid, bipartisan majority of Congress wish. A more prudent and realistic assumption is that non-defense appropriations will grow at least with inflation and more likely with inflation and the increase in the size of the U.S. population — that is, that the real, per-capita level of funding will remain constant. Holding the real per-capita level of funding constant for non-defense appropriations would add about $250 billion to the ten-year costs reflected in the Mid-Session Review and could itself prove to be a conservative assumption, as it would result in spending on these programs that, as a share of GDP, would fall to 3.0 percent by 2011, the lowest level on record. It also is worth noting that for 12 of the last 14 years, the real, per-capita funding for these programs has increased, even though most of that period was one of substantial deficits.

***Entitlement spending*** — The Mid-Session Review includes $190 billion for a Medicare prescription drug benefit, a modest increase above the Administration's budget proposal. Congress, however, has set aside $300 billion for a Medicare drug benefit in its budget resolution. Some analysts question whether even this higher amount will be sufficient to provide a benefit that seniors would find adequate. By setting its request well below the Congressional level, the Administration understates the eventual costs associated with providing a prescription drug benefit.

The Congressional budget resolution also includes about $70 billion over ten years for farm price supports. The House Agriculture Committees has already reported legislation, with floor consideration anticipated for September. The Senate Agriculture Committee is planning to take up its version of the legislation this fall, with floor consideration thereafter. Even if no multi-year authorization is enacted, past experience has shown that Congress will act on an annual, ad hoc basis to provide farmers with price support payments. The Administration acknowledges the eventual costs of the farm bill moving through Congress, but includes no funds for it in its Mid-Session request. Rather, the Administration contends that the costs "will have to be offset where necessary to maintain on-budget surplus," although the Administration has proposed no such offsets. It would appear optimistic, given all the other pressures on the budget that are not accounted for in the Administration's proposals, to assume that offsets of this magnitude could easily be found. These expenditures are virtually certain to be incurred whether or not offsets are found.

Finally, the Administration allocates no funds in the Mid-Session Review to address the solvency of the Social Security or Medicare HI trust funds. Nearly all recent proposals to restore or significantly enhance Social Security solvency — by Republicans and Democrats alike — have relied in part on resources from the general fund to help mitigate the severity of the problem; without such resources, the magnitude of the benefit cuts or payroll tax increases needed to restore long-term solvency is likely to be too great for any solvency plan to survive.

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[3] Note that the Administration's request for non-defense appropriations is below the levels in the Congressional budget resolution, which itself was $45 billion below the amount needed to keep pace with inflation over the decade.

(In the past, we have suggested that $500 billion might be devoted to these purposes and noted that such an amount would go only 30 percent of the way to bringing 75-year solvency to Social Security and Medicare.)

## Conclusion

The Administration's Mid-Session Review relies on a variety of tactics to portray the fiscal outlook over the next ten years as being substantially rosier than it actually is. A last-minute accounting change in adjustments to Social Security receipts in 2001 and above-consensus economic projections for 2002 helped the Administration to project a $1 billion surplus outside the Social Security trust fund in each of those two years. The margins remain narrow through 2005 as well. Moreover, in most years, the budget would use all or nearly all of the Medicare Hospital Insurance trust fund surpluses for other purposes. These other purposes include substantial additional tax cuts the Mid-Session Review proposes (mostly tax cuts included in the original Bush budget but not yet enacted).

To fit within these tighter budget constraints, the Administration adjusted some of its policy proposals. For instance, it delayed until 2004 a number of its remaining tax-cut proposals and deleted from the budget the funding it earlier proposed to extend an array of tax credits expiring this year (while stating that it still supports their extension). It also has relied heavily on unrealistic assumptions to make the numbers add up, leaving out costs virtually certain to occur over the decade. In its Mid-Session Review, the Administration acknowledges some of these costs — such as further defense increases, the farm bill reauthorization, and the extension of popular tax credits expiring in 2001 — but excludes them nonetheless from its projections. In other cases, future costs are not even mentioned, notably those that will have to be incurred to address the explosive growth in the Alternative Minimum Tax. Had these various costs been accounted for, the Administration's projections of the surplus would have shrunk by between $800 billion and $1.25 trillion over the next ten years — overwhelming the $575 billion non-Social Security surplus that it estimates in the Mid-Session Review.